Promoting Good Tax-Governance in Third-Countries: The Role of The EU

In-Depth Analysis for the ECON Committee

2015
Promoting Good Tax-Governance in Third-Countries: The Role of The EU

IN-DEPTH ANALYSIS

Abstract

This paper forms part of a series of analytical pieces on the absence of EU-coordination regarding aggressive tax planning and its effects, prepared by Policy Department A at the request of the ECON Committee of the European Parliament. Globalization is knitting separate national economies into a single world economy. This is occurring as a result of rising flows of trade and investment, greater labour mobility, and rapid transfers of technology. Deregulation of financial markets, reductions in trade and investment barriers, and reduced communications and transportation costs have spurred those trends. High tax rates are more difficult to sustain in this new economic environment. As economic integration increases, individuals and particularly businesses gain greater freedom to take advantage of foreign economic opportunities. However, the lack of transparency is giving raise to political concerns to opposition to unfair international tax competition. Against this background, the paper sets out some suggestions for how the EU could use taxation to promote good governance in third countries and intensify its work in this area.
This document was requested by the European Parliament's Committee on Economic and Financial Affairs (ECON)

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Original: EN

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Policy departments provide in-house and external expertise to support EP committees and other parliamentary bodies in shaping legislation and exercising democratic scrutiny over EU internal policies.

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Manuscript completed in September 2015
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This document is available on the Internet at: http://www.europarl.europa.eu/studies

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1. BACKGROUND

Illicit financial flows (IFFs) and the impact on less developed countries have been high on the international agenda for the past decade and was center stage at the discussions on Finance for Development (FFD) debate in Addis Ababa in July 2015. The control of illicit financial flows requires coherent actions and cooperation between different actors within countries and on the part of the EU. Such action must tackle corruption, bribery, money laundering, tax crimes and other forms of illicit activities by bringing together academia, business, and government. It must promote cooperation between different law enforcement agencies and tax administrations, changing the interaction between tax administrations, taxpayers, and tax intermediaries and in the tax and legal framework. Promoting good governance requires an effective state with the capability and determination to address the problem and achieve a corrupt-free and transparent tax system, particularly in Africa.

2. THE ORIGINS OF THE TAX AND GOOD GOVERNANCE CONCEPT

It is only relatively recently that the EU and others have acknowledged the linkages between taxation and governance. The first paper highlighting the significance of taxation for governance was delivered in 1991 by Deborah Brautigam. In her article for the World Bank, she analysed conditions for introducing strengthened accountability, participation, transparency and predictability. Among these conditions, the important role of taxation in shaping governance was emphasised.

The growing academic interest in the topic was reflected in the studies of Charles Tilly. In his work from 1992, he argued that states, in order to be more accountable and responsive to citizens, should have laws “motived to bargain over taxation, state financing and public policy”. Later, the concept was developed by Kiren Chaudhry who in 1997 was convinced that changes in state financing have a direct effect on the way governments function. Based mainly on these works, tax relationships have become the keystone to good governance. As was captured by Mick Moore, “the more government income is earned, the more likely are state-society relations to be characterised by accountability, responsiveness and democracy.”

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1 The author would like to thank Alicja Majdanska (Research Associate, at the WU Vienna University of Economics and Business) for assistance in drafting this section and draws upon a project recently launched at the WU Institute for Austrian and International Tax Law, in cooperation with the African Tax Institute on Tax & Good Governance.


3 M. Moore, supra, no. 1, p. 9.

4 M. Moore, supra, no. 1, p. 9.

5 M. Moore, supra, no. 1, p. 9.

The connection between taxation and governance has been criticised by some scholars. Thus, it has been stated that all such studies are based on generalizations that as such may overlook or ignore the realities.\(^7\)

Nonetheless, since the early 90s the concept has evolved in the literature and has become the subject of studies undertaken by academia, international organizations, governments and other bodies. In general, there is now substantial research material showing how tax can promote good governance.

