

**The fight against tax havens
and tax evasion
Progress since the London G20
summit and the challenges ahead**

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Acronyms

CBC	Country by country reporting
CCCTB	Common Consolidated Tax Base
FATF	Financial Action Task Force
FSB	Financial Stability Board
IASB	International Accounting Standard Board
IFRS	International Financial Reporting Standard
MDGs	Millennium Development Goals
OECD	Organisation for Economic Co-operation and Development
STD	Saving Tax Directive
TOD	Transparency Obligations Directive

Abstract

The recent crisis of 2008 has served to highlight the increasingly harmful effect of tax havens on the economy and on the social cohesion of developed and developing countries. The issue took on major importance at the G20 London Summit (April 2009), where the leaders announced a number of important steps to combat tax havens.

However, that initial drive has gradually lost momentum. The measures agreed at the time have proved incomplete, and in subsequent summits the G20 leaders have often limited themselves to expressing good intentions without taking concrete measures. It is to be expected that the next summit in Cannes (November 2011) will re-launch important aspects of the fight against harmful tax practices.

On the other hand, during the Spanish and Belgian presidencies of the EU in 2010, some important steps were taken towards a greater transparency in the international financial system and practices of multinational companies, which if fully implemented could have greater impact than the G20 measures.

This study seeks to take stock of progress achieved so far at the international level, particularly at the G20 and in the EU, and also to propose concrete measures for waging a more effective battle against one of the greatest scourges of our time: the dispossession of important resources from states and citizens for want of international coordination on taxation.

Executive summary

Tax evasion, tax avoidance and capital flight have become a global problem with repercussions that extend throughout the world's economy, as clearly seen in the recent economic and financial crisis of 2008.

A great number of multinational corporations (MNCs), banks and criminal networks use tax havens to evade or avoid paying taxes, taking advantage of the following 'favourable' conditions: banking secrecy, a very low or non-existent tax rate for non-residents, a lack of cooperation with other jurisdictions and deregulation.

It is extremely difficult to calculate the amount of money which passes through or is hidden in tax havens. The Tax Justice Network NGO estimates that 9.2 trillion euros have been placed offshore.

The number of tax havens has risen from 25 in the 1970s to around 72 today. Most of these territories are interrelated with the world's main financial centres. In fact, the relationship between tax evasion and tax avoidance and the deficiencies of the financial system is unquestionable. Weak regulation in tax havens has facilitated the development and worldwide dispersion of opaque and risky financial products and has made it difficult to assess the health of financial institutions with activities and assets in these offshore centres.

Moreover, the tax schemes typical of many tax havens, which are aimed at attracting financial and other geographically mobile activities, can create harmful tax competition between states and consequently result in a decrease these states' tax capacity.

Capital flight may worsen the indebtedness situation of many countries. This is because the drain on national foreign exchange resources forces governments to borrow abroad. In this respect, harmful tax practices increase a state's deficits, thereby forcing these states in turn to increase taxes on their citizens or cut social expenditure. This threatens the social contract between states and their citizens, through which the latter pay taxes in exchange for services provided by the state.

Poorer countries lose out even more from tax avoidance. Their finances depend to a larger degree on corporate taxes than wealthier countries do. Besides, resources from taxes cannot be replaced by external sources of finance (aid or debt), which are much more volatile and often affected by external factors. The recent cutbacks in the Official Development Debt intended for this purpose has demonstrated this.

According to Global Financial Integrity, 'crime, corruption and tax evasion drive \$1 trillion out of developing countries every year - that's \$10 lost for every \$1 that comes in as aid. Christian Aid, meanwhile, estimates the fiscal cost of harmful tax practices to developing countries at \$160,000 million per year.

The fight against non-cooperative jurisdictions appeared on the agenda of the four G20 summits held after the crisis, taking on special relevance during the London Summit (April 2009). However, over one and a half years after London, progress has been slow and the initial impetus is quickly evaporating. The issue found its way back to the top of the agenda at the last G20 in Seoul (November 2010), where important progress was made towards strengthening developing countries' tax systems and administrations.

This issue had already been mentioned in the conclusions of the EU Council of Foreign Affairs Ministers of 14 June 2010 on tax and development, drafted at the end of the Spanish presidency. The Councils' conclusions went even further than the commitments secured at the different G20s by detailing, although still tentatively, concrete measures for combating harmful tax practices, such as country-by-country reporting and exchange of tax information between States (see below).

This study aims to provide an account of what has been achieved so far at various G20 summits and via EU initiatives. It also aims to take advantage of the important role developed by the Spanish government in the fight against tax evasion and tax havens, in order to present proposals for implementing the measures that have already been adopted.

I. Improve cooperation and the exchange of information among the States

This aspect will require action in the following fields:

1. Encourage a new definition of tax havens by creating a more exhaustive and objective list of non-cooperative jurisdictions than the one already proposed by the OECD.

During the London G20, the OECD was commissioned with drawing up lists (black, grey and white) of tax havens, according to their degree of compliance with OECD standards on transparency and exchange of tax information. A jurisdiction's lack of cooperation could lead to sanctions being imposed by G20 members. However, in order to be removed from the black/grey lists, these territories merely had to sign 12 bilateral agreements with other countries, whether in the form of Double Taxation Agreements (DTAs) or Tax Information Exchange Agreements (TIEAs). These lists emptied very quickly and criticism soon followed. In response to this criticism, a three-year peer review process was set up, under the auspices of the Global Forum of Taxation, with the aim of assessing the degree of compliance with member states' transparency requirements, according to more demanding criteria. This peer review process, which concludes in 2014, may be a good opportunity to introduce more comprehensive assessment criteria that also take into account aspects relating to financial regulation and money laundering.

2. Launch an initiative aimed at multilateral tax cooperation based on the OECD and Council of Europe Convention on Mutual Administrative Assistance in Tax Matters.

Basing cooperation and the exchange of tax information between Administrations on the signing of bilateral agreements is not the best approach. Implementing a multilateral system would dramatically reduce the transaction costs of negotiating bilateral agreements with each of the tax havens.

Furthermore, experience has shown that until now very few developing countries have had sufficient influence to obtain bilateral agreements with tax havens.

Another advisable measure would be the implementation of a system of collective sanctions that is more of a deterrent than the current one, which leaves the initiative of imposing these sanctions up to individual governments.

3. Support the implementation of an automatic system of information exchange to replace the current on-request OECD model.

This OECD model places the onus of proving tax fraud on the administration requesting the information, leaving the decision to accept the request in the hands of the tax haven. Generally, administrations requesting information must present strong cases, providing ample opportunities for tax havens to block requests on legal technicalities.

In an Automatic System of Exchange of Information, however, the problem of the income generated by foreign-held assets (e.g., interest on a bank account held by a Spanish citizen in The Netherlands, NL) is resolved by obliging the bank involved to report information automatically, not only to the country where the account is held (NL), but also to the country of origin of the beneficiary of this account (Spain).

4. Speed up the EU Saving Tax Directive (STD) review, which contains an incomplete model of automatic information exchange, and internationalise the revised version beyond the EU.

The STD requires that information about income payments to non-residents be reported automatically and transferred to the tax-payer's state of residence. Nevertheless, the impact of the STD has been limited so far, due to certain shortcomings which need to be rectified: a) various jurisdictions included in the directive (some of which are not members of the EU, e.g. Monaco, Switzerland) still benefit from a 'temporary exemption' from the obligation to exchange tax information automatically; b) the STD only affects natural persons and not legal persons, which means that it can be avoided by transferring the funds from an individual to a company or a trust; c) the STD is only applied to savings income in the form of interest payments (and not to other forms of investment income and insurance-based products).

A recent ECOFIN agreement (7 December 2010) regarding a new European directive on administrative assistance in tax matters, in addition to strengthening administrative and technical cooperation between tax administrations, also extends the automatic system to five categories: a) income from employment; b) directors' fees; c) certain life insurance products; c) pensions; and d) ownership of and income from immovable property. The above-mentioned ECOFIN agreement of 7 December 2010 establishes the possibility of extending the STD, from July 2017 onwards, to three further categories: dividends, royalties and capital gains.

Despite these advances, some important challenges still need to be addressed: a) internationalising the tax transparency standards that result from these reforms to other territories not included in the STD (e.g. Singapore, Macao, Delaware State) and; b) widening the scope of the directive to include companies and trusts.

5. Promote the mandatory establishment in all EU member states of a national register of trusts, companies, foundations and other legal entities created in their territories, which could eventually lead to the creation of a European register with information on accounts, beneficial owners, nominee intermediaries, managers, trustees and settlors.

It is common to use offshore trusts, shell companies and other legal structures as intermediary vehicles to hide the real beneficiary of the funds and assets. Trustees or administrators are named with practically no other role than that of front men, masking the identity of the real owner of the money, who therefore remains exempt from all tax liability.

Creating a public register of trusts and companies will enable tax administrations to access all the necessary data for an effective exchange of tax information.

6. Create global and European multilateral fiscal bodies to fight against tax evasion, capital flight and tax competition. A first step could be to grant the UN Tax Committee a political mandate by UN member states and ensure that the tax evasion and capital flight code of conduct is adopted and upheld by countries and companies.

In addition to the fact that cooperation between Administrations is indispensable to strengthening the fight against harmful tax practices, the magnitude and transnational nature of the issue justifies the creation of international and European fiscal institutions. These institutions could help to unify the legal definition of tax fraud and substantially improve the prosecution of tax crimes with an international or European dimension, in coordination with the corresponding national tax authorities.

II. Towards greater transparency in MNCs' accounts

It is essential that MNCs also contribute to this climate of tax cooperation, basically by introducing greater transparency into their activities and the way they report their annual accounts. The principal measures that should be implemented in this regard are the following:

1. Urge the European Commission to push ahead with developing the Common Consolidated Corporate Tax Base (CCCTB) initiative to fight against transfer mispricing more efficiently.

The most commonly used method among MNCs for presenting their accounts is the consolidated account system, which enables them to report financial information aggregated at a regional level, instead of doing so country by country.

The fact that in many cases MNCs present their accounting information for the whole group has resulted in the widespread abuse of practices of transfer mispricing (we must not forget that 60% of world trade is intra-group). Transfer mispricing occurs when subsidiaries of the same group located in different jurisdictions trade with each other and artificially distort the recorded price. In this way MNCs minimise their overall tax bill by placing profits in subsidiaries located in low-tax jurisdictions.

The most widely used system for controlling transfer mispricing until now, the ‘arms length’ principle, is becoming increasingly ineffective against the changes that are taking place in world trade and it needs to be complemented with other methods.

At the EU level, the European Commission is working on the CCCTB initiative, which is similar to the formulary apportionment system already used in the USA. This system is based on the idea of an MNC’s total profit being allocated for tax purposes among the countries in which it operates according to a formula that takes into account the company’s real activities (the share of a company’s total property, payroll and sales), instead of prioritising the legal form in which an MNC organises itself and its transactions.

2. Country-by-country reporting as a fundamental instrument for preventing tax evasion and avoidance

The obligation for MNCs to present their annual accounts on a country-by-country (CBC) basis means that these companies would have to report in their books and accounts the countries in which they operate and under which name, as well as their financial performance in each country, including: a) sales, both within the group and outside the group; b) purchases; c) financing cost; d) labour costs and employee numbers; e) pre-tax profits; f) tax payments to the government where they are trading.

CBC reporting is a very valuable accounting tool which could serve as a complement to the above-mentioned methods in order to alleviate the effects of transfer mispricing and to strengthen the fight against tax evasion. Thus, by improving the quality of the comparable data, CBC reporting provides a stronger basis for the requests for tax information exchange made by an administration.

There are various ways of introducing CBC reporting into MNCs’ accounting practices. Among them, we would highlight the following:

A) By modifying the standards set by the International Accounting Standards Board (IASB), a fundamentally private organisation that is on the way to

becoming the world's principal regulator of MNCs' accounting standards.

The current situation provides two possible courses of action:

- Ensure that the review process initiated by the IASB to create a new international accounting standard applicable to MNCs in the extractive industry (IFRS 6) continues to progress and leads to the establishment of a comprehensive CBC reporting standard, without exemptions, which takes into account the information needs of tax authorities and all stakeholders.
- Promote the extension of a similar CBC reporting standard to all sectors, before the end of 2011, by means of a review of IFRS 8 on operating segments. Segment information provides relevant indicators of business models and the economic reality of a company's operations and is therefore one of the most vital aspects of financial reporting.

B) The other possible route to introducing compulsory CBC reporting is stock market legislation.

At EU level, it is important to take advantage of the current review of the Transparency Obligations Directive (TOD) in order to include Recital 14 in the main body of the directive. Doing this would convert the voluntary CBC reporting included in Recital 14 into a compulsory requirement for extractive industry MNCs that participate in EU capital markets, in harmony with stock market legislation in the USA and Hong Kong. The TOD review should go one step further than the legislation of these two territories by introducing comprehensive CBC reporting applicable to all sectors.

