EU listing of tax havens

SUMMARY

Broadly speaking, 'tax havens' provide taxpayers, both legal and natural persons, with opportunities for tax evasion or avoidance, while their secrecy and opacity also serves to disguise the origins of the proceeds of illegal and criminal activities.

One might ask why establishing a list of tax havens or high-risk countries is useful. Drawing up such lists began with action to end harmful tax practices arising from the discrepancy between the global reach of financial flows and the geographically limited scope of jurisdictions that match or exist inside national borders.

However we refer to tax havens, they all have one thing in common: they allow individuals or organisations to escape from taxation. Distinctive characteristics of tax havens include low or zero taxation, fictitious residences (with no bearing on reality) and tax secrecy. The latter two are key methods for hiding ultimate beneficial owners. In the EU, the process of adopting a common list of non-cooperative tax jurisdictions was initiated as part of efforts to further good tax governance, and its external dimension. On 5 December 2017, the Council adopted a first common list resulting from the assessment of third countries against distinctive criteria. Pursuing the assessment process, the Council has updated the list on the basis of commitments received, while also reviewing countries that had not yet been assessed.

This briefing updates an earlier one, from May 2018 – itself an updated and extended version of a briefing from December 2017: 'Understanding the rationale for compiling "tax haven" lists', PE 614.633 – to take account of the changes in the lists since that date.

In this Briefing

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Introduction

Tax havens have long existed, and have been widely used since the 1930s. However, they have become a prominent concern of tax and economic policies with the globalisation of the economy, in which taxpayers can try to structure their activities and choose the geographical location of their wealth, and plan the location of their tax bases accordingly. The digitalisation of the economy has made establishing a link between a jurisdiction and flow of money even more tenuous.

In this briefing, the terms 'tax havens', 'secrecy jurisdictions' and 'non-cooperative jurisdictions' are interchangeable since they share commonalities.

Background: the global economy and tax havens

Tax jurisdictions[1] cover a defined territory, whereas some global taxpayers – multinational enterprises (MNE) and high net worth individuals (HNWI)[2] – are able to move profits and their tax bases around the globe, from one tax jurisdiction to another.[3]

Tax avoidance, aggressive tax planning, and base erosion and profit-shifting

As recently highlighted, for example, by the Panama papers and Paradise papers leaks, those striving for discretion or anonymity will seek the assistance of facilitators such as advisors, law firms and banks, and use various types of instruments, such as shell, offshore and/or letterbox companies, as well as trusts, and route funds via a number of countries which have created tax regimes that are attractive for those offering or seeking such practices. The, legal and illegal, tax-planning schemes uncovered have once again highlighted the role played by tax havens in the routing and sheltering of funds.

Opaque transactions hide money laundering carried out in support of all kinds of illegal and criminal activities, including tax evasion and fraud. As regards tax challenges, even tax avoidance (which is *a priori* legal) can also rely on opacity, as risk-taking tax-strategies (minimising tax liability) are less likely to be scrutinised in a shadowy environment. Opacity helps prevent detection of aggressive tax-planning schemes, and therefore lowers the tax burden, not to mention that tax avoidance is legal as long as it is not deemed illegal by the tax authorities or, ultimately, by the courts. Uncovering aggressive tax planning schemes results in negative publicity and reputation costs.

Tax competition, by its very nature, is asymmetric. This means that some parties benefit from tax competition at the expense of others, and high-tax countries are more likely to lose tax resources as well as face reduced economic activity (and ultimately lower growth). By its nature, the issue of tax havens – in breach of taxation good governance principles – has an external relations dimension, which extends to the development field. It is connected with tax fairness (not all taxpayers are able to use global aggressive tax-planning schemes) and the link between real economic activity and taxation (the nexus connecting the taxable event with the tax authorities).

Harmful tax competition and tax havens

Identifying and listing territories as tax havens was envisaged as part of the strategy to identify and address harmful tax competition used by companies and MNEs. Tax havens are also closely related to secrecy and anonymity, which are central elements in tax evasion and aggressive tax planning. A report prepared by the Organisation for Economic Co-operation and Development (OECD) entitled 'Harmful tax competition: an emerging global issue', published in 1998, responded to demands to counter this phenomenon. It was intended 'to develop a better understanding of how **tax havens** and harmful preferential tax regimes, collectively referred to as harmful tax practices, affect the location of financial and other service activities, erode the tax bases of other countries, distort trade and investment patterns and undermine the fairness, neutrality and broad social acceptance of tax systems generally'.

