On the blacklist

International Tax

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Bill Dodwell provides an update on the EU Council of Finance Masters list of non-cooperative jurisdictions

The EU Council of Finance Ministers has finally agreed the list of non-cooperative jurisdictions. It had originally been hoped to finalise the list in September and then November but politics and the complexity of the task meant that agreement took longer than anticipated. The purpose of the list is to have EU-wide agreement on the black-listed countries – after widespread criticism of the original June 2015 list.

The listing criteria were agreed by ECOFIN in November 2016 and February 2017. There are three areas to satisfy: Transparency; Fair Taxation and Implementation of the G20/OECD-led Base Erosion and Profit Shifting project. It was agreed that having a zero-rate of corporate tax was acceptable – despite the efforts of some countries to impose minimum tax rates.

Transparency requires that a jurisdiction adopts the main global agreements on providing data to other countries (the Common Reporting Standard and standards on exchanging information on request, including ratification of the OECD Multilateral Convention on Mutual Administrative Assistance by the end of 2018). It also requires adoption of whatever is finally agreed on exchanging beneficial ownership data. Finally, the jurisdiction must receive positive assessments on implementation of the standards. Fair Taxation means that the country must have no harmful preferential tax measures and no attraction of profits not reflecting economic activities. Finally, the requirement to join the BEPS Inclusive Framework and implement the minimum standards no doubt helps explain why so many countries have signed up in recent months. There is also a requirement to receive a positive assessment once the Inclusive Framework has set monitoring criteria.

The review of countries was conducted by the Code of Conduct group, which consists of tax and finance officials from member states. The group produced an initial screen and made detailed assessments of each country's performance, including asking for information. A long list of 92 jurisdictions was presented to the November ECOFIN meeting but several member states objected to aspects of the list. The Code of Conduct group immediately sought commitments from jurisdictions to make changes to their domestic regimes, or to sign international agreements, in both cases by the end of 2018, so as not to be included on the final list.

In the end, 17 countries remained on the list agreed on 5 December by the Member States. Eight Caribbean islands, including the British Virgin Islands, were given an additional year for their assessment due to the severe hurricanes earlier in the year.

The 17 are: American Samoa, Bahrain, Barbados, Grenada, Guam, South Korea, Macao, Marshall Islands, Mongolia, Namibia, Palau, Panama, Saint Lucia, Samoa, Trinidad & Tobago, Tunisia and United Arab Emirates.

The largest and perhaps most surprising inclusion is South Korea, which was assessed as having several harmful preferential regimes and did not commit to changing them. The response from Mongolia highlighted one of the challenges for small developing countries, when they explained that they did not have the resources to adopt and manage many of the new international requirements.

Trinidad and Tobago is the only country identified by the Global Forum on Transparency as non-compliant. The OECD Secretariat recently announced that it is providing technical support to the islands; there are no doubt many others where help will be needed if they are to participate fully in the new global accords of BEPS and transparency.

44 jurisdictions agreed to make changes, across all three monitoring areas. 24 countries have agreed to modify identified harmful regimes. The most important country in this category is Switzerland, which of course is in the midst of reforming its wider corporate tax regime. Taiwan, Thailand and Turkey also feature, together with many smaller locations.

Five countries and jurisdictions have agreed to address the concerns relating to economic substance: Bermuda, Cayman Islands, Guernsey, Isle of Man, Jersey and Vanuatu. This is an interesting challenge, since it appears to imply that the jurisdictions should adopt negative, or downward transfer pricing. Economic substance isn't defined although there is likely to be a link to the BEPS output on transfer pricing, where profits are allocated to locations where a multinational has employees, based on the value created by their activities. The concept clearly goes beyond corporate residence. Transfer pricing is typically an anti-avoidance measure whereby tax authorities may increase the reported profit to what would have been recorded in an arm’s length scenario. Reducing profit sounds a little like the Belgian Excess Profits regime, where Belgium reduced taxable profits below accounting profits. As we know, this has been determined to be unlawful state aid (subject to appeal). An important part of negative transfer pricing adjustments must be reporting the adjustment to those tax authorities entitled to make an upwards adjustment. Without such a reporting mechanism, profits might go unrecorded.

There is no Directive setting out a package of sanctions. Instead, the Council urges member states to set reporting requirements for payments to listed locations and optionally disallow payments; add a withholding tax; or bring the income in the scope of CFC legislation.

The outcome of the listing project seems to be that carrots have held much more sway than sticks – and international change is continuing.