\(^7\) M. Moore, supra, no. 1, p. 9.
3. CURRENT WORK OF DIFFERENT STAKEHOLDERS, INCLUDING THE EU

3.1 Academia

German and Austrian academics pioneered the study of fiscal sociology in the early 20th century. It was the science that promoted the argument of taxation as central to state building. The most prominent scholars who contributed to this were Otto Hinze, R. Godsjeid and Joseph Schumpeter. They perceived taxation as the source of revenues which is necessary to build a state. The development of theory is revealed in the principle of “4 Rs of taxation”. “4 Rs” stand for revenue creation, the redistribution of income and assets, the curbing of socially undesirable behaviour, for example by means of tobacco and alcohol taxes, and the realm of democratic State building (representation). The last dimension – representation – was presented by the scholars as part of the rule of taxation. A corollary of this was the creation of representative governments. This thesis has, however, been criticised. In the work of M. L. Ross, who argues that taxation does not always enhance representation; instead, Ross establishes that there is a close linkage between taxation and government services in general. He believes that the level of taxation is not contested as long as commensurate government services are provided to citizens.

In the last two decades, many papers have been prepared showing the influence of taxation on lowering corruption, providing higher public goods or better institutional development. In general, the existing literature proves that “tax-reliant governments are forced to bargain with citizens, buying quasi-voluntary tax compliance in return for democratic institutions or policy concessions.”

This theory was further developed by L. Martin, who showed that not only are taxation and corruption related, but that taxation itself creates a significant increase in the level of accountability which citizens demand from leaders. She claims that taxation activates stricter tax norms. Moreover, she suggests that “taxation pushes citizens into the realm of losses, increasing the expressive benefit that individuals receive from imposing sanctions on a non-accountable leader.”

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14 L. Martin, Taxation and Accountability: Experimental Evidence for Taxation’s Effect on Citizen Behaviour, Yale University, May 12, 2013.
In the debate about the connections between taxation and the quality of governance, important contributions have also been made by researchers from the Institute of Development at the University of Sussex. In their publication How Does Taxation Affect the Quality of Governance? Mick Moore summarized the implications of taxation on the quality of governance. He focused on two dimensions of this issue: from where governments should get their revenues and how taxes should be assessed and collected. First, he established that the more states are dependent on tax revenues, the more they are accountable and responsive to citizens. However, this will not happen if, in order to raise more revenues, they use coercive measures and thereby damage state-society relations. Therefore, taxation should be based on consensual practices which might enforce good governance. In the case of developing countries, he suggested that donors including the EU may play a significant role.

The main study covering the influence of governance on illicit financial flows is Capital Flight from Africa. The book considers both the economic and institutional aspects of capital flight from Africa. It discusses the importance of capital flight in the context of the development policy discourse at the national and international levels. It pays attention to the role of governance, tax evasion and tax secrecy in driving outflows and stresses the role of corruption as a facilitator of capital flight.

An overview of the existing academic and non-academic research literature was provided by Marc Herkenrath, who identified the problem of quantifying illicit financial flows and stressed the greater need for international financial and technical cooperation from aid donors.

3.2 International and regional organizations

Illicit financial flows and the impact on sustainable development are high on the agenda of many international and regional organizations, whose goal is to accelerate development not only in developing countries. The extensive research on the topic undertaken by international organization is presented below.

The concept was highlighted for the first time in 1989. In the World Bank report From crisis to sustainable growth - sub Saharan Africa: a long-term perspective study which noted that: “A root cause of weak economic performance in the past has been the failure of public institutions. Private sector initiative and market mechanisms are important, but they must go hand-in-hand with good governance – a public service that is efficient, a judicial system that is reliable and an administration that is accountable to its public.” In the report, the promotion of good governance was presented as a necessity in the era of crisis of governance in Africa.

22 World Bank, supra, n. 22, p. xii.
The concept evolved in the work of the World Bank, with the publication of its report in 1992 in which governance was defined as the manner in which power is exercised in the management of a country's economic and social resources for development. Good governance was presented as an essential complement to sound economic policies, efficient and accountable management by the public sector and a predictable and transparent policy framework. Two years later, the Bank added: “Governance is epitomized by predictable, open, and enlightened policymaking (that is, transparent processes); a bureaucracy imbued with a professional ethos; an executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law.”