At Spanish level, promote Law 24/1988 on the stock market review in 2011 to make it mandatory for listed extractive industries companies to publish, for each country, all payments made to resource-rich states.

3. It is also important, in parallel with the previously mentioned legislative initiatives, to continue fostering initiatives that promote voluntary CBC reporting, especially in those countries that do not yet have binding rules on this matter. Noteworthy among these are:

A) The Extractive Industries Transparency Initiative (EITI), a multi-stakeholder initiative involving the participation of governments, companies and investment funds. Its objective is to set a standard of transparency for companies to publish what they pay and for governments to disclose what they receive.

Although this initiative is facing major difficulties regarding its implementation, EITI is making an important contribution to enhancing transparency and accountability in resource-rich developing countries. After the approval of the Financial

Reform Bill in the USA, the EITI could play a complementary role regarding this legislation in areas and countries which fall outside the scope of the latter.

B) The OECD is currently considering incorporating CBC reporting through a review of its Guidelines for Multinational Enterprises. This work was initiated after the UK-France summit held in July 2009 at Evian. After that, both the OECD and the EU made clear commitments in this area of CBC reporting and the EU Foreign Affairs Council's conclusions of 14 June 2010 encourage the OECD to pursue its work.

As a result of voluntary initiatives, some extractive industries companies have made a commitment to transparency and CBC reporting (e.g. Newmont, Río Tinto and Anglo American).

1. Introduction

On 2 April 2009 the leaders of the Group of Twenty (G20) declared during their summit in London that “the era of banking secrecy was over”. The London summit raised unprecedented expectations that the most powerful governments in the world had the political will and means to tackle one of the most corrosive and destructive aspects of economic globalization: tax havens and the associated obscurity and impunity with which many companies, banks and individuals move their money around the globe, hidden and protected by secrecy laws and regulations in many countries.

Two and a half years after the London summit, we can say that, to a large extent, those expectations have not been met. Tax havens continue to exist and, although some progress has been made to increase transparency and to tax and regulate illicit capital flows, much remains to be done at the international level.

At the European level, in June 2010, EU foreign affairs ministers went beyond international agreements and committed themselves to “pushing for a more development-friendly international framework”, in order to address tax evasion and harmful tax practices and to increase cooperation and transparency. In December 2010, the EU Economic and Financial Affairs Council went a step further, reforming Directive 77/799/EEC, “on which administrative cooperation in the field of taxation has been based since 1977”.

This working paper attempts to take stock of the commitments made and progress achieved in various G20 summits and EU initiatives in terms of effectively addressing cross-border tax evasion and illicit financial flows. It will also discuss official and civil society proposals to make the most of the opportunities opened up by the G20 and EU agenda for 2011.

2. Capital flight, tax evasion and tax avoidance and the global economic and financial crisis

Tax evasion, tax avoidance and capital flight are global problems, the repercussions of which have become patently clear as a result of the current crisis. Offshore financial centres (tax havens) specialize in attracting investment from abroad, thereby mostly making use of banking secrecy, a very low or non-existent tax rate for non-residents, the lack of cooperation with other jurisdictions and deregulation. The opacity of these territories provides cover for speculators, tax evaders and criminal networks.

Tax avoidance, although legal, involves the abusive exploitation of loopholes in national and international laws that allows multinational corporations (hereinafter MNCs) to shift profits from country to country, often to or through tax havens, with the intention of reducing the amount of taxes they pay. As the collapse of Enron showed, multinational corporations may have thousands of subsidiaries concealed throughout the world. Corporate entities often use structures such as trusts or shell companies to transfer profits abroad in order to reduce tax liability. It is extremely difficult to calculate the amount of money which passes through or is hidden in tax havens.

From studies performed by the Bank for International Settlements, the Boston Consulting Group and the McKinsey Group research department, the Tax Justice Network NGO estimates that 9.2 trillion euros have been placed offshore¹ (see Box 1 for a breakdown by jurisdictions).

¹ Murphy, R., Christensen, J., and Kemmis, J., Tax us if you can, *Tax Justice Network*, p.18, August 2005.

Precise figures are not available for the EU. The European Parliament, in a report dated 17 July 2008, regretted this fact and recognized that this was, in part, due to national standards for the presentation of information varying considerably. In this report, the Parliament called on the European Commission to create a uniform European system for compiling data and statistics on tax fraud.

Although there is no official study regarding **tax fraud in Spain**, from several studies and reports it is possible to calculate that unpaid taxes amount to approximately 280,000 million euros. On this basis, tax fraud in Spain, at around 20% to 25%, is double the average for Europe².

According to a recent study published in Spain by the Observatory of Corporate Social Responsibility (ORSC)³, 80% of the IBEX 35 firms have a presence in tax havens via investee companies and do not provide information about their activities in these territories. Likewise, said report states that, while investments in tax havens by IBEX 35 companies have experienced very rapid growth (between January and September 2010 investment was double that of the whole of 2009), in Spain revenue from corporation tax plummeted by 55% between 2007 and 2009, despite the fact that in the same period the profits of the major companies fell by just 14%.

The ORSC also explains that even with the nominal rate of corporation tax at 30% for large companies, exemptions and deductions mean that in practice the actual rate does not exceed 10% of profits on average.

According to the Tax Justice Network, the number of tax havens has risen from 25 in the 1970s to around 72 at present. Most of these territories used to be protectorates of the great powers and still continue to be very dependent on the main international financial centres. **Governments in certain developed countries are largely responsible for the development of these territories.**

The latest international financial crisis of 2008 has served to highlight the harm that offshore territories can cause and their role in contributing to the financial instability of the world economy, as has been recalled at the G20 summit in Seoul in November 2010, where leaders once again “reiterated their commitment to preventing non-cooperative jurisdictions from posing risks to the global financial system”.

2 Peláez, J.M., El fraude fiscal en España, *Economía Exterior*, nº 49, 2009.

3 Seventh edition of the study *Corporate social responsibility in the annual reports of the Ibex 35 companies* relating to 2009, carried out by the Observatorio de Responsabilidad Social Corporativa.

Tax havens were already associated with the dark side of globalization during the G7 summit in Lyon (July 1996): “globalization is creating new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between states, carrying risks of distorting trade and investments.”

Indeed, **weak regulation in tax havens has facilitated the development and worldwide dispersion of opaque and risky financial products and made it difficult to assess the health of financial institutions with activities and assets in these offshore centres.** Many financial institutions carry off-balance sheet liabilities, often registered in low tax-secrecy jurisdictions, thus fomenting distrust among corporations and enhancing information asymmetry.

Furthermore, the poorly regulated global financial system and its increasing complexity (and high speed) have also fuelled flows of money to tax havens. The liberalization of finances has effectively enabled a shadow financial system to develop, comprising elements such as hedge funds, investment banks and structured vehicles (like trusts) that take advantage of the low or null taxes levied in certain jurisdictions for non-residents. The link between tax havens and financial centres is particularly relevant in the case of trusts (see section 4.4). A trust may be located and administered in an offshore centre such as Jersey, but the underlying assets may be located in London; in this case, Jersey serves as a satellite of the City, sweeping up assets from around the world and parking them in London.

Along the same lines, Ronen Palan, Christian Chavagneux and Richard Murphy explain that “Cayman Islands, British Virgins Islands, Bermudas and Bahamas receive 52% of the worlds’ speculative funds”⁴. It is therefore hardly surprising that tax havens have attracted the attention of financial regulatory authorities as one of the causes of the world financial crisis of 2008, the subsequent sovereign debt problems of several EU countries and speculation regarding commodities.

Hence, as will be explained below, the battle against tax evasion and avoidance needs to be accompanied and reinforced by measures aimed at overcoming cross-border oversights of the financial system, so that the solutions devised are effective.

4 Palan, R., Chavagneux, C., and Murphy, R., Tax havens. How globalization really works, Cornell University Press, p. 97, 2010.

2.1 The impact of tax evasion and tax avoidance on developed and developing countries

Revenue losses due to tax evasion generally lead to a greater tax burden on wage incomes, which are more easily controlled than capital incomes. Furthermore, **tax evasion by MNCs represents unfair competition for local small and medium enterprises (SMEs), which do not have the same capacity for banking profits offshore.** Such practices, therefore, accentuate social inequalities and weaken social cohesion within a country.

Moreover, capital flight may exacerbate the indebtedness situation of many countries. This is because the drain on national foreign exchange resources forces governments to borrow abroad. The loss of capital has huge repercussions on the ability of states to deliver essential services to the poorest people and of the private sector to obtain access to financial resources for productive investment.

Yet the impact of tax evasion and tax avoidance is especially dramatic **on developing countries**, given their higher dependence on taxes paid by MNCs. Furthermore, the percentage of the budget allocated to social spending tends to be lower in developing countries than in developed countries. **According to NGO Christian Aid, the fiscal cost of harmful tax practices to developing countries is \$160,000 billion per year⁵** (see Box 1 for details).

Resources from taxation, which are, by definition, regular and predictable, enable states to plan spending and to play a part in redistributing wealth. These resources cannot be replaced by external sources of finance, which are much more volatile and often affected by external factors. The recent cutbacks in development funds from developed countries make it even more imperative to mobilize the domestic resources of developing countries.

Tax competition between states aimed at attracting financial and other geographically mobile activities – particularly facilitated by the new context resulting from globalization – is endangering the welfare systems of developed economies and the achievement of the Millennium Development Goals in developing countries. Tax evasion, capital flight and the trend in a number of countries to de-fiscalize certain kinds of incomes (typically incomes from capital) have all contributed to reducing fiscal capacity and to growing indebtedness.

5 Christian Aid, <http://www.christianaid.org.uk/Images/false-profits.pdf>.

Furthermore, **unlike aid and debt, which tend to make rulers more accountable to aid donors and foreign creditors, taxes generally build relationships of accountability between rulers and citizens.** They form the basis of an implicit social contract in which citizens pay their taxes in return for services provided by the state. In the 18th century, Adam Smith, speaking of the regulation of a rational tax system, stated that all citizens should contribute to sustaining the state in accordance with their capacity. Equitable contribution in return for universal and efficient public services has characterized modern fiscal systems, now endangered in the face of the sheer scale of tax evasion and illicit capital flight.

Box 1. Illicit financial flows from developing countries 2000-2009

Global Financial Integrity (GFI) recently released a report with the following information:

- Illicit outflows increased from \$1.06 trillion in 2006 to approximately \$1.26 trillion in 2008, with average annual illicit outflows from developing countries averaging \$725 billion to \$810 billion, per year, over the 2000-2008 time period measured.
- Illicit flows increased in current dollar terms by 18.0 percent per annum from \$369.3 billion at the start of the decade to \$1.26 trillion in 2008. When adjusted for inflation, the real growth of such outflows was 12.7 percent. Real growth of illicit flows by regions over the nine years is as follows:
 - Middle East and North Africa (MENA) 24.3 percent;
 - Developing Europe 23.1 percent;
 - Africa 21.9 percent;
 - Asia 7.85, and
 - Western Hemisphere 5.18 percent.
- Implications for economic development policy: The illicit outflows measured in this report are approximately ten times the amount of official development assistance (ODA) going into developing countries. The ratio of illicit financial flows coming out of developing countries compared to ODA is 10-1, meaning that for every \$1 in economic development assistance which goes into a developing country, \$10 is lost via these illicit outflows.

Source: Global Financial Integrity, January 2011

3. Tax justice issues at the centre of the international political scene: developments between the London and Seoul G20 summits and the EU Foreign Affairs Council conclusions

The fight against tax evasion and tax havens has found its way to the top of the agendas of the main international forums due to the current economic crises. **The matter was on the agenda of the G20 summit in Washington, but it was the London summit of April 2009 that gave rise to lists of tax havens and the threat of sanctions against “non-cooperative jurisdictions”.**

Nonetheless, the political momentum of London, well represented by the slogan, “Tax havens are a thing of the past”, reiterated by several leaders, has gradually lost steam in subsequent summits. As will be seen below, good intentions have not always been transformed into concrete measures.

It is symptomatic that in the G20 Summit in Pittsburgh (September 2009), world leaders merely took note of the impressive results so far and promised to take countermeasures against tax havens by March 2010 – an undertaking which, however, has not borne fruit.

Among the steps that have been taken in subsequent summits, it is worth recalling that in the statement issued during the Seoul G20 summit (November 2010) fiscal matters were linked to development policies with a view to “improving developing countries’ tax administration systems and policies and highlighting the relationship between non-cooperative jurisdictions and development”.

The fight against tax avoidance and tax evasion has increasingly been discussed in a pro-development context, as a means of mobilizing the resources of the poorest countries. **This is how the issue of tax evasion became one of the central themes in both the United Nations (Monterrey and Doha declarations on develop-**

ment financing) and in the European Union. In this respect, the G20 summit in Seoul included some innovative ideas, such as strengthening tax collection powers in developing countries and establishing an action plan with measures for asset recovery and the detection of money laundering.