Subsequently, identifying 'tax havens' and seeking their commitment to the principles of transparency and effective exchange of information was one of the areas of work defined in the project on harmful tax practices in 1998.

A look at tax compliance: behavioural economics and taxation

Tax compliance refers to willingness to comply with tax laws, declare income accurately, claim the correct deductions, relief and rebates, and pay all taxes on time. At the taxpayer level, compliance is encouraged by the fight against tax evasion and fraud, without which non-abiding taxpayers would gain an economic advantage likely to deter compliance.

Classic economic models[4] describe taxpayers as decision-makers seeking an economically optimal situation. Behavioural economics in taxation draws a more complex and nuanced portrait of taxpayers, where moral suasion in tax collection, culture, and the likelihood of being audited play an important role. However, studies mostly concentrate on personal income tax and individuals.

Listing tax havens

Currently lists are established by international organisations, non-governmental organisations and countries. (The situation in the European Union and its Member States is covered in the section below.)

Common features of lists

At first, the term 'tax haven' designated countries offering attractive low-tax regimes to attract financial services. Later, it was used to describe jurisdictions that do not respect tax good governance principles vis-à-vis other jurisdictions, since their objective is to attract tax bases or investment. The terms 'tax haven', 'offshore financial centre' and 'secrecy jurisdiction' describe jurisdictions that feature distinctive characteristics such as low or zero taxation, fictitious residences (with no bearing on reality) and tax secrecy. Each one focuses on a different feature: the foreign location of offshore centres, and the anonymity or non-disclosure of financial dealings and ownership of assets, in the case of secrecy jurisdictions. Low-tax jurisdictions underline the lack of, or minimal, taxation on the income and assets of non-residents.

Three elements, commonly used as distinctive criteria, contribute to the conclusion that a location is a tax haven:

- lack of effective exchange of relevant information with other governments on their taxpayers, minimal or no disclosure on financial dealings and ownership of assets,
- no or minimal taxation on income and assets of non-residents, tax advantages for non-resident individuals,
- general non-application of accepted minimum standards of corporate governance and accountability.

Establishing lists follows a similar pattern, starting with the definition of criteria, followed by the establishment of the list itself. This is supplemented by incentives for those named on the list to remedy the shortcomings, with a view to complying with conditions necessary to be delisted. In short, setting and monitoring lists is a dynamic process. (Black)listing is thus a method to bring about regulatory compliance. Standards and rules serving as criteria are applied by the members of the organisation that sets the list, in respect of others joining or gaining membership. The objective of the list is therefore to pressurise tax havens to apply those rules and standards. This implies that members of the organisation themselves are outside the scope of the list, which does not automatically mean that they are immune to criticism.

Since the purpose of drawing up such a list is to encourage jurisdictions that do not comply with the chosen criteria (rules, standards or principles) to commit to adopting or endorsing them, once they do so they may be delisted. (Black)listing is therefore a tool, rather than a solution. Each list describes the state of compliance or non-compliance with identified criteria, offering a snapshot of the global situation at a set date. The map of jurisdictions labelled with one of those criteria is therefore not static.

Examples of tax haven lists

International organisations

In the early 2000s, the OECD drew up a list of uncooperative tax havens, which was updated on the basis of commitments by countries placed on the list with regard to the specific criteria concerned. Following G20 intervention, this 'black list' was complemented by a 'grey list' and a 'white list', according to the commitments made and their level of implementation during the late 2000s. The International Monetary Fund 2014 offshore list assessment was established on the basis of predefined standards from several international bodies.

Among the organisations setting lists of countries which are relevant to tax matters, the Global Forum on Transparency and exchange of information for tax purposes (often referred as the Global Forum) has a particular role on tax transparency, as the multilateral framework gathering OECD and non-OECD economies since 2000. Regarding the assessment of the implementation of the standard exchange of information on request (EOIR), the Global Forum regularly reviews the commitments to join the multilateral Convention on Mutual Administrative Assistance in Tax Matters.

Non-governmental organisations

Secrecy jurisdictions are determined on the basis of a Tax Justice Network (TJN) assessment, which applies a secrecy score measuring banking secrecy, the capacity to create shell companies or offshore structures, and barriers to cooperation and information exchange. On this basis, TJN has published a list every two years since 2009 – the **Financial Secrecy Index** (FSI) – which ranks a hundred jurisdictions according to their secrecy and the scale of their offshore financial activities.

Oxfam also published a study containing a list of tax havens assessed with regard to transparency, fair taxation and participation in international fora on tax criteria, as defined for the establishment of an EU list by the Council, shortly before the latter adopted its initial list in December 2017 (since updated several times – see below).