The importance of good governance in the work of the World Bank is exemplified by the measures the organization has taken to measure governance. The Worldwide Governance Indicators (WGIs) examine six dimensions of governance: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption.

Good governance also appeared on the agenda of the Organisation for Economic Co-operation and Development (OECD), particularly that of its Development Assistance Committee (DAC). In its 1993 report on participatory development and good governance, the OECD referred to the broad concept of good governance that encompasses: “the role of public authorities in establishing the environment in which economic operators function and in determining the distribution of benefits as well as the nature of the relationship between the ruler and the ruled. It is often useful to distinguish between three aspects of governance: the form of political regime; the processes by which authority is exercised in the management of a country’s economic and social resources; and the capacity of government to formulate and implement policies and discharge government functions. The rule of law, public sector management, controlling corruption and reducing excessive military expenditures are important dimensions of governance.”

The International Monetary Fund (IMF) also declared in 1997 that promoting good governance is one of the basic elements contributing to economic growth. In its report on good governance, it presented the main ways in which the IMF promoted the concept. First, it assisted member countries in creating systems that limit the scope for ad hoc decision making, for rent seeking, and for undesirable preferential treatment of individuals or organizations. It enhanced their capacities to design and implement economic policies, in building effective policymaking institutions, and in improving public sector accountability. Additionally, it called attention to transparency in financial transactions. The purpose was to limit the opportunity for corruption, and to increase the likelihood of exposing instances of poor governance.

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The United Nations (UN) has also played an important role in defining good governance. In its publication *What is Good Governance?*, good governance was defined as being determined by 8 characteristics. It was stated that it is consensus oriented, participatory, following the rule of law, effective and efficient, accountable, transparent, responsive, equitable and inclusive.

Extensive work on good governance in tax matters has also been undertaken by the European Union. The EU policy in this field evolved over the years on the basis of a series of Commission initiatives. Already in 2008 EU Finance Ministers meeting in the Council (ECOFIN) recognised the need to promote good governance in tax areas on as broad a geographical basis as possible. It was also the time when the fundamental concept of good governance in tax matters was defined within the European Union as meaning the principles of transparency, exchange of information and fair tax competition. At that time, it was agreed that a provision on good tax governance should be added to relevant agreements that are concluded by the Community and its Member States with third countries or third-country groupings.

In 2010, an EU Communication proposed a consistent approach to provide enhanced support in building efficient, fair and sustainable tax administrations in third countries. Among the suggested actions were: supporting multilateral and regional initiatives, deepening regional integration as well as donor coordination were recommended. Later in 2012 the Commission announced its intention to set up a Platform for Tax Good Governance with its main task to take the work on aggressive tax planning and good governance in tax matters onto a sustainable basis. Measures were identified to encourage third countries to apply minimum standards of good governance in tax matters and to identify third countries not meeting these minimum standards. A ‘toolbox’ of sanctions measures in regard to third countries according to whether or not they comply with those standards, or are committed to comply with them were proposed. Among the suggested measures the possible blacklisting of non-compliant jurisdictions and the renegotiation, suspension or conclusion of Double Tax Conventions (DTCs) were listed.

In 2013, the “Platform for Tax Good Governance”, Aggressive Tax Planning and Double Taxation was established. It brings together the tax authorities of all Member States and 15 organisations representing business, civil society and tax practitioners. The Platform meets approximately three times a year. It is chaired by the Director-General of DG Taxations and Customs Union.

In the last month next steps have been taken to further enhance a fair, growth-friendly corporate tax framework by promoting good governance in tax matters. In June 2015 European Commission published an “Action Plan for fair and efficient corporate taxation in the EU”, outlining a number of intended measures for the coming years, including in the area of good governance.

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In 2015, the scope of the Platform was broadened so that it can help to facilitate discussions on Member States’ tax rulings in light of the proposed new information exchange rules, and provide feedback on new anti-avoidance initiatives. At the same time, the EU released an EU-wide list of third country non-cooperative tax jurisdictions, compiled from Member States’ independent national blacklists. The list is expected to encourage Member States to align their national lists. Together with other steps it should help to improve the coordination of possible counter-measures towards non-cooperative tax jurisdictions and to assist third countries in dealing with non-compliant jurisdictions.