What was lost in Seoul, however, was the opportunity to adopt key measures to ensure genuine transparency in the financial system that would truly have an impact on tax evasion, such as the mandatory implementation of country-by-country (CBC) reporting for MNCs, automatic tax information exchange and full disclosure of corporate ownership and beneficiaries of offshore trusts and accounts. It is to be hoped that these measures, to be discussed in more detail below, will be taken on board by the G20 Development Working Group, which at the Seoul summit was tasked with “monitoring implementation of the Multi-Year Action Plan⁶ on Development, so that we may review progress and consider the need for any further steps at the 2011 Summit in France”.

The credibility and legitimacy of the G20 as the main international forum for global economic cooperation has been based, since the crisis began in 2008, on the effectiveness and rapidity of its actions. The fight against tax evasion and tax havens has been on the agenda from the outset; however, if decisive steps continue being put off, the G20’s new coordinating role risks being called into question.

The G20 to be held in November 2011 in Cannes represents a unique window of opportunity to take the plunge. France has been one of the most active countries in this area within the OECD, the Financial Stability Board and the Financial Action Task Force. If political circumstances permit, the French presidency may offer the chance to consolidate progress to date and to guide the G20 towards a coherent and comprehensive approach to the problem.

It could be said that the EU is one step ahead, as tax and development issues played an unparalleled role in the conclusions of the Foreign Affairs Council of 14 June 2010, released at the end the Spanish rotating EU Presidency. These conclusions build on the European Commission Communication of 21 April 2010 on Tax and Development.

6 The Multi-Year Action Plan on Development forms part of the Seoul Development Consensus for Shared Growth.

Box 2. Conclusions of the EU Foreign Affairs Council of 14 June 14 2010

Below is a summary of some of the most relevant conclusions adopted by the EU Foreign Affairs Council meeting of 14 June 2010 on tax and development, cooperating with developing countries in promoting good governance in tax matters: “(...)

7. The EU and its Member States should enhance their support for the EITI (Extractive Industries Transparency Initiative), which is an increasingly effective tool to strengthen governance through promoting transparency and mutual accountability in natural resource-rich settings, and consider expanding similar practices to other sectors.
8. Within the remit of their respective competences, the EU and its Member States should also further promote a transparent and cooperative international tax environment, including the principles of good governance in tax matters. In this regard, the EU and its Member States should enhance the aspects of policy coherence for development, and work towards:
 - a. **Exploring country-by-country reporting as a standard for multinational corporations**, by encouraging the OECD to pursue its work on country-by-country reporting, including as regards the OECD Guidelines for Multinational Enterprises and its Principles of Corporate Governance and on propriety, integrity and transparency in the conduct of international business and finance. In addition, Member States should support ongoing consultation work by the IASB (International Accounting Standard Board) on a country-by-country reporting requirement in IFRS 6 (International Financial Reporting Standard 6) for the extractive sector, and encourage the IASB to look beyond the extractive sector;
 - b. **A global system for exchange of tax information**, including through multilateral instruments, building on the EU and OECD experiences on spontaneous, on-request and automatic exchange of information. First steps at the international level could be to promote the availability of the beneficial ownership of all legal structures taking note of the ongoing review of the international standards of the Financial Action Task Force, as well as to strengthen the role of the Global Forum on Transparency and Exchange of Information. The EU and its Member States should also support the strengthening of developing countries' administrative capacities to negotiate TIEAs (Tax Information Exchange Agreements) and sign TIEAs. The EU should also support efforts to ensure that OECD standards are relevant and applicable to developing countries, especially LDCs;
 - c. **Reducing incorrect transfer pricing practices**, including by paying special attention to the development of local audit capacities. The EU will promote research on innovative approaches to help developing countries to assess liabilities of their taxpayers at low cost, and support the adoption and the implementation of the OECD Guidelines on Transfer Pricing (...)” [our emphasis].

From the very outset of its conclusions, the EU Foreign Affairs Council makes its intentions very clear by emphasising the need for “the EU to take development objectives into account in non-development policies that are likely to affect developing countries”, in accordance with the commitments on policy coherence for development. Along these same lines it is important to understand the Council’s support for “a more development-friendly international framework (...) to address harmful tax practices and tax evasion and to increase domestic resources”.

Unlike the G20 summits, various key measures are outlined in these conclusions, such as exploring CBC reporting as a standard for MNCs and promoting an international tax information exchange framework. With regard to the latter, ECOFIN took a great step forward on 7 December 2010 by approving Directive 77/799/EEC on administrative cooperation in the field of taxation.

In the same vein, a European Parliament resolution of 10 February 2010 urged member states to improve on the standards of the OECD with a view to making automatic and multilateral information exchange an international standard.

These issues are analysed in this document, along with development measures that are still pending implementation.

3.1 Strengthening tax systems and administrations in developing countries

Both the Seoul G20 document and the conclusions of the EU Foreign Affairs Council (14 June 2010) coincide in underlining that international measures to prevent capital flight from developing countries should be accompanied by assistance to developing countries in strengthening their tax systems and administrations.

The tax burden in low-income countries does not reach one third of that in developed countries. Another feature characterizing most of the developing countries is that only a very small proportion of taxpayers contribute to tax revenues. These economies also have large informal sectors (shadow economies), with many people not working for registered organizations. **It is therefore necessary in most of these tax systems to expand the income-tax base and end the proliferation of unjustified exemptions and deductions** (such as those contained in certain oil and gas contracts).

Furthermore, as noted in the conclusions of the EU Foreign Affairs Council, technical and institutional weaknesses in tax administrations require developing countries to “strengthen their capacity to effectively process tax information and ensure tax compliance for all economic actors, national and international”. Experiences in emerging economies have shown that once tax information databases are established, significant progress is made in tackling the informal sector.

The lack of effectiveness also extends to revenue collection systems in developing countries, which typically present high shares of rural populations with low incomes, where the cost of tax collection is high.

In this regard, a positive element is the fact that in the Multi-Year Action Plan on Development adopted by the G20 in Seoul,⁷ leaders have asked the OECD, UN, IMF, World Bank and regional organizations to make recommendations by June 2011 to improve “the efficiency and transparency of tax administrations and strengthen tax policies to broaden the tax base⁸ and combat tax avoidance and evasion”.

The Global Forum on Taxation, already called on during the London G20 summit to assess the performance of countries included in the OECD tax information exchange lists, has now been asked to present a report at the next summit in Cannes (November 2011) “to enhance its work to counter the erosion of developing countries tax bases”.

Nonetheless, the great emphasis of the Seoul G20 on improving developing countries’ tax regimes as an instrument for increasing these countries’ tax revenues, was not accompanied by decisions to resolve the other side of the problem: tax drain from developing countries resulting from the tax-dodging practices of MNCs and the use of tax havens. G20 leaders merely declared themselves to be in favour of “identify[ing] ways to help developing countries tax multinational corporations through effective transfer pricing”. There was no mention of specific measures, such as the implementation of CBC reporting (see section 5.2) or others.

7 The Multi-Year Action Plan on Development is included in the Seoul Consensus on Development.

8 Tax base is the sum of taxable activities, the collective value of real property and assets subject to tax in a community.

4. The eradication of tax havens and cooperation between tax administrations

4.1 OECD list system definition of tax havens. The need for a more objective and detailed definition

One of the most controversial aspects of the fight against tax evasion is the definition of what constitutes a tax haven. In 1998, the OECD published a report in which it laid down a set of criteria to identify tax havens. They would refer to tax jurisdictions with: (i) no or only nominal taxes; (ii) lack of effective exchange of information; (iii) lack of transparency and; (iv) no substantial activities.

While the actual identification of tax havens has remained a matter of dispute, an important milestone in the fight against them took place during the G20 London summit in April 2009. On that occasion, **the G20 leaders agreed “to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over”**. They envisaged the following:

- Creating a ‘toolbox’ with possible sanctions, with measures such as increased disclosure requirements on the part of taxpayers and financial institutions to report transactions involving non-cooperative jurisdictions.
- Withholding taxes in respect of a wide variety of payments.
- Denying deductions in respect of expense payments to payees resident in a non-cooperative jurisdiction.
- Reviewing tax treaty policies.

- Asking international institutions and regional development banks to review their investment policies.
- Giving extra weight to the principles of tax transparency and information exchange when designing bilateral aid programs.

Notwithstanding the list above, any further references to other sanctions, to decisions on which countries could be sanctioned, or to the process leading up to the imposition of those measures were completely absent in subsequent G20 Summits after London. One might expect that once the Global Forum on Transparency delivers its report on progress in the peer-review process towards the end of 2011, world leaders will attempt to “walk the talk” and impose some of those sanctions on the jurisdictions considered non-cooperative.

The EU should also draw up a list of sanctions against non-cooperative jurisdictions. An effective measure, which member states should apply in a coordinated way, would be to tax capital flows from and to tax havens, also applying coordinated sanctions. Other sanctions (besides the above-mentioned ones) could include measures such as cutting off development aid, removing tariff preferences or preventing European banks from operating within those jurisdictions. The EU should show clear signs of intending to implement them.

Proposal

- **Promote at the European level the application of sanctions on non-cooperative jurisdictions.** Following the spirit of the G20 London Summit, the EU should draw up a list of sanctions against non-cooperative jurisdictions and show clear signs of intending to implement them. They should include, among others, the review of tax treaty policies, denying deductions in respect of expense payments to payees in a non-cooperative jurisdiction, asking international institutions and regional investment banks to review their investment policies, cutting off development aid, removing tariff preferences or preventing European banks from operating within those jurisdictions. Stronger sanctions should be applied to EU off-shore territories that do not implement European legislation.

However, the aspect that was somehow different during the London Summit, and which attracted plenty of media attention, was that G20 leaders took note of three lists, prepared by the OECD. The lists, containing all the relevant offshore centres in the world, were divided into three different categories:

- A black list of four jurisdictions that have not shown any desire to move towards greater transparency⁹.
- A grey list of jurisdictions agreeing to comply with the OECD standards on transparency and exchange of tax information but which had not made sufficient progress to meet that objective. This list contained 30 tax havens (defined as such according to the OECD 1998 definition mentioned above) and eight other financial centres¹⁰.
- A white list of jurisdictions that have substantially applied the OECD's transparency standards, signing at least 12 bilateral agreements with other jurisdictions¹¹.

A few days after the London summit, the black list was already empty. Many states that had been identified as secrecy jurisdictions suddenly began to make more commitments to exchanging information for tax purposes. Nowadays, it is safe to say that no territory can afford to refuse at least to enter into dialogue with the OECD on this matter.

According to the OECD standard of tax transparency and information exchange, countries should:

- exchange tax information on request where it is “foreseeably relevant” to the requesting administration and enforcement of the domestic laws of the treaty partner;
- impose no restrictions on exchange caused by bank secrecy or domestic tax interest requirements;
- have availability of reliable information and powers to obtain it;
- have respect for taxpayers' rights;
- impose strict confidentiality of information exchanged.

A major rule of international tax law is that relevant connections must exist between a country and a tax object if the country is to have the right to tax a person, a transaction or a property. The mobility of individuals, production factors and goods between different countries creates circumstances in which the same tax-

9 Costa Rica, Malaysia (Labuan), Philippines and Uruguay.

10 Among others, Chile, Singapore, Belgium, Luxembourg, Austria and Switzerland.

11 Most OECD countries, but also tax havens such as Jersey, the Isle of Man and Mauritius. China was included in the white list, with the mention in a footnote that Hong Kong and Macau are not included.

payer or tax object has connections with more than one jurisdiction (double taxation). The most important measure for limiting double taxation is the signature of bilateral tax treaties. These agreements normally build either on the domiciliary principle (the general rule in international law), which assigns the right to tax to the taxpayer's country of domicile, or the source state principle, which assigns this right to the country where the income is earned¹².

The OECD standards on tax cooperation can be articulated mainly through two types of agreements:

- *Double taxation agreements* (DTAs), which determine the terms between two states to prevent income or profits from international economic activity being taxed twice. The provision for information exchange is described in Article 26 of the OECD Model Tax Convention on Income and Capital (OECD Model). The latest version of this article (2005) provides for information exchange which is “foreseeably relevant” for the correct application of the tax agreement. Earlier versions were limited to the exchange of information “necessary” for its application, which was equivalent to not exchanging information unless there was double taxation, but not to prevent tax evasion and avoidance. More than 3,000 DTAs are based on the OECD Model but not all have integrated the latest version of Article 26.
- *Tax information exchange agreements* (TIEAs), which are international treaties much narrower in scope than DTAs but more detailed on the subject of information exchange. They are used in addition to DTAs or even with jurisdictions with which cooperation is more complex (Bermuda, Cayman Islands and Mauritius). TIEAs are based on an OECD model agreement published in 2002 by the Global Forum on Taxation.