Secrecy and anonymity provided by tax havens

Secrecy results from a lack of exchange of information between countries, as well as from the anonymity provided by various mechanisms rendering establishment of the identity of the ultimate beneficial owner difficult, thanks to partial or complete lack of traceability of transactions. Situations hidden by complex mechanisms spanning several countries – in a chain of operations and a string of operators and intermediaries – involve tax havens using tools such as letter box companies, shell companies and offshore structures or trusts, and in particular networks of these. As a result, information essential to authorities is obscured, creating a safe haven out of the sight of authorities (tax and others, depending on the nature of the operations). For that reason the Global Forum on Transparency is building on the work of the Financial Action Task Force (FATF) concerning the definition of beneficial ownership in the terms of reference for the exchange of information on request (EOIR).

The secrecy offered by tax havens provides advantages for non-residents by shifting income away from its actual geographical source, and as a result reduces the tax base in the country in which they are tax resident. The income moved to tax havens is kept out of sight by secrecy or anonymity vis-à-vis the country of tax residence. This key feature also provides opacity, not only for tax purposes (avoidance and evasion) but also for illegal and criminal activities such as money laundering (bringing money of illegal/criminal origin back into circulation) and a range of related criminal activities. Regulatory measures allowing traceability and the sharing of information (concerning the movement of financial transactions and other relevant information, within the framework of anti-money laundering, in particular through customer due diligence obligations) are appropriate tools for counteracting these practices.

Distinct but connected: high-risk third-country lists

The Financial Action Task Force (FATF) identifies high-risk and non-cooperative jurisdictions (those with weak measures to combat anti-money laundering and counter-terrorist financing (AML/CFT)), using lists that are reviewed periodically. The lists of third countries presenting a high risk with regard to money laundering focus on legal and institutional indicators relevant in money laundering (of illegal activity proceeds, including evaded taxes) and connected activities (financing of terrorism), including secrecy and anonymity, which are also criteria in the assessment of tax havens.

In its Article 9, Directive (EU) 2015/849 of the European Parliament and of the Council provides for the identification of high-risk third countries with strategic deficiencies so as to protect the proper functioning of the internal market. The Commission is empowered to adopt such a list by delegated acts, the FATF's work serving as a basis for the list of high-risk third countries with strategic deficiencies.

European Union lists

Lists in the EU

Based on the existence of national black/white listing processes inside the EU, the Commission published, following its 17 June 2015 action plan, a list of cross-references of EU Member State national lists. This aimed at identifying the jurisdictions appearing on at least 10 national lists. This list was not a common list, but rather a move towards more collective identification of problems than the available patchwork of assessments available would allow.

Establishment of an EU list of third countries

The establishment of a list of non-cooperative tax jurisdictions (tax havens) is a tool for securing a level playing field, and was envisaged in the Commission's communication on an external strategy for effective taxation presented in the 2016 anti-tax-avoidance package. A common EU system for assessing, screening and listing third country tax jurisdictions allows the identification of those that play a particular role in tax avoidance and evasion.

A three-step process was established for drawing up a common list of tax jurisdictions which do not meet some of the criteria identified as essential for not being considered a tax haven. They consist of a neutral scoreboard of indicators (a tool for helping to determine the potential risk level of each third country when assessing tax governance); a screening of third countries identified on the basis of the scoreboard (based on a dialogue in which the third countries could decide to bring their rules into line with the criteria and make such a commitment – 213 countries were pre-assessed); and finally the adoption of an EU list of third country non-cooperative tax jurisdictions.

The criteria set out in the external strategy relate to three main aspects for tax:

- Transparency: through compliance with the international standards on automatic exchange of information (AEOI) and exchange of information on request (EOIR), and checking whether a jurisdiction has ratified the multilateral convention;
- Fair Tax Competition: assessing the existence of harmful tax regimes, contrary to the Code of Conduct principles or the OECD's Forum on Harmful Tax Practices;
- Base erosion and profit shifting implementation: participation in the Inclusive Framework.