3.2.1 Illicit financial flows

Illicit financial flows have gained the attention of international and regional organizations. As observed in some papers, the notion suffers from a lack of terminological clarity (sometimes being used interchangeably with capital flight), which somewhat limits the emergence of an effective tool for curbing the practice. It has sometimes even been used interchangeably with capital flight. Nevertheless, it now appears to be widely accepted that illicit financial flows represent a particular type of capital flight which is characterised by its unrecorded character.

According to the OECD, IFFs are cross-border capital transactions either concealing illegal activities or facilitating them: “There are various definitions of illicit financial flows, but essentially they are generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws.”

In the 2013 report of the United Nations Economic Commission for Africa (UNECA), illicit financial flows are characterised by their proceeds, which may appear in three main forms: (i) the proceeds of theft, bribery and other forms of corruption by government officials; (ii) the proceeds of criminal activities including drug trading, racketeering, counterfeiting, contraband, and terrorist financing; and (iii) the proceeds of tax evasion and laundered commercial transactions.

The World Bank provides a broader definition; that illicit financial flows should be understood as financial flows that have a direct or indirect negative impact on (long-term) economic growth in the country of origin (depending on the particular national development situation). This definition underscores the outcome of a particular activity. The activity is categorized as illicit if it hampers economic growth.

Within the European Union, the notion of illicit financial flows is not formally recognized. There are two separate terms that cover the similar material scope of IFFs. These are artificial capital flows and financial crimes. The first term appears to cover aggressive tax planning, whereas the latter one covers money laundering and terrorist financing.

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3.2.2 Illicit financial flows, taxation and good governance

The OECD has been at the center of actions to curb illicit outflows by enhancing good governance. In 2011, the OECD launched the program Tax & Development. The project is a cooperative effort of the Committee on Fiscal Affairs and the Development Aid Committee, in both of which the European Commission plays a key role. Its main aim is to support developing countries in building effective, transparent and cooperative tax systems. The program emphasizes the idea of taxation as an essential element in the state building process and in development as the next step. The concept paper clarifying the influence of taxation on good governance and state development was prepared by Ben Dickinson.49

The report Illicit Financial Flows from Developing Countries: Measuring OECD Responses is an outcome of the OECD Strategy on Development launched in 2012. It provides a comparison of country performance in the following areas: combating money laundering, tax evasion, international bribery, freezing, recovering and repatriating stolen assets, the role for development agencies. The report shows the progress on the fight against illicit financial flows that OECD countries have made. Nevertheless, it also reveals some shortfalls in the existing regimes. Particularly, it highlights the weak beneficial ownership requirements and deficiencies in the implementation of the OECD Anti-Bribery Convention. The paper then lists recommendations in respect of each of the examined areas.

Another paper, which focuses on the linkages between taxation and governance, was published by the OECD in 2013. In Tax and Development. Aid Modalities for Strengthening Tax Systems, these interconnections in respect of developing countries were referred to as a vicious circle: the lack of domestic resources from fair and efficient taxation undermines good governance, which in turn worsens tax compliance. The report focuses on how to change it into a virtuous circle by improving the tax system and at the same time enhance good governance, resulting in revenue mobilisation and sustainable economic growth. The paper affirms a mutually inclusive relationship between taxation and governance.

The issues of taxation, good governance and fighting illicit financial flows were also considered in another OECD paper published in 2014. In the Development Co-operation Report 2014. Mobilising Resources for Sustainable Development, two assertions are examined. The first which presents taxation as a catalyst for governments that are more responsive and accountable to their citizens and for expanding state capacity. The second considers links between illicit financial flows, development and governance. It considers the particular role of building capacities and good governance in fighting different forms of illicit outflows.

In view of the decision by the Financial Action Task Force (FATF) to make tax crimes a “predicated offence”, the OECD delivered a catalogue of the main instruments available for facilitating international cooperation against tax crimes and other financial crimes and another on effective inter-agency cooperation in fighting tax crimes and other financial crimes.