Nevertheless, these cooperation instruments do not resolve the question of the availability of tax information. For example, Jersey and the USA had one of the first ever TIEAs signed and yet, in period of over 5 years to 2008, for which data is available, less than ten successful exchanges of information arose, whilst Cayman Islands budgeted in 2009 to receive no more than 120 requests for information under its TIEA network, which includes one with the USA. This is a long way short of effective information exchange.

In order for an exchange of information to be effective, said information must be accessible in the tax haven. Often the legislation in these jurisdictions favours the creation of legal structures which prevent access to information by other countries

12 Sometimes these principles are combined in the treaties signed, e.g., granting the source country a restricted right to impose a withholding tax that divides the tax revenue between the two countries.

and which cut the link with real ownership while providing anonymity that caters to tax evasion in the country of domicile. This problem is closely linked to shell companies and other legal structures such as trusts, discussed in section 4.4.

A) OECD list system defects. The need for a more objective and detailed definition of tax havens

A major problem when promoting financial transparency lies in the actual definition of tax havens. **The standard used by the OECD to define a jurisdiction as a tax haven and include it in the black or grey list, is certainly a very lax one, and refers solely and exclusively to tax cooperation matters.** During the run up to the London summit, there were intense negotiations to arrive at a more comprehensive definition of tax havens, which would encompass the fight against tax evasion (OECD), and other aspects related to the fight against money laundering (Financial Action Task Force, or FATF) and financial regulation (Financial Stability Board, or FSB).

Box 3. International institutions combating tax evasion

Other than the EU and G20, whose role is to promote and coordinate actions by other bodies, the following organizations are involved in combating tax evasion:

- **The OECD** plays a key role, especially following the London G20 summit. It has defined transparency standards for tax information exchange which are adopted when countries sign bilateral agreements (DTAs and TIEAs). These same standards have been included in the UN Model Tax Convention of 2008.
- **The Global Forum on Transparency and Exchange of Information for Tax Purposes**, created in 2009 by the OECD, monitors implementation of tax information exchange agreements. It has a secretariat which follows up on the evaluation tasks (the peer review system) of members.
- **The Financial Action Task Force (FATF)**, created by the G7 in 1989, has the mission of advising states on anti-money laundering policies. It drew up the 40+9 Recommendations that have become international standards and has identified 23 non-cooperative jurisdictions, which have been requested to implement additional measures against money laundering.
- **The Financial Stability Board (FSB)**, which replaced the Financial Stability Forum at the London G20, combats illicit financial flows and asks states for information on the functioning of their financial systems and regulation and supervision mechanisms. It promotes transparency and integrity in the financial markets and the need for protection against illicit financial risk arising in non-cooperative jurisdictions.
- **The UN** had adopted several lines of action on tax evasion and illicit capital flows. These include the Committee of Experts on Tax Issues, which makes recommendations on tax agreements, strengthening tax systems and combating illicit capital flows. There is also a UN Money Laundering Information Network and an Office on Drugs and Crime, which deal with matters arising from tax havens.

Source: Alonso, J.A, Garcimartín, C., Ruiz-Huerta, J., Díaz Sarralde, S., Fortalecimiento de la capacidad fiscal de los países en desarrollo y apoyo a la lucha contra la evasión fiscal, ICEI Policy Papers.

However, due to stronger pressures from certain emerging countries and financial centres, the more narrow and relaxed version of tax havens was finally used by the OECD to draw up the three lists of countries, versus a tougher standard of transparency favoured by leaders like Barack Obama and Nicolas Sarkozy.

The arbitrary threshold of 12 bilateral agreements laid down as a condition to be considered transparent is, by no means a guarantee that an effective global regime for information exchange will be set up, and this is really the Achilles heel of the whole effort. The G8 meeting in L'Aquila in 2009 indicated that “criteria used to define jurisdictions which have not yet substantially implemented internationally agreed standards on tax information exchange and transparency should be revised as part of the peer review assessment process to ensure an effective implementation of international standards” (G8 2009).

Evidence of the defects of the OECD list system is the fact that, within a few days of the London G20, the black list was already empty. Most countries reacted quickly and signed up to 12 TIEAs in order to get their name dropped from the black list. In some cases, notorious tax havens signed bilateral treaties among themselves¹³, thus laundering their names. The grey list currently includes only 9 tax havens and 5 other financial centres¹⁴.

It is clear that the current classification of tax havens sets a standard that it is patently insufficient to be fully effective in the promotion of transparency and the fight against tax evasion. More strict criteria need to be established, which should incorporate other aspects beyond the tax rate and number of bilateral treaties signed, such as the tax benefits of these territories, their facilities by way of company legislation, the effective transparency of complex legal mechanisms such as trusts, etc. Recent proposals presented by think-tanks and civil society organizations point in that direction¹⁵. For example, the non-governmental coalition Tax Justice Network published, in November 2009, a list based on more comprehensive criteria such as banking secrecy, availability of information regarding the beneficiaries of trusts and owners of companies and the quality of tax cooperation¹⁶.

13 For instance, those signed between the Faroe Islands and Gibraltar (20 October 2009), Monaco and Andorra (18 October 2009) and the Faroe Islands and Netherlands Antilles (10 September 2009).

14 Most of the countries in the grey list have moved up to the white list: e.g., Austria, Luxembourg, Belgium and Switzerland.

15 See, for instance, the proposal by the French platform Paradis Fiscaux et Judiciaires (www.argentsale.org).

16 The Tax Justice Network took into account 60 countries ranked at least twice in the 15 or so tax haven lists published by different bodies since 1970.

The Tax Justice Network drew up another list combining the opacity of a jurisdiction with the weight of its associated offshore financial centres. The results were rather revealing: heading the ranking of the first list were Switzerland, Barbados and the Bahamas, which the OECD has already “laundered” from its lists. In the second classification, the result was even more compromising, as the top position was occupied by the USA, with the UK in fifth place.

On the basis of the opacity indexes established by the Tax Justice Network, the French NGO CCFD-Terre Solidaire has calculated that the G20 countries represent 39% of international financial opacity and that the percentage rises to 88% if other EU countries and territory under their control are included¹⁷.

One of the first results of the G20 emphasis on tax evasion was the revitalization of the OECD Global Forum on Transparency and Information Exchange, which expanded its membership to 91, to include all G20, OECD and offshore jurisdictions. Moreover, in reaction to the harsh criticism sparked by the publication of the above-mentioned lists, in March 2010 **the Global Forum on Taxation launched a three year peer-review process to monitor both the implementation of the standards and the regulatory frameworks of jurisdictions**. Thus, between now and 2014 this system should allow member countries to be assessed in two phases:

- In the first phase, peer review teams will assess whether the legal texts and regulations guarantee the availability of information (regarding the beneficiaries of societies and other legal structures like trusts), its accessibility by tax authorities and cooperation planned with other tax administrations.
- The second phase will involve on-site visits to judge the effectiveness of the implementation of the information exchanges.

At the request of the G20, the peer review group first met in July 2010. During the Toronto summit, leaders encouraged the Global Forum on Taxation to report to them by November 2011 (date of the Cannes G20 summit) on the progress countries had made in addressing the legal framework required to achieve an effective exchange of information. This issue was also brought up again in the Seoul summit, where the Global Forum was urged “to swiftly progress its phase 1 and 2 reviews to achieve the objectives agreed by the leaders in Toronto and report progress by November 2011”. Furthermore, “reviewed jurisdictions identified as not having the elements in place to achieve an effective exchange of information should promptly address the weaknesses” .

17 CCFD-Terre Solidaire, *L'économie déboussolée: multinationales, paradis fiscaux et captation des richesses*, 7 December 2010.

Box 4. Tax haven classification according to opacity level

<p>1) 95-100% opacity Bahamas Barbados Belize Brunei Dominica Malaysia (Labuan) Samoa Seychelles Saint Lucia Saint Vincent & The Grenadines Switzerland Turk & Caicos Islands Vanuatu Mauritius Antigua & Barbuda Bahrein Bermudes British Virgin Islands Caymans Islands Cook Islands Costa Rica Gibraltar Grenada Marshall Islands Nauru Panama Portugal (Madeira) Sudan United Arab Emirates US Virgin Islands USA (Delaware) Austria Lebanon Israel Liberia Anguilla Jersey Liechtenstein Luxembourg Macao Uruguay Andorra Aruba Isle Of Man Malta Philippines Maldives</p>	<p>2) 75-94% opacity Guernsey Montserrat Singapore Cyprus Hungary Latvia Netherland Antilles Belgium Monaco Hong Kong Irlanda</p> <p>3) 40-74% opacity Netherlands Uk (London)</p> <p>The UK, including London, Jersey and Guernsey, accounts for 24% of world “private banking”. Switzerland, meanwhile, is the leader in terms of off-shore fortune management, with 27% of assets, followed by Luxembourg (14%), the Caribbean (12%), Singapore (7%), USA (7%) and Hong Kong (6%)*.</p> <p style="text-align: center;">***</p> <p>For Spanish authorities, of particular concern are Gibraltar and, to a lower extent, Andorra. In terms of non-resident companies, Gibraltar is more opaque as its legislation governing banking and foreign investments is more permissive. Andorra has just come out of the Spanish list of tax havens</p>
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* Data from www.gardinerfinance.com/fr/.

Source: Tax Justice Network Financial Secrecy Index, August 2009¹⁸.

18 For the full classification see www.financialsecrecyindex.com.

The Global Forum has just released (January 2011) 10 reports which evaluate jurisdictions' commitment to tax transparency and examine whether information is made available and accessible to foreign tax authorities. These reports follow eight others released in September 2010¹⁹. More than 60 reports will be completed by the end of 2011.

This peer review initiative is very meaningful, because it will help to bring to light whatever deficiencies exist in the process. It constitutes a multilateral forum where parties can discuss on an equal footing and hold even the most powerful accountable (for instance, the US on the State of Delaware and China on Hong Kong and Macau). Jurisdictions should know that, if they do not take the standard seriously, they might face new stigmatization by the G20 and eventual sanctions. Special attention should, however, be paid to follow-up with regard to the jurisdictions on the grey lists. The system is designed to enable the self-assessment of the tax cooperation undertaken by the different jurisdictions plus the reporting duty. The awareness that subsequent summits of leaders will evaluate each step of the process encourages actors at the lower levels in the process to deliver.

More importantly, the peer review mechanism could improve the criteria currently used to consider a jurisdiction as being non-cooperative (signature of 12 treaties).

The Seoul summit not only demonstrated an interest in the evaluation work carried out under the auspices of the Global Forum, but also in that carried out by other institutions. Leaders called on the Financial Stability Board “to determine, by spring 2011, those jurisdictions that are not cooperating fully with the evaluation process” and on the Financial Action Task Force “to regularly update a public list on jurisdictions with strategic deficiencies (regarding anti-money laundering requirements), with next update being in February 2011”²⁰.

In conclusion, it can be said that the current classification of compliant jurisdictions by the OECD, which sets the international standards, is largely inadequate to reflect the current situation and assess progress towards a fully transparent interna-

19 Four jurisdictions, Barbados, the Seychelles, San Marino and Trinidad and Tobago fall short of the international standard regarding phase 1.

Other five jurisdictions went through “combined” reviews (phase 1 and 2). Four of them, Australia, Denmark, Ireland and Norway have achieved effective exchange of information in practice, whilst Mauritius combined review showed that there are missing elements in the legal framework.

20 Despite the fact that the G20 in London had recommended performing these tasks in 2009, after declaring that it would closely monitor the anti-money laundering efforts of 25 countries, the FATF limited itself to publishing, in October 2010, a list with two non-complying states (Iran and South Korea); the FSB, meanwhile, made no reference to the matter in its plan of action presented to the G20 in May 2010.

tional financial system. By now, it has become clear that a much stricter and more comprehensive definition of tax havens is needed, which should incorporate other dimensions beyond exchange of information and take into account their weight in the international financial system. The peer review system, whose results will be evaluated in November 2011 during the G20 summit in Cannes, may be the forum which opens the door to the publication of a more exhaustive list of tax havens.

Proposal

Speed up the creation of a new list of tax havens, taking advantage of the work done in the Global Forum of Taxation's peer review process which will conclude in 2014. The new list should be more complete and objective than the current one proposed by the OECD (signature of 12 tax information agreements) and it should be based on assessment criteria that are not limited to tax cooperation but which include financial regulation and money laundering. The tax havens included in the list should be categorized according to the risk level they pose.

4.2 Changing the current bilateral cooperation system to a multilateral framework to enable developing countries to benefit from tax cooperation

Another frequently questioned aspect of the OECD model we have described is the bilateral nature of tax cooperation. As mentioned above, many treaties have been signed by tax havens with the sole purpose of acquiring the 12 agreements required to take them off the black list. For example, Faroe Islands, Greenland and Iceland have become very popular – these three tiny jurisdictions providing a quarter of the required quota to meet the required international standard, with no prospect of real information exchange arising as a result.