The Council adopted the first EU list of non-cooperative jurisdictions for tax purposes on 5 December 2017, in Annex I to the Council conclusions; the list is periodically updated (see below).[5] Six other documents accompany the list, and are aimed at future updates and follow-up measures:

- a 'State of play of the cooperation with the EU with respect to commitments taken to implement tax good governance principles' (as Annex II); referred to as the 'Watch list', also updated periodically
- 'Defensive measures'(as Annex III);
- 'Guidelines for further process concerning the EU list of non-cooperative jurisdictions for tax purposes' (as Annex IV);
- 'Criteria on tax transparency, fair taxation and implementation of anti-BEPS measures that the EU Member States undertake to promote' (as Annex V); and
- two documents specifying two of the criteria used ('Criteria on the duration of the reasonable time frame' (Annex VI) and 'Criteria on the absence of a corporate tax or a nominal corporate tax rate equal to zero or almost zero' –as Annex VII);).

The initial list itself comprised 17 jurisdictions outside the EU that are non-cooperative in tax matters. These jurisdictions had failed to make commitments on meeting the criteria sufficiently in advance of the adoption of the list, or had made commitments that were deemed insufficient. Another 48 jurisdictions were placed on a watch list, meaning that their commitments were deemed sufficient, but that EU will closely monitor their implementation. Finally, eight Caribbean region jurisdictions[6] were given more time (until the end of 2018) before they were screened, because of the disruption caused by a September 2017 hurricane. In total, 92 countries were screened in the process of setting up the lists (see below).

Monitoring compliance and reviewing the lists was envisaged, meaning that the lists would be adapted to take account of implementation.

Updates resulting from the monitoring of commitments

Formally sufficient commitments were monitored against their effective implementation, with the results due by either the end of 2018, or in some cases 2019. The commitments made are publicly available through the Council's register. Procedural guidelines for the process of monitoring commitments concerning the EU list of non-cooperative jurisdictions for tax purposes were drawn up and agreed by the Code of Conduct Group (Business Taxation) on 14 February 2018.

In cases where implementation of the commitments was deemed insufficient, this would result in inclusion in the list of non-cooperative jurisdictions. The introduction of measures countering the requirements could also result in inclusion. In addition, assessment in 2018 of those jurisdictions initially placed on the 'Hurricane list' resulted in some being placed either on a 'watch list' or on the EU list itself.

Both the EU list of non-cooperative jurisdictions for tax purposes[7] and the 'State of play of the cooperation with the EU with respect to commitments taken to implement tax good governance principles' (as a 'watch list') were updated shortly after the adoption of the initial list.

Regular monitoring resulted in four further changes to the list in 2018. The list was also further reviewed in 2019, in June and October.

However, in future, adjustments to the lists will be carried out according to the Council conclusions of 12 March 2019, which indicate that 'from 2020 onwards, such updates of the EU list should be done no more than twice a year, leaving sufficient time, where appropriate, for Member States to amend their domestic legislation'.

FURTHER READING

Chavagneux C., Combattre les paradis fiscaux, 2015.

Dourado A. P., 'The EU Black List of Third-Country Jurisdictions', *Intertax,* Vol. 46 (3), 2018, pp.179-180.

Palan R., History of tax havens, 2009.

Schjelderup G., 'Secrecy jurisdictions', *International Tax and Public Finance*, Springer, 2015.

Sharman J.C., 'International Organisations, Blacklisting and Tax Haven Regulation', 2004 (for historic part until 2004).

ENDNOTES

[1] 'Tax jurisdiction' defines which authority is competent to adopt tax rules within a territory, which may be smaller than a national state and cover an area that for other issues is covered by the law of the state in which it is situated.

[2] This relies on the globalisation of legal persons, which taxpayers (natural or legal persons) can make use of to escape taxation. Consequently, income can be relocated, with an increase in fiscal engineering strategies, which require enormous resources for authorities to trace. On the adaptation of taxpayers to the new rules, see for instance, H. Bouthinon-Dumas, A. Jeny and B. Leca, '*L'adaptation des fiscalistes aux nouvelles conditions de l'optimisation fiscale*', *Revue internationale de droit économique*, 2018/4, tome 32, and the presentation of the 'dynamic capabilities' concept.

[3] The interplay of a number of corporate taxpayers 'going global' (MNEs with activities spanning the globe) and the development of 'tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and ... lead to the erosion of national tax bases', G7 countries communiqué, issued by the G7 Heads of State at their 1996 Lyon Summit.

[4] See, for instance, K. Devos, Tax Compliance Theory and the Literature, in: *Factors Influencing Individual Taxpayer Compliance Behaviour*, Springer, Dordrecht, 2014.

[5] Official Journal of the European Union, 19 December 2017, C 438, p. 24.

[6] The list is provided in point 12 of the Council conclusions.

[7] Each amendment is published in the Official Journal of the EU. The latest, C 210, and C 351, date from 1 June and 17 October 2019, respectively. A dedicated Council web page provides updated information.

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