Therefore, the work done by the UN and its affiliated programmes, funds and specialized agencies deserves particular attention.

A significant perspective on illicit financial flows was released by the World Bank in 2012. In *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*, the authors focus on the intersection of policy and its tools and illicit outflows from developing countries. They examine different channels facilitating illicit flows. In their conclusions, they draw attention to the complementary role of international measures to internal reforms. Greater international cooperation is identified as an effective tool to deal with the nexus of problems resulting from illicit outflows.

The newest report released by the High Level Panel on Illicit Financial Flows from Africa under the auspices of the UN was on 26 January 2015. The report is not merely an analysis of the existing illicit outflows from Africa, but also provides an interesting insight into how and why these outflows occur. It establishes that commercial activities, particularly so called “transfer mispricing”, are by far the largest contributor to illicit financial flows in Africa. These are followed by organized crime, public sector activities and corrupt practices. It reveals the linkage between good governance and illicit outflows. It points out that the tax administrations on the continent still lack skilled staff, while their regimes suffer from secrecy. The report also includes a set of recommendations for addressing the issue of illicit financial flows in Africa. Referring to both the legal and the institutional framework, it emphasizes the role of good governance, transparency and the exchange of information.

The FATF work is also of relevance. It publishes guidance designed to assist countries in the proper implementation of standards. One example of this is the guidance published in its 2014 publication on Transparency and Beneficial Ownership.

Along with the work done by the FATF, significant steps have been undertaken within the European Union, especially as regards money laundering and terrorist financing. The European Commission not only participates in the FATF but also has observer status on the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval). Its policy against illicit financial flows (mainly money laundering) is pursued through many channels. Especially EU-wide cooperation fora are strongly supported. So far the Expert Group on Money Laundering and Terrorist Financing, the Committee on the Prevention of Money Laundering and Terrorist Financing, the informal network of Financial Intelligence Units and the Joint Committee of European Supervisory Authorities have been initiated.

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46 UNECA Report, supra, no. 8.
However, it is the EU legal framework that constitutes the most significant dimension of its anti-money laundering policy, designed to keep the financial system safe from money laundering and terrorist financing. The framework is based, to a large extent, on the international standards adopted by the FATF. Its cornerstones are the Directive 2005/60/EC on preventing the use of the financial system for money laundering and financing terrorism (the proposal for a new directive has been issued), the Regulation (EC) No 1781/2006 on information on the payer accompanying transfers of funds and the Commission Directive 2006/70/EC that sets out measures to implement Directive 2005/60/EC.

Moreover, there was introduced the non-EU country equivalence principle. EU countries are obliged to inform each other, the EU supervisory authorities and the Commission if they recognize a third country that meets anti-money laundering/CFTs standards equivalent to those of the EU. It is the individual EU countries prerogative. One of the latest actions against money laundering undertaken within EU was the adoption of new rules to help fight money laundering and terrorist financing in the EU in May 2015. All these measures are intended to facilitate the work of national Financial Intelligence Units and to establish a coherent policy towards third countries that have deficient anti-money laundering and counter-terrorist financing regimes, ensuring full traceability of funds transfers within, to and from the European Union.

### 3.3 Governments

Governments, including from EU countries, also participate in the debate on tax and good governance. However, the number of available papers published by governments on the analysed topic is limited. Because their actions are taken mainly through their aid agencies, a review of the projects initiated by them provides a better overview of their understanding of the analysed issues.

One example of a project related to the scope of this paper is the programme Tax for Development, launched in 2011 by the Norwegian Agency for Development Cooperation. The program was based on the assumption that a sound tax system provides revenues that are essential to long-term growth and contributes to good governance. The program is implemented through supporting tax authorities in partner countries (Mozambique, Tanzania and Zambia), multilateral cooperation, research and supporting civil society.48

Similar projects have also been carried out by many other aid agencies, for example The Department for International Development (DFID), which is a United Kingdom aid agency, or the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, the German aid agency.

Nevertheless, governments do publish some papers, usually in cooperation with academia. One example is the article prepared by researchers from the Oxford University Centre for Business Taxation for the UK Department for International Development (DFID): Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature.49 Its main purpose was to review the literature on tax gap estimates for developing countries.