Furthermore, states must renegotiate their existing DTA treaties (to include the new version of OECD Article 26) or negotiate new treaties with all other interested states. The negotiation of these treaties would require many resources and much time, as there are between 50 and 72 tax havens and 100 countries with which they could negotiate agreements²¹.

21 In a report from 2010 the OECD indicated that 50 TIEAs were signed in 2009 and 397 TIEAs were signed in 2010. The data assume a new significance if we bear in mind that the total number of bilateral treaties that could be signed between tax havens and states is 58,000.

There is very little evidence that TIEAs will give rise to meaningful information exchange and to date almost no TIEAs have been signed with developing countries. It seems rather unlikely that they will be able to negotiate bilateral treaties with different tax havens. There is a very strong risk of them ending up totally excluded, as they lack the capacity to engage in lengthy negotiations that require considerable administrative resources.

In fact, only the most powerful countries can impose the best terms, as witnessed in the case of the bank UBS, regarding which Switzerland eventually had to give in to pressure from the US administration. It is unlikely that this situation would be reproduced if the requesting administration was a country wielding much less weight on the international stage than the USA.

In the treaties signed between tax havens and developing countries, the latter tend to limit and even renounce their right to tax capital, given their weak negotiating position; a large proportion of foreign direct investment in developing countries is channelled through tax havens because investors want to exploit the tax benefits and secrecy with such jurisdictions offer. Developing countries depend on tax treaties to secure access to investment from tax havens²².

In order for developing countries to have any chance of benefiting from tax cooperation, it would be necessary to implement a multilateral initiative that would oblige tax havens to exchange information regardless of which country was requesting it. In this regard, the UK government, backed by the French government, has championed the signing of a multilateral convention on the exchange of tax information.

Such a system would dramatically reduce the transaction costs to negotiate agreements, making it easier to involve many more jurisdictions. At the same time, by requiring automatic exchange of information, the system would be much more effective. By forcing all jurisdictions involved to collect the necessary information in their territory, the cases of fraud of which tax authorities were not yet aware of can be detected, and has therefore a major deterrence effect. Thanks to available technological means and regulatory know-how, this approach is technically feasible for developed and developing countries alike.

An automatic and multilateral arrangement must eventually include all jurisdictions likely to exchange tax information and rely on a **system of collective sanctions, more deterrent than the current system that leaves the initiative of im-**

22 See Murphy, R., Investment for Development: Derailed to Tax Havens. A Report on the Use of Tax Havens by Development Finance Institutions, September 2010.

posing these sanctions up to individual governments. Indeed, the London G20 announced that its members were ready to impose sanctions on jurisdictions which do not comply with OECD standards.

The individual sanctions could lead, among other measures (see section 4.1), to the termination of the bilateral treaty with these territories, the consequences of which could include limiting economic exchanges with them. Nevertheless, the lack of credibility of the current OECD lists raises doubts about the viability of the sanctions strategy announced by the G20.

It is a shame that no multilateral initiative has been put forward to date. Despite the Pittsburgh and Toronto summits having reiterated their commitment to the fight against non-cooperative jurisdictions, no concrete solutions have been proposed to make developing countries benefit from this new climate of tax cooperation.

There are, however, precedents for multilateral information exchanges. The most useful one is the Convention on Mutual Administrative Assistance in Tax Matters, created by the OECD and the Council of Europe in 1988. This document is a genuinely multilateral treaty and is open for the members of these two organizations to sign. In April 2010, it was amended to permit the exchange of information between the 14 signatory states. On 28 May 2010, a further step was taken, opening up the possibility for developing countries to sign the convention. What remains now is the arduous task (which could be assumed by the G20) of “convincing” tax havens to participate in this convention.

Proposal

Make developing countries benefit from the new climate of tax cooperation by:

- **Launching an initiative aimed at multilateral tax cooperation based on the OECD and Council of Europe Convention on Mutual Administrative Assistance in Tax Matters**, in which both developed and developing countries could participate. Strongly urge tax havens to sign the convention, so that those that refuse to do so will be considered uncooperative.
- **Establishing a system of multilateral sanctions** to replace the current system that leaves the initiative of imposing sanctions up to individual governments, meaning that only the most powerful countries have sufficient leverage to force tax havens to cooperate.

4.3 OECD on-request exchange of information model. Towards an automatic exchange of information system. The example of the EU Savings Tax Directive

The current OECD model provides for exchange of information based on an on-request system, which requires the requesting state to provide indications of fraud. Essentially, the tax administration which requests tax information from another country must prove that such information is “foreseeably relevant” to its tax inspection procedure. **The request must be accompanied by very detailed information about the taxpayer under investigation, including name, the action alleged to have been committed, the bank, company or legal structure affected by the request, etc.**

These very demanding conditions are, in theory, designed to prevent countries making imprecise requests aimed at detecting irregularities (“fishing expeditions”).

However, in many developing countries tax authorities lack the resources and capacity to combat fraud in their national territories, let alone mount strong cases and gather all the evidence in the huge number of requests that would be needed to tackle the enormous tax drain they are experiencing.

Moreover, ultimately, it is the authority of the tax haven that decides whether the demands for tax information are admissible or not, thus providing ample opportunities to block requests on legal technicalities. The evidence so far is that TIEAs have produced only sporadic exchanges of information.

An obvious alternative to exchange of information on request is a system for automatic exchange of information, which has proven to be the most effective in solving the difficulties regarding residents of one country paying tax on the income generated by foreign held assets. Thus, the existence of a bank account (e.g. in The Netherlands) held by a resident of another country (e.g. Spain) is not usually known by the tax administration of Spain (in this case), unless the Spanish citizen decides to report to his country information about the income paid on this account. **With a system of automatic exchange of information, the Dutch bank would be obliged to report this information to its tax administration (The Netherlands), and also to transfer the same information to the Spanish tax administration.**

This is not something new, as there are relevant precedents, such as the previously mentioned Convention on Mutual Administrative Assistance in Tax Matters signed by the OECD and the Council of Europe. This is a comprehensive arrangement that covers all information needed for both assessing and collecting taxes from all

taxpayers. It allows information to be provided automatically, as well as on request and spontaneously (information that is foreseeably relevant to the other party but has not been specifically requested).

Some critics have argued (on occasions the OECD itself) that an automatic system would generate huge information flows which would overburden the administrations of developing countries. However, although it is clear that some countries would need to strengthen their tax administration systems, modern technology allows for easy and non-expensive ways to manage large information databases. The OECD itself has long set out electronic information transmission standards for automatic information exchange. The latest version based on ordinary XML-web language requires only a simple Excel sheet to transmit the information.

A) The European Union Savings Tax Directive and the recently reviewed Directive 77/99/EEC on administrative cooperation in the field of taxation

A good example of an automatic tax information exchange system is the Directive 2003/48/EC on Taxation of Savings Income in the form of Interest Payments (Savings Tax Directive, or STD), which came into force on 1 July 2005 to partially revise Council Directive 77/799/EEC, concerning Mutual Assistance by the Competent Authorities of the Member States in the field of Direct and Indirect Taxation²³ (Directive on Administrative Cooperation in the Field of Taxation).

The STD's area of application extends to all EU member states, their dependent or associated territories (Jersey, Gibraltar, the Netherlands Antilles, Anguilla, etc) and other jurisdictions that have agreed to participate (Andorra, Liechtenstein, Monaco, San Marino and Switzerland).

According to Article 1, the objective of the STD is “to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident for tax purposes in another Member State, to be made subject to effective taxation in accordance with the laws of the latter Member State”.

The STD is an attempt to palliate, at least partially, the problem of establishing different tax rates for nationals of a member state and for non-residents of another member state with accounts or incomes in the first country²⁴. **Thus, the non-residents (Spanish citizens with accounts in the Netherlands, to replicate the former example) would be obliged to pay taxes in their country of ori-**

23 STD Recital 15 establishes that Directive 77/799/EEC should continue to apply to such exchanges of information in addition to this Directive insofar as this Directive does not derogate from it.

24 Tax havens normally establish a more favourable tax regime for non-residents than for national companies with a view to capturing international funds.

gin (Spain), as the country hosting the accounts (the Netherlands) would be obliged to send, annually and systematically, account information details to the EU country of residence of the account owner. As will be seen, this STD obligation has been somewhat softened.

Due to the resistance of some countries, the STD provides for some **temporary exceptions**. Thus, Austria, Luxembourg (and 11 of the 15 non-EU jurisdictions that participate in the STD) are allowed²⁵ to withhold taxes on the accounts in their territories belonging to non-residents, rather than to provide the account and tax information to the home countries.

The STD has had, to date, a very modest impact on tax evasion practices because STD application may be avoided in several ways: 1) by placing or transferring funds on deposit in the name of a limited company, a trust or a foundation (legal persons) – since it only applies to individuals (natural persons); 2) by moving the investment out of cash and into another form of investment (e.g., shares); and 3) by moving the sum deposited to a non-participating country (e.g., Singapore).

For several years now there have been calls to revise the STD in order to:

- Extend its area of application beyond individuals to encompass all legal entities, especially private companies and trusts. It is essential to ensure the taxation of interest payments that are channelled through these intermediate vehicles and to devise more accurate rules for verifying the current residence of the beneficial owner for the purposes of the STD (see section 4.4).
- Extend the income covered by the STD to include all forms of investment income and insurance-based products (shares, investment funds, etc) and not only interest payments, as is the case currently.

The Directive is supposed to be reviewed every three years. The EU Commission presented in 2008 a proposal regarding the STD review and presented it to the Council in November 2009²⁶. This proposal had been blocked by countries such as Luxembourg, Austria and Belgium.

The transitional period for the exceptional withholding tax will end once the EU reaches agreement with Switzerland, Liechtenstein, San Marino, Mona-

25 Instead of tax being paid by the resident of a country in that country, this option ensures only that a withholding tax is paid, which is likely to be lower than the full liability due in the recipient's country of residence. The tax withholding rate is currently of 20% and will increase until 35% from July 2011. Thus, part of the benefit goes to the country where the account is held, rather than that in which the recipient resides.

26 <http://register.consilium.europa.eu/pdf/en/09/st16/st16473-re01.en09.pdf>.

co and Andorra to exchange information according to the above mentioned OECD “on request” model²⁷.

The main problem now concerns Austria and Luxembourg, which are trying to prevent the European Commission from opening negotiations with Switzerland, San Marino, Andorra and Monaco.

Another danger for the process comes from the fact that Switzerland has offered a final withholding tax as a substitute for information exchange to certain European Countries, namely Germany and UK. **This increases the risk of not achieving a coordinated European position for an agreement with Switzerland, implying that the transitional period of the STD might never end.** Furthermore, Luxembourg and Austria’s position may be to block negotiations with Switzerland within the Council, to avoid being required to implement fiscal transparency in their territory.

Clearly, this situation of blockage is to be avoided. Political pressure on these two EU countries should be applied by, for instance, other EU member states adopting measures contained in Article 65 of the Treaty on the Functioning of the EU, which allows exceptional restrictions on the free circulation of capital within the EU.

Nonetheless, an important breakthrough in this area was achieved at the end of the Belgian presidency of the EU. **The Economic and Financial Affairs Council (ECOFIN) of 7 December 2010 included, among other agreements adopted, a very important “political agreement on a draft directive aimed at strengthening administrative cooperation in the field of direct taxation so as to enable the member states to better combat tax fraud”²⁸.** The draft directive will overhaul the above-mentioned Directive 77/799/EEC on Administrative Cooperation in the Field of Taxation in a significant way, especially regarding the principles on which EU tax information exchange has been based.

Firstly, as an immediate measure, the Directive will ensure that the “OECD model tax convention on income and capital” is implemented, thereby preventing a member state from refusing to supply information concerning a taxpayer of another member state on the grounds that the information is held by a bank or other financial institution.

The Directive will also exceed the convention’s requirements by:

- Extending cooperation between member states to cover taxes of any kind
- Allowing officials of one country to participate in enquiries in another country

27 These countries have recently withdraw their general objections on the OECD standard.

28 <http://register.consilium.europa.eu/pdf/en/09/st16/st16473-re01.en09.pdf>.

- Facilitating the process of information exchange through standardization, formats and channels of communication.

Another aspect that will facilitate information exchanges lies in the reduction in the burden on the requesting state. The directive will only require the requesting tax administration to provide the identity of the person under investigation and the tax purpose for which the information is sought.

But perhaps the most important advance of the new directive is that it establishes automatic information exchange, “provided that the information is readily available”, beyond interest income (STD) to five new categories from 2015. The new categories are: a) income from employment; b) directors’ fees; c) certain life insurance products; d) pensions; e) and ownership of and income from (immovable) property.