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The authors conclude that available knowledge on tax revenue losses in developing countries caused by tax evasion and tax avoidance is limited, the main reasons for which lie in the shortcomings of existing studies, which are not based on reliable methods and data.

3.4 NGO & research institutes

Illicit financial flows are also in the spotlight of different NGOs. There are many organizations dealing with this topic, but in this paper only the activity of the Global Financial Integrity (GFI) is discussed and the recently launched project by the Institute for Austrian and International Tax Law at the WU Vienna University of Economics and Business on "Tax and Good Governance".
The GFI work describes illicit financial flows as "cross-border transfers of funds that are illegally earned, transferred, or utilized."50

The GFI publishes an extensive number of research reports on illicit financial flows. The experience of African countries is of particular interest to GFI. The most recent report was published in December 2014 and covers data from 2003-201251. The study provides a unique comparison of the available data on illicit financial flows, on foreign direct investments and on official development aid. It also includes a comparative analysis of these data by region. Its main conclusion emphasizes the necessity of curbing the opacity in the global financial system comprising tax haven secrecy, anonymous companies and money laundering techniques.

Among the research institutes, perhaps the most prominent is the Chr. Michelsen Institute, which focuses on democracy and governance, as well as tax and public finance management. They publish several papers covering questions regarding different forms of illicit financial flows, their influence on development, weak institutional architecture and the role of tax measures. One of these is *Taxation, Institutions and Participation*, which is aimed at investigating the effects of tax havens on the domestic revenue system, institutions and citizen participation in African countries, with a particular focus on Angola, Tanzania and Zambia. Another project is the U4 Anti-corruption Resource Centre, the purpose of which is to assist donors in addressing corruption challenges through their development support.

Another noteworthy paper written by the Chr. Michelsen Institute refers to the possibility of good governance working as a façade.52 The authors, Kalle Moene and Tina Søreide, argue the necessity to look behind the façade and check if it is not a corruption-driven infrastructure, recognizing the possibility that illicit financial flows may be concealed under the veil of supposed institutional improvements. They state that more attention should be paid to final outcomes and performance than policies.

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51 Dev Kar and Joseph Spanjers, Illicit Financial Flows from Developing Countries: 2003-2012, Global Financial Integrity.
Last but not least, a significant publication was prepared jointly by researchers from different institutes: Deborah Brautigam, Odd-Helge Fjeldstad and Mick Moore. In Taxation and State-Building in Developing Countries: Capacity and Consent they present the importance of taxation which extends beyond the raising of revenue, serving as the cornerstone of building a state and sustaining its power. The authors emphasise the direct link between revenue raising and governance. They focus on three questions. The first is how taxation and sources of public revenue affect state-society relations and governance in contemporary developing countries. The second is when the revenue imperative begins to create a virtuous circle of institutional development. The third is what are the key political considerations involved in enabling the governments of contemporary developing countries to tax more effectively, equitably and sustainably.

3.5 The special role of dependencies of EU member states

The dependencies of EU countries, particularly those of the UK, have always played a special role in the offshore world. Traditionally, they provide a haven for taxpayers wishing to shelter their wealth and activities from the tax and regulatory authorities of their home country. Different dependencies are specialized in different areas. Some have focused on providing a holding regime from multinational enterprises (MNEs) (e.g. the British Virgin Islands); others have focused on trusts (e.g. Jersey and Guernsey); some have targeted individuals (e.g. St. Lucia); others on corporations (e.g. Bermuda); in some cases jurisdictions have acted as conduits for investment into emerging markets (e.g. the British Virgin Islands is one of the largest sources of inward investment into China); others in providing attractive locations for MNEs to hold their “cash boxes”.

Since 2009, we have seen a gradual move towards more transparency on the part of these dependencies and this is something that we should welcome. All now subscribe to the G20/OECD standard of exchange of information on request and have negotiated a wide network of tax information exchange agreements (TIEAs) with the EU and other countries, including a number of developing countries. The peer reviews carried out by the Global Forum on Tax Transparency suggests that these measures are now beginning to work and almost all of the dependencies are now able to engage in effective exchange of information. Almost all of the major dependencies have also signed up (sometimes reluctantly) to the new automatic exchange of information standard and the expectation is that by 2018, they would be implementing this standard, although probably mainly with OECD/EU countries. At the same time, all of the major financial offshore centers have subscribed to the FATCA and have agreements with the US on how to implement this arrangement.

As regards to the broader issue of transparency, progress has been slower. There is an ongoing debate as to whether some of the Caribbean dependencies will be able to identify the beneficial owners behind trusts and other entities that operate out of their jurisdiction. While some have agreed to create a public register, it is unclear how they will collect the information that will be needed to identify who are the ultimate beneficiaries – especially where there are a number of trusts involved in a chain.

One broader concern is whether some of the smaller dependencies have the capacity to implement the new tax, regulatory and financial standards since in some of these jurisdictions there are very few officials to deal with the tax, money laundering and financial regulations and in some cases they lack a significant domestic financial market.

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One role that the EU could play here is to explore with these jurisdictions and other aid agencies whether they would like a long term assistance program in order to help them to exit from the financial sector. This would be very much a decision for them and one which would require them doing a rigorous cost/benefit analysis of what are the net gains from operating in the financial sector. This will not be an easy decision given the limited scope of the options that they have to replace the revenues and jobs generated by their financial sectors are limited.

Another action that the EU member states could explore is to review the way in which an increasing number of member states are entering into full tax treaties with these dependencies. From the perspective of an offshore financial jurisdiction, having an extensive tax treaty network increases their attractiveness to both individuals and business as an offshore financial center. One of the side effects of the OECD/G20 initiatives has been that certain jurisdictions (Hong Kong is perhaps the best example) have, by committing to the exchange of information standards, been able to develop a network of tax treaties. The EU should perhaps aim at having a common position as regards which dependencies they would give full tax treaties to and which they would not, preferring to rely on TIEAS.

The EU, possibly in the context of the base erosion and profit shifting (BEPS) discussions, could also review the way in which Member States identify tax havens both within and outside the context of their controlled foreign cooperation legislation. The controversy over the list that the EU commission issued earlier this year shows that this is not an easy task. Prior to 2009, there was a broad consensus that a tax haven was a jurisdiction which had a low or nominal rate of tax, lacked transparency and refused to engage in effective exchange of information. These were the criteria used to draw up the “infamous” OECD blacklist in 2009. Today, almost all the jurisdictions on that list now engage in effective exchange of information on request (although they continue to have zero or no nominal income taxation). So it is increasingly difficult to distinguish between what may be called a “normal” country and a “tax haven”. Perhaps we now need to move the debate away from this distinction to one that looks at the effective rate of tax within different regimes, particularly for mobile activities.

It is also essential that these dependencies play a constructive role in the implementation of the newly reporting requirements in transfer pricing. They must be prepared to use TIEAS to respond to requests from EU and other countries for information required to correctly calculate the transfer price on inter-subsidiary activities. They must also play a constructive role in the country by country exercise and more generally in the implementation of the BEPS recommendations. The effectiveness of new transparency rules is only as strong as the weakest link in the chain: dependencies must be helped to ensure that they are able to implement these rules.
4. WHAT CAN MORE THE EUROPEAN UNION DO TO PROMOTE GOOD TAX GOVERNANCE IN THE THIRD COUNTRIES?

As can be seen from the earlier sections of this paper, work is already being done by the EU and others in encouraging dependencies and third countries to use taxation to promote good governance. This section sets out some suggestions for how the EU could intensify its work in this area.

The EU is the largest single economic area in the world and is also the largest single donor of aid to developing countries, so it is well placed to promote good governance in the tax area, especially when it works in partnerships with other international players.

The following are some of the areas where the EU could by its actions strengthen the link between taxation and good governance.

- **Inserting a good governance clause into its Bilateral Free Trade Agreements.** The EU has a growing network of bilateral free trade agreements yet it has only recently begun to propose that these agreements should include a clause which recognizes the emergence of new tax transparency standards. As the largest single economic group in the world, the EU is well placed to insist that such clauses should become a standard part of such bilateral treaties and may also want to consider the insertion of such clauses into multilateral free trade agreements.