Furthermore, the EU ECOFIN foresees a **“step-by-step approach aimed at eventually ensuring unconditional exchange of information for eight categories of income and capital”²⁹.**

In this respect, by 1 July 2017, the EU Commission will provide a report and, if need be, a proposal for extension to eight major categories of income and capital. When examining that proposal, the Council will examine the possibilities for removing the condition of availability and extending the number of categories from five to eight. The eight categories are as follows:

- Income from employment
- Directors’ fees
- Dividends
- Capital gains
- Royalties
- Certain life insurance products
- Pensions
- Ownership of and income from real estate property.

Despite the progress represented by these reforms, **three main issues remain pending:** a) the extension to the still to be included categories of income (dividends, royalties and capital gains) is not guaranteed; b) it is crucial to multilateralize the

²⁹ EU Council press release, 7 December 2010.

agreement so that developing countries can benefit from these improvements in tax cooperation and; c) the effectiveness of the whole system depends on the possibility raised by the ECOFIN of suppressing (July 2017) the above mentioned condition of availability of information (“provided that the information is readily available”).

Regarding the first of these issues, it is important to put pressure on countries not covered either by the STD or by the revised directive, in order for them to enter into a similar dynamic. **The current environment presents a great window of opportunity for this new regulation to be considered as the template for negotiation on international agreements.** Moreover, along the same lines, the EU should take a stronger stance against non-transparent jurisdictions, imposing sanctions or adopting other measures for countries that refuse to accept these standards of disclosure, thus preventing jurisdictions like Singapore, Hong Kong, Macao and Dubai from marketing themselves on the basis of being outside this scheme and so available for use by tax evaders.

The second issue, referring to the availability of information and the use of companies and trusts as intermediate vehicles to prevent administrations accessing relevant data, is discussed below.

Proposal

- **Speed up the EU Savings Tax Directive review**, which already contains a model of automatic information exchange, with the aim of broadening its scope of application to all legal entities and other legal structures (like trusts).
- Implement the ECOFIN agreement of 7 December 2010 (which has already approved the extension to five new categories for 2015) to extend automatic tax information exchange between states to eight main categories of income and capital by 2017, namely, income from employment, directors’ fees, dividends, capital gains, royalties, life insurance products, pensions and ownership of and income from immovable property.

Promote the generalization of the STD and 77/799/EEC Directive by:

- a) Suppressing the “temporary exemptions” still benefiting some of the countries within the scope of application of the STD.
- b) Extending the STD standards to other as yet excluded jurisdictions, placing pressure on tax havens to which the directives do not apply to comply with the same demands regarding information exchange.
- c) Suppressing the condition that information should be “readily available” for tax information automatic exchange referring to the new categories.

4.4 The abusive use of trusts and companies to conceal the real owners or beneficiaries of assets and funds from tax authorities. Advancing transparency by creating a register of companies and trusts

In order for the exchange of fiscal information to be real and effective, it is not sufficient to implement an automatic system. The main concern when tackling capital flight is the illegal, disguised nature of illicit fund flows. Typically, large deposits resulting from illicit financial flows are not held in individuals' own names. Tax evaders use a number of sophisticated financial instruments available to them in offshore centres to hide their funds. The legislation in many tax havens makes it relatively easy and inexpensive to set up entities to conceal money flows from public authorities. The most used ones for this purpose are shell companies, foundations and other legal structures like trusts, *anstalts* and *stiftungs*.

Special attention should be paid to so-called **offshore trusts**, which are often used by large corporations with many subsidiaries to maintain their capital, disguising the true ownership of the funds and considerably reducing the tax on income from assets. Trusts, Anglo-Saxon in origin, have been used for many decades for inheritances and charities among other purposes. However, nowadays trillions of dollars' worth of assets are probably channelled through this kind of legal vehicle worldwide.

Unlike limited liability companies, trusts do not have a legal personality. They are a collection of assets where the legal owner agrees to manage the assets for the benefit of another person. They are created by means of a simple contract signed by three parties: the settlor, who transfers control over assets to another person, the trustee who manages the assets for the benefit of a third party, and this third party, called the beneficial owner. Instructions on how the trustee should manage the assets are given in the trust deed (trust agreement). Thus, for example, in the case of an inheritance, the settlor creates a trust to pass assets to offspring (beneficial owners) and trustees manage these assets on their behalf. The trust structure ensures that the beneficiaries receive access to the trust funds through the management of an independent manager (the trustee).

The trustee, therefore, is the legal owner but not the beneficial owner. Trustees exercise ownership not on their own behalf but on behalf of the beneficiary. The form of ownership held by a trustee is similar to that of an owner, but is limited by the contents of the trust agreement or trust deed. Depending on the power granted in the trust agreement, the trustee may buy and sell the trust's property, mortgage it, take loans, etc. In a limited liability company, however, the owners control the

company as beneficial owners. They have full control (and disposal) of the company on their own behalf. From a fiscal perspective, if the trust is properly set up, the settlor loses control over the assets transferred with the creation of the trust and so cannot be taxed on its income. However, even though the trustees formally own the funds of the trust, they are not liable for the taxes on the fund³⁰ and nor are the beneficiaries before the funds are distributed to them, hence, in principle, no one is liable for tax purposes.

In many cases, however, the settlor has not, in fact, released the assets and so enjoys the corresponding income while not paying tax. The legislative framework in most tax havens grant ‘extraordinary powers’ to settlors, giving them, for example, the right to make investment decisions, appoint and remove trustees, amend and revoke the terms of the trust and claim back ownership of the assets. **The beneficial owner is often none other than the settlor and the trustee is nothing less than a screen (front man) who hides the identity of the real financial beneficial owner and who acts on the instructions of the latter.**

In brief, even if formal documents shown to the outside world state otherwise, in most tax havens settlors and beneficiaries have control in respect of the trust funds and receive distributions from the trust. Nevertheless, due to secrecy rules, tax administrations do not have any possibility of accessing information on the real circumstances of this control.

Thus, the real problem with trusts is the availability of information. Since trusts are based on a simple contract and do not have a legal personality, they do not need to be registered in certain jurisdictions, which renders their identification extremely difficult. Even if it is known who the trustee is, the identity of the settlors and beneficiaries may remain unknown by virtue of a confidentiality agreement signed between the three parties.³¹ In fact, in tax havens, the trustee will typically be an anonymous trust company that specializes in acting as trustee for many thousands of trusts.

The issue is further complicated by the creation of new legal tools to protect the identity of beneficiaries. Many tax havens allow re-domiciliation or ‘flight clauses’, which require trustees to transfer assets to a different jurisdiction (normally another tax haven) in the event of an imminent preliminary enquiry by tax authorities.

In some cases, the migration to another jurisdiction is done without moving the assets of the trust but using an extensive network of MNC subsidiaries in differ-

30 The assets do not form part of their personal wealth.

31 If the trustee is a lawyer, it is generally claimed that the management of the trust is subject to the lawyer’s obligation of professional confidentiality.

ent countries. A number of tax havens allow re-domiciliation of trusts, which is achieved by transferring the position of trustee to a different jurisdiction. Since trusts are not registered publicly anywhere, the position of trustees may be moved between different jurisdiction without formalities and without moving the assets.

The level of sophistication is further enhanced when the settlor, the trustee, the beneficiary and the assets are split between different jurisdictions and even when the trust is layered on another trust or another structure. For example, the assets deposited in a trust may be shares of a company controlled by nominee directors³² in a tax haven that does not reveal any information about the activities or directors of that particular company. The trust could also be the top tier in a corporate chain of “exempted companies”³³. For example, in the case of the Virgin Islands Special Trust, a trust is placed at the highest tier of a structure and the trustees have the formal authority to legally dispose of and control the shares of subordinate companies and, therefore, over their management and distributions.

Using and registering **shell companies** in low tax secrecy jurisdictions is another way to conceal wealth and beneficial ownership information. Such companies do not perform any productive activity in the tax haven territory. They are false legal structures, with the tax haven offering investors the opportunity to establish an additional domicile that allows them to exploit what amounts in practice to a virtually zero-tax regime. The companies registered are no less than fronts-desks serving as mail boxes for parent companies operating in high-tax jurisdictions.

Some data are very revealing. **In 2004, there were more than 70,000 companies registered in the Cayman Islands, yet the population count in 2009 was only 54,000³⁴.** A survey of Mauritius Island conducted by Eva Jolly, Chair of the Committee on Development of the European Parliament, noted that “nine people (...) administer 1,500 companies (...) which makes economists burst out laughing”³⁵. Three countries in the world have more companies than population: Liechtenstein, the Cayman Islands and the British Virgin Islands.

As this trend becomes increasingly visible to tax authorities, many companies often devise virtual addresses and mail-drop services in financial centres that are not tax havens to avoid investigation into the identities of beneficial owners suspected

32 In tax havens, it is common for a few people to be nominated as the chief executive for hundreds of companies. The same individuals also serve as directors of these companies.

33 Exempted companies: non-resident companies that pay no tax in the tax havens and who receive different tax treatment to the national companies in the tax haven.

34 US Department of State, Background note on the Cayman Islands, 24 May 2010.

35 Who benefits?, film by theThe NGO Counter Balance coalition, 2010.

of illicit activities. However, the company or trust is still legally registered in the tax haven for tax flight purposes, although any details associated with the company are diverted elsewhere. This is often accompanied by the production of fake stationery with the shell-company address and a telephone switchboard re-direction service that serves to conceal the true registered location of the company.

In short, highly qualified lawyers spend their time combining various legal tools in different offshore jurisdictions to build additional layers of secrecy and reduce the risk of detection.

A) Measures to overcome obscurity. The establishment of a trusts and companies register

A general rule in most states is to impose the obligation on citizens to inform tax authorities of their income and assets. This rule should also be extended to the beneficiaries of trusts and other legal structures.

Without a public registry of trusts, it is normally difficult for tax authorities to obtain information on assets located in a trust. Likewise, a registry would enable detection of whether trusts were created for legitimate purposes, i.e., to designate funds to be managed by individuals without influence from the settlor or beneficiary and in the interest of the beneficiary, or whether their only purpose is to reduce the tax bill.

One important step forward would be to make it mandatory for all countries in the EU to create a national register of trusts and other legal entities in their territory that included information on settlors, beneficiaries, trustees and other intermediaries.

This information should be available to the authorities in other states. Ideally, the data in the registers should be automatically exchanged with the jurisdiction in which beneficiaries of trusts and other structures are located³⁶. Only in this way could individuals who have transferred some of their wealth to an offshore trust be forced to pay taxes in their country of residence.

Entities and trusts which fail to supply the required information should be subject to penalties, e.g., the penalty of forfeiture of the title to ownership or cessation of the entity. Likewise, strong penalties should be applied to a country or jurisdiction

36 That location is to be identified by both the place of main residence of beneficiaries and by the country which issued their passports.

if information transmission to relevant authorities in another country which have requested it is hindered.

It is, however, essential to resolve the problem of different information requirements in each country regarding the companies and other entities. The solution would be to **harmonize requirements for national registers of companies, as that would be the only way to prevent individuals or companies from benefiting from differences in national legislative frameworks, thereby undertaking activities in one country and fraudulently concealing profits in another country.**

In the EU, this harmonization of national registers should lead to the creation of a **European register of companies, trusts and other entities** that would provide information on the real beneficiaries and real owners of all entities created within Europe³⁷.

What needs to be established, as a matter of priority, is the minimum information which should be available to fiscal authorities: whether an entity or trust exists (a bank account qualifies by itself as a structure for this purpose), in whose name is it held, who manages it, where it banks and who in the jurisdiction benefits from it.

In this respect, a reasonable proposal could encompass that the following information be required under EU legislation³⁸:

1. All companies must be registered with full details of the following information on public record:

- a) All beneficial owners and all nominee intermediaries should be disclosed.
- b) All directors must be placed on public record and also the full names of all those in accordance with whose instructions they act.
- c) All accounts must be on public record and abbreviated accounts should not allowed.
- d) The same should be required for all protected cell companies³⁹ and international cell companies with full details disclosed for each cell.

2. Similar details should be filed for all limited liability partnerships.

37 This issue is related to that of the harmonization of company law at the European level and the recent creation of the European company - both beyond the scope of this article.

38 Richard Murphy and John Christiansen, Consultation document on the modernization of Directive 2004/109/EC, Tax Research LLP and Tax Justice Network, 20 August 2010.

39 Cell companies divide their assets and liabilities into different cells, each with its own name and representing a single asset (or asset class). The total number of cells thereby comprises the whole company. Such a company provides protection against national tax authorities and creditors.

3. All trusts should be placed on public record, with the following information fully disclosed:
 - a) The trust deed.
 - b) All letters of wishes.
 - c) The name and address of the settlor.
 - d) The names and addresses of all trustees and the names and addresses of all those on whose instructions they act.
 - e) The name of any enforcer and the instructions they hold.
 - f) The annual accounts of the trust.
 - g) Details of all trust distributions with names and addresses of beneficiaries on record.
4. Similar information should be made available for all foundations and charities.
5. Similar information should be supplied for all charities.
6. Full details of all re-domiciliation must be on public record.

The ongoing review of the EU Transparency Obligations Directive (TOD, see section 5.4) provides the perfect opportunity to ensure that the ultimate beneficial ownership of entities and trusts is on public record and disseminated through the Regulatory Information Service.

However, the scope of the TOD lies within national frameworks. **Therefore, the optimal solution would be to create a European register to avoid illicit flows of money within the EU seeking more permissive jurisdictions.**

By creating such a European registry, the EU could show the way to the rest of the world until a similar registry was established at the global level. Moreover, the EU could also exert pressure on other countries to comply by, for instance, not merely demanding this kind of information from all EU trusts and similar entities but also demanding this information from all those wishing to trade with Europe. The inclusion of such requirements in bilateral TIEAs and DTAs could be an effective provisional measure.

Another important measure could be adopted through the TOD: if a legal entity or structure from outside the EU wished to record ownership of shares in the EU, then it should be required to either record the necessary information in the European register or place it on public record in the location where the shares are registered.

Furthermore, in order to ensure that MNCs also comply and do not circumvent registration, they could be required to include not only a statement of the legal owner-

ship of their shares but also a statement listing the beneficial owners of the shares or providing full details of the public register entry where these details can be found.

A number of important measures are being discussed in other forums to reduce the opacity resulting from abusive use of trusts y companies. In the G20 summit in Seoul, leaders invited the FATF “to continue to update and implement the FATF standards (see Box 2) calling for transparency of beneficial ownership”. The FATF, whose main task is the fight against money laundering, agreed in February 2009 that the question of transparency of beneficial ownership was a key priority for reassessment.

However, the G20 needs to ensure that the FATF strengthens the standard to achieve compliance with Recommendation 33 and 34 (devoted to the misuse of trusts) and require public registries of beneficial ownership and control of companies and trusts. To date, very few secrecy jurisdictions come close to implementing these FATF standards adequately, as has been noted by the review of compliance with these standards undertaken by the Tax Justice Network. Furthermore, it is currently possible to be in compliance with the above-mentioned recommendations by reaching the low standard of ensuring that beneficial ownership information is accessible to law enforcement officials.

In this respect, there have been discussions as to whether to mandate that no trust would be enforceable against the trustee unless it was registered on a public record.

Proposal

- **Promote the mandatory establishment of a national register of trusts, companies, foundations and other legal entities created in their territories in all EU member states**, with information on accounts, beneficial owners, nominee intermediaries, managers, trustees and settlors. This information should be made available to any fiscal authority that requests it.
- **Create a European register of companies and trusts** for all the EU member states that can be consulted by any interested fiscal authority or any other interested party.
- **Request the Financial Action Task Force (FATF) to review Recommendations 33 and 34** regarding beneficial ownership, so as to make sure that no trust would be enforceable against the trustee unless it was placed on public record.

4.5 The establishment of a new global and/or European tax authority

As explained above, the EU and the OECD have been active in developing different tools to combat tax evasion and avoidance. The two bodies represent significant expertise and experience in this field and, in some cases, such as the STD, are fighting in the vanguard against harmful tax practices.

Nonetheless, the problem of representativeness of developing countries has not been resolved and these often complain that the topics of most interest to them are left off the discussion agenda.

It also seems that the G20, despite the inclusion of several emerging economies and despite its rapid and effective way of facing the serious problems posed after the 2008 crisis (especially in the earlier summits), cannot be considered as the global institution dealing with problems associated with harmful tax practices. Its work in this area is and will continue to be fundamental, but the G20's informal nature calls for the complementary participation of a more permanent multilateral body, preferably linked to the UN.

In this regard, an interesting and ambitious proposal was submitted by an expert panel chaired by former Mexican President Ernesto Zedillo, at the 2002 UN International Monterrey Conference on Financing for Development. **The Zedillo report's idea to create an international tax agency is probably the most ambitious of those put forward to date.** Such organization would be responsible for the following tasks:

- To compile statistics, identify trends and problems, publish reports, provide technical assistance and act as a forum for the Exchange of ideas and the development of standards for tax policies and administration. To oversee tax systems in a way similar to the macroeconomic policy supervision implemented by the IMF.
- To negotiate with tax havens with a view to bringing an end to disloyal tax competition and halting tax competition aimed at attracting multinationals.
- To develop arbitration systems to resolve tax conflicts between countries.
- To sponsor a mechanism for the multilateral exchange of information aimed at reducing tax evasion.

The proposal was nonetheless rejected at the Monterrey Conference, and the closing declaration was limited to a statement in favour of the need to “strengthen international tax cooperation”.

Yet, the embryo of an international tax body probably lies in the UN Tax Committee, dating back to 1968, which in 2004 was turned into an ad hoc Committee of Experts on Tax Issues. It is made up of 25 members representing developed and developing countries who meet annually in Geneva.

Its mandate, which has been extended several times, is quite broad: (a) to monitor and adapt the model UN Treaty on Double Taxation and guidelines for negotiation of tax treaties; (b) to provide a forum for international cooperation between national tax authorities; (c) to address emerging issues and their tax implications and make recommendations; (d) to make recommendations on capacity building and technical assistance to tax authorities; and (e) to pay special attention to developing countries.

There have been many calls for a greater role for the UN Tax Committee in the fight against tax evasion and tax fraud. Among the demands of note is a proposal⁴⁰ to upgrade the Expert Committee into an intergovernmental body. Committee members should be given a political mandate by UN member states and, the proposal suggests, the mandate of the committee should be of limited duration to ensure a rotation of the countries represented. Furthermore, without being radically altered, the mandate of the committee should give priority to:

- The production of reports, particularly on emerging issues and paying special attention to developing countries.
- Further work on the UN Model Tax Convention.
- The development, promotion and monitoring of a code of conduct against tax evasion and illegal capital flight, with monitoring to take the form of a review by both peers and experts, closely coordinating with the OECD and focusing, in particular, on the application of international standards concerning information exchange and transparency.
- The production of recommendations concerning demand-driven technical assistance and capacity building for tax administrations in the South.

If an international fiscal organization is not viable immediately, given the reluctance of certain countries to cede sovereignty in this field, this should not prevent the EU from taking the initiative as it has done on other occasions. The

40 “Reinforcing the UN tax committee - Preparatory note for the Doha Conference on financing for development,” Briefing compiled by Jean Merckaert (CCFD- Terre Solidaire / Plate-forme Paradis Fiscaux et Judiciaires).

recent crisis of the euro and the reform of the European economic governance have laid bare the need to move towards further economic integration, including in the areas of fiscal and tax policies.

Hence, **the creation of an EU Tax Authority**, with its own human resources cooperating with national officials (as in the formula applied to the European External Action Service introduced by the Treaty of Lisbon) could be an effective tool in addressing an issue with implications that increasingly go beyond national boundaries. Such a body could help to unify the legal definition of tax fraud and substantially improve the **prosecution of tax crimes with a European dimension** in coordination with the corresponding national tax authorities. The latter would imply acknowledging at the EU and international level the criminal and fraudulent nature of many behaviours and activities, including the operations of the main beneficiaries from tax havens operations, the MNCs and financial institutions⁴¹.

Proposal

- Promote the creation of a **Multilateral Tax Agency** to fight against tax evasion, capital flight and tax competition:
- Grant, as a first step, the **UN Tax Committee** a political mandate by UN member states and ensure that the tax evasion and capital flight code of conduct is adopted and upheld by countries and companies.
- The creation of an **EU Tax Authority**, with its own human resources, which would cooperate with national administrations in prosecution of cross-border fiscal crimes.

41 The Government Accountability Office of the USA (GAO) issued a report in December 2008 showing that 83 out of 100 largest American corporations have subsidiaries in tax havens. This list counts famous banks like Citigroup, with nothing less than 3,122 subsidiaries in tax havens. <http://www.gao.gov/new.items/d09157.pdf>.

5. Towards greater transparency in the way multinational corporations (MNCs) report their annual accounts

The fight against harmful tax practices calls for action not only in the public sphere (cooperation between tax administrations) but also in the private sector. Promoting greater transparency in the way MNCs report their accounts appears to be an unavoidable measure for guaranteeing that the right amount of taxes are paid by MNCs and for ensuring greater accountability.

Current international accounting standards establish what kind of accounting information is to be reported by MNCs. **These standards allow MNCs, usually group structures, to adopt the consolidated account system, thus enabling them to report financial information aggregated at a regional level, instead of doing so country by country.** Very often, the information provided by MNCs represents the transactions of all the companies within the group. The consolidated account system is based on the premise that the entity is a single company although, legally, each subsidiary pays tax individually in the particular country it operates in.

The fact that intra-group transactions are not reported makes it extremely arduous for tax authorities to penetrate the accounts of MNCs. This is no trivial matter. **The OECD indicates that 60% of global commerce is of the intra-group type and, thus, susceptible to transfer mispricing or to being funnelled into tax havens.** According to Global Financial Integrity, “trade mispricing was found to account for an average of 54.7% of cumulative illicit flows from developing countries over the period 2000-2008”⁴².

42 Global Financial Integrity “Illicit financial flows from developing countries 2000-2009”, January 2011.

5.1 Different methods to combat transfer mispricing

Transfer mispricing occurs when subsidiaries of the same group located in different jurisdictions trade with each other and artificially distort the recorded price. They deliberately minimize the overall tax bill of the group by localizing profits in subsidiaries based in jurisdictions with lower tax burdens (for example, in tax havens). The recent cases of Google and Praxair, widely aired by the media in Europe and Spain, prove that these practices are not exclusive to unknown and obscure companies operating in far-off developing countries, as some may believe (see Box 5).

Box 5. Two examples of abusive transfer mispricing practices and other financial engineering operations by multinational corporations: Google and Praxair

- 1. Google:** a good example that has come to the attention of the media recently* is the case of Google, one of the best-known companies in the world, whose astronomical growth is linked to the rapid expansion of the Internet in the globalized world. Despite Google's incredible success and growing number of users, it has managed to reduce its taxes by some 3,100 million USD in the last 3 years and has reduced its tax on overseas profits to 2.4%. Google has in fact avoided paying taxes at its main international headquarters by transferring most of its profits to offshore locations where, to all effects and purposes, it has little real activity. The obscure system of internal mispricing has allowed it to do so (and especially through the sale of intellectual property rights).
- 2. Praxair:** a multinational company based in the USA with subsidiaries in over 40 countries, is an industrial gas company. It is one of the world's most profitable companies in terms of its own resources. The Spanish High Court has confirmed that between 2001 and 2003, this company committed tax evasion on numerous occasions through Praxair España, Praxair Ibérica and Oximesa, among other companies. The more profitable companies transferred shares to other companies, which, in the same period, reduced capital through the amortization of its own shares**.

From 2004, the group paid tax through consolidated accounts for Praxair Euroholding. According to the sentence, Praxair continued with a strategy of concealing profits and fabricating expenditure and losses to avoid paying tax according to its true profits.

In 2004 Praxair Euroholding used transfer mispricing purchasing shares in one of the Praxair companies for 142 million euros and selling them on a week later to Praxair Canada for 92 million euros, thereby generating an accounting loss of 50 million. In order to illicitly deduct goodwill and interests, Praxair conducted operations that involved subsidiaries in Luxembourg, Switzerland and even the mother company in the USA.

* *El País* 25 October 2010: Google usa paraísos fiscales para pagar solo un 2,4% de impuestos - La filial española declara una mínima parte de los ingresos que genera [Google uses tax havens to pay just 2.4% in taxes – its Spanish subsidiary declares a minimum proportion of its income]. See other articles about Google in *The Guardian* (20-4-2009) Google is accused of UK tax avoidance and in *Le Figaro* (7-1-2010), Nicolas Sarkozy stigmatises Google.

** *El País*, La Multinacional Praxair confiesa que defraudó al fisco español 146 millones, 23 January 2011.

To resolve this issue of transfer mispricing, a principle known as “**arms-length transfer pricing**” was developed, which requires that two companies under common control sell any goods or services they supply to each other at market prices, for example, at the price that two independent companies would negotiate for supplying the same goods or services.

However, this principle has become very hard to implement and even harder to monitor. The complexity of the trade undertaken by MNCs has increased considerably, with a predominance of trade in services over trade in goods. Transactions are increasingly being made for immaterial goods, the market value of which is unknown or uncertain (royalties on a brand, patents, legal services, etc.).

Despite the shortcomings of the measure, the OECD and the United Nations Tax Committee have both endorsed the arms-length principle, which is also widely used as the basis for bilateral treaties between governments.

In the conclusions at the EU Foreign Affairs Council, the EU supported the “OECD guidelines on transfer mispricing”, which is unfortunate given that, in the opinion of most experts, they alone are ineffective in resolving the problem and are excessively complex to be implemented by developing countries⁴³. Therefore, there is a need to complement them with other methods⁴⁴.

A number of proposals exist to overcome transfer mispricing, such as the “comparable profits method” or the “formulary apportionment system”. Under the latter, an MNC’s total profit would be allocated for tax purposes between the countries in which it operates according to a formula which would take into account the share of companies’ total propriety, payroll and sales.

Already used in USA, this system treats a corporate group as a unit. The corporate groups’ income is “apportioned” out to the different states according to an agreed formula. Each state can thus apply its own state income tax rate to whatever portion of the overall unit’s income was apportioned to it. Each state (or country) would be free to set whatever local tax rates it wanted.

This is a way of redistributing resources based on a company’s real activities and production. Such a formula, instead of prioritizing the legal form in which an

43 Transfer mispricing typically involves huge and expensive databases and high-level expertise to handle.

44 The European Commission has commissioned a study in transfer mispricing that will be issued in June 2011.

MNC organizes itself and its transactions, would allocate profits to a state or country based on real factors such as third party sales and the value of physical assets actually located in each territory in which the MNC operates.

The European Parliament, in a resolution of 10 February 2010, urged the Commission to advance in developing a Common Consolidated Corporate Tax Base (CCCTB), with a view to ending transfer mispricing using a similar approach as used for formulary apportionment. In this context a technical working group⁴⁵ was set up to find ways to incorporate the Common Consolidated Tax Base in a more general strategy for removing corporate tax obstacles in the EU Single Market.

At a session before the European Parliament in May 2008, the then EU Commissioner for Taxation and Customs Union Laszlo Kovacs, indicated that CCTB was an “important policy initiative (that) will remove tax obstacles still experienced by our companies in the internal market. It will be optional for companies and concerns only the tax base, not tax rates”.

While the European Commission is currently conducting an impact assessment on CCCTB, recent tensions in the euro zone concerning tax competition between member states may render it a priority. The CCCTB initiative, besides being a more efficient system than the arms length principle to combat transfer mispricing, could also be the outcome of a tax harmonization (of tax basis not of rates) within the EU and a step forward towards solving the difficulty of having to deal with up to twenty seven different tax systems⁴⁶.

Proposal

- **Urge the European Commission to advance in developing the Common Consolidated Corporate Tax Base (CCCTB) initiative** to fight against transfer mispricing more efficiently, in line with which has been expressed by the European Parliament resolution of 10 February 2010.

45 The CCCTB working group was established with the mandate to examine from a technical perspective the definition of a common consolidated tax base for companies operating in the EU and; to discuss the basic tax principles, fundamental elements of a common consolidated tax base and other necessary technical details such as a mechanism for “sharing” a consolidated tax base between member states.

46 The recent competitiveness pact presented by Angela Merkel and Nicolas Sarkozy at the last European Council (4 February 2011) concerns the issue of a minimum harmonisation of tax basis within the EU.

5.2 Country-by-country reporting as a fundamental tool for preventing transfer mispricing and tax evasion and avoidance

Important progress in the fight against transfer mispricing and tax evasion could be achieved by the compulsory introduction of country-by-country reporting for multinational companies.

Compulsory CBC reporting requires MNCs to report in their books and accounts the countries they operate in and under which name, as well as their financial performance in each country, including:

- Sales, both within the group and outside the group.
- Purchases, split the same way.
- Financing cost, split the same way.
- Labour costs and employee numbers.
- Pre-tax profits.
- Tax payments to the government where they are trading.

CBC could serve as the accounting basis for formulary apportionment. But even without formulary apportionment, CBC could be extremely valuable in order to try to determine whether arm's length principles explained above are being complied with.

This accounting tool would enhance the quality of the comparable data and hence, help tax administrations to raise red flags regarding potential abuse worthy of further investigation. For example, it could serve as the basis for a request for tax information exchange from one country to another.

In the above-mentioned Conclusions, the EU Foreign Affairs Council of June 14, 2010 declared itself in favour of “exploring country-by-country reporting as a standard for multinational corporations”. Although it is regrettable that the Council was not more assertive and explicit in this respect, CBC reporting is, in view of most experts, the best instrument for identifying where MNCs earn their profits and where they pay their taxes and, hence, for verifying whether this allocation reflects their real activity.

Through CBC reporting, tax authorities are in a position to verify what the MNCs located in their territory are really doing, how they run their commercial operations, what profits and taxes they declare, etc.

5.3 The extractive industries' accounting standard review as a first step to establishing compulsory country-by-country reporting in all sectors

The Conclusions of the EU Foreign Affairs Council call on EU member states to support ongoing consultation by the International Accounting Standards Board (IASB) on reporting requirements in International Financial Reporting Standard (IFRS) 6 from the extractive sector and beyond, thus opening the way towards CBC reporting in all economic sectors.

The IASB is the institution that sets the IFRS. It is a self-appointed private sector policy-making body, of a technocratic nature and made up principally of members connected with industry, auditing and accounting.

Despite the fact that public authorities, either national or international, are very poorly represented in its board and in its decision making⁴⁷, **the IASB is on the way to becoming the principal regulator in matters of international accounting standards for MNCs.** Its rules are already applicable, among others, in the 27 states of the EU. Currently, there is an ongoing process, sponsored by the G20, to harmonize IASB accounting standards with those applied in the USA by the Financial Accounting Standards Board (FASB). If the convergence process with FASB and other jurisdictions (Japan, China, India, etc) is successful, it will mean that the IFRS will be applied in more than 110 countries. **Therefore, introducing transparency requirements through a revision of the IASB accounting standards would guarantee a level playing field for the bulk of MNCs.**

A first step to enforcing CBC reporting is taking place in the extractive industries (petrol, gas and minerals), where a consultation process was launched by the IASB at the beginning of 2010 on the possibility of adopting a new accounting standard for that sector. **Thus, the purpose of the current IFRS 6, "Exploration for an**

47 The IFRS Foundation, **the oversight body of the IASB**, published, on 5 November 2010, a paper titled Status of the Trustees' Strategy Review for public consultation, to collect the opinions of stakeholders with a view to improving IASB governance, accountability and decision-making process. The consultation period will close on 24 February 2011 and the IASB Trustees expect to conclude the strategy review during their meeting in March 2011.

Evaluation of Natural Resources”, is to address the specific unique aspects of the extractive industries which justify the need for a model of financial reporting specifically designed for them. Indeed, the extractive industries are uniquely exposed to material country-specific, tax-regulatory and reputational risks. Exposure to these risks is heightened by the massive capital employed in this sector and the critical importance that natural resources hold for energy and food security in many countries.

In many developing countries, the discovery and exploitation of natural resources is associated with corruption, mismanagement of public resources, and internal strife for their possession. The problem is so widespread that the term cursed is often used to refer to those countries endowed with large natural wealth. If natural resources are the source of conflict and poverty rather than development and growth, it is due to a large degree to the obscurity in which firms in the extractive sector typically operate.

The deadline of 30 July 2010 was set for written submissions on the IASB discussion paper about IFRS 6, the first phase in the process of reviewing the IASB rules. As a result of lobbying carried out by the civil society international coalition Publish What You Pay, the CBC principle was introduced into the IASB discussion paper published in April 2010.

However, as it stands the IASB proposal would not lead to the establishment of a comprehensive and systematic CBC reporting standard. In this regard, the proposed text presents the following shortcomings:

- It allows companies to decide whether they report their financial information in a country depending on the importance of the activities of a particular MNC in that country.
- It allows firms to opt out of reporting country-specific data where they feel this would “prejudice the position of the entity”.
- It rejects country-specific reporting requirements related to production revenues, subsidiaries and properties.
- The discussion paper proposals have been assessed only from the perspective of capital providers, without taking into account the interests of other users of company financial information, and, in particular, those of tax authorities.

For the above-mentioned reasons, even though there has been an improvement compared to the current state of play, the IFRS 6 review process is unlikely to lead

to a major overhaul in company reporting, and furthermore, its scope remains narrow as it only affects the extractive industries.

The review of the IFRS 8: there is, however, another ongoing review process, which affects all sectors and whose implications are potentially much greater for CBC reporting. This relates to the revision of IFRS 8, which has been demanded by many civil society organizations, primarily through the Tax Justice Network coalition. IFRS 8, whose transposition into community law was rather controversial, is the international norm on financial information that requires companies to reveal information about their “operating segments”.⁴⁸ This is one of the most vital aspects of financial reporting. Segment information provides relevant indicators of business models and the economic reality of a company’s operations. For this reason those preparing this information (companies) generally want to maintain tight control over it, while users (investors, creditors, tax authorities, etc) want it to be specifically objective and non-distorted.

The version of IFRS 8 that was finally approved by the IASB (November 2006) favours a “pro-manager” approach by the company. The company management’s point of view is taken as a reference, in detriment to an analysis based on the risks and profitability of the sectors. Therefore, the company is given considerable freedom to decide what information to release and, in particular, it can define segments and segment information as it wishes. It also restricts the need for geographical disclosure, which companies are generally reluctant to provide, claiming that it is politically sensitive.

For all the reasons detailed above, the need to modify IFRS 8 appears vital if we want the transparency provided by CBC reporting to reach all the sectors in which MNCs operate.

The EU Foreign Affairs Council conclusions of 19 June 2010 (Box 1) make an indirect reference to the IFRS 8 review by encouraging IASB to extend CBC reporting beyond the extractive industries:

“In addition, Member States should support ongoing consultation work by the IASB on a country-by-country reporting requirement in IFRS 6 (International Financial Reporting Standard 6) for the extractive sector, **and encourage the IASB to look beyond the extractive sector**” [our emphasis].

48 IFRS 8 defines an operating segment as a component of an entity that engages in revenue earning business activities, and whose operating results are regularly reviewed by the highest authority in the decision-making of those operations.

The process of amending IFRS 8 is due to commence in 2011. Moreover, the European Parliament has urged the Commission to report back to it, at the latest, during 2011, on the process of reforming IFRS 8⁴⁹.

Given its relevance, it would be very important for the review process not to be delayed or bogged down by external interest groups.

Proposal

- Ensure that the review process initiated by the IASB to create a new international accounting standard applicable to MNCs in the extractive industry (IFRS 6) continues to progress and leads to the establishment of a fully fledged, comprehensive and systematic CBC reporting standard, without exemptions, that takes into account the information needs of tax authorities and all stakeholders.
- **Promote the extension of a similar CBC reporting standard to all sectors** by means of a review of IFRS 8 on operating segments. Ensure that the IASB does not delay the start of the review process beyond 2011, in line with the wish expressed by the European Parliament to supervise the IFRS 8 calendar of reforms.

5.4 The introduction of country-by-country reporting through stock regulations

In parallel with the open processes of reviewing IASB regulations, different national and international initiatives are underway to introduce the requirement for CBC reporting into stock market regulations.

At the European level, Directive 2004/109/EC (Transparency Obligations Directive, TOD) came into force in 2007 with the purpose of promoting transparency in EU capital markets and ensuring greater investor protection throughout the EU. This directive affects companies operating in the extractive industry sector.

49 In virtue of its power of scrutiny in accounting standardization matters, the European Parliament also issued a motion of resolution (2007), in which it urged the IASB to “move beyond voluntary guidelines and support the development of an appropriate accounting standard requiring country-by-country reporting by extractive companies”. In general, the European Parliament vindicates having more say than it has had to date in the process of developing accounting standards.

Of particular relevance from the point of view of CBC reporting is Recital 14 of the directive, which states that EU members “should encourage issuers whose shares are admitted to trading on a regulated market and whose principal activities lie in the extractive industry to disclose payments to governments in their annual financial report.” Unfortunately, this paragraph is found under Recital 14, outside the main body of the directive and hence has no legal weight.

The TOD is a “minimum harmonization” directive, meaning that a member state can impose more stringent requirements on domestic issuers when it implements the directive. In this respect, the European Commission published a report, in May 2010, showing its concern that “none of the EU member states has transposed the recommendation of Recital 14 into nationally binding legislation”⁵⁰.

In effect, the TOD, as it is currently drafted, lacks the teeth to make it effective in enhancing transparency and accountability. Therefore, under the current review process the text should be reinforced and amended to ensure the following:

- That it incorporates Recital 14 recommendation in the main body of the directive and pushes member states to make it a legal requirement for issuers.
- That it extends the TOD’s area of application to all sectors, over and above the extractive industry.
- That it establishes a uniform EU regime regarding issuers and disclosers, requiring companies to report, in addition to payments made to governments, a minimum set of information for each country in which they have operations see section 5.2).

On 26 October 2010, the Commission launched a consultation process with a view to incorporating CBC reporting into European legislation⁵¹. It proposes two alternative approaches to