- **Redirecting a greater proportion of its aid to improve tax capacity and making its aid program contingent on advances in good governance.** Currently less than 3% of the EU’s aid goes into tax related projects. The EU should aim to double this amount in the context of the Finance For Development outcomes from the Addis conference on Finance For Development. In particular, the EU could do better to assist less developed countries to improve their capacity to engage in effective exchange of information, to put in place any recommendations that are relevant for them from the BEPS project and to counter harmful tax practices. As regards country by country reporting, the EU could create a common technical cloud based platform which would enable less developed countries to have easier access to this information rather than going through the treaty network. The EU should also insist that the recipients of aid should commit to effective exchange of information on request and be willing in the longer term to move towards automatic exchange; provide country by country reporting for multinationals which operate within their territories; and commit to exchanging information with interested parties. The EU could also discourage global and regional multilateral banks from using non-cooperative jurisdictions as platforms for delivering assistance. In addition, the EU could examine whether it could use its aids programs to encourage resource rich developing countries to join the EITI (Extractive Industries Transparency Initiative).

- **Undertake a “spill over” analysis of how the tax policies in the EU may influence the tax systems of developing countries and in particular the ability to protect their revenue base.** The recent EU communication on a fairer tax system of June 2015 identified non-compliant jurisdictions (although the basis for identifying such jurisdictions is questionable). This could be a helpful move from the perspective of developing countries since it would have positive effects on their ability to counter the use of such jurisdictions by their own residents and multinational enterprises. There are, however, some recent changes in EU Member State tax policies, and in particular the move towards a territorial tax system, which may have negative impacts on the
tax positions in developing countries since such moves are likely to make tax competition more fierce.

- **The Commission could intensify the role of its recently created "Platform for Tax Good Governance" to identify measures which could be taken to assist developing countries to move towards more transparent tax systems and to improve tax governance.**

- **Using its seat at international fora, to ensure that the voice of developing countries is heard.** The EU is a major player at the IMF, the World Bank, the OECD, the G20 and it should use its influence in these different fora to ensure that any emerging standards meet the needs of developing countries and that they have the capacity to exploit such standards in a way which promotes good governance.

- **Assessing the impact of BEPS on less developed countries.** The Commission is well placed to work with such regional organizations as CATA (Commonwealth Association of Tax Administrators), CREDAF (Centre de Rencontres et d'Études des Dirigeants des Administrations Fiscales) and IOTA (Inter-European Organisation of Tax Administrations) to assist them in countering base erosion and profit shifting and developing solutions that are adapted to their political, economic and capacity constraints.

- **Encouraging cooperation with regional economic groupings on how to counter harmful tax competition.** The EU could share its experience with developing countries of its Code of Conduct Group in counteracting harmful tax practices. Many regional groupings in Africa (e.g. SADC (Southern African Development Community), ATAF (African Tax Administration Forum)) and elsewhere are interested in this area but very few have succeeded to date in putting in place an institutional framework similar to that of the Codes.

- **Getting behind the veil of beneficial ownerships and trusts.** The EU should play a leadership role in encouraging all of its Member States and all recipients of its aid to commit to issuing a public register of the ultimate owners of corporations, limited liability partnerships and trusts and other vehicles and that this information should be available in an easy format to developing countries.

To conclude, there are many ways in which the EU could enhance the use of its economic and political influence to strengthen the inter-link between taxation and good governance in third countries.
5. CONCLUSION

Governments, especially within the context of the single market, need to pursue vigorously all these forms of cooperation that are referred to above, since it is only in this way that all forms of illicit activities – smuggling, tax evasion, money laundering, bribery and other cross-border financial crimes – can be effectively countered, that a “bright red line” can be drawn between what is acceptable and unacceptable tax competition and that new international tax rules can be put into place which promote good governance within the EU and third countries. The European Union has a leadership role to play in this transformation of the tax environment, using both its legally binding powers, “soft” law and its economic weight. This leadership role has to include dependencies and third countries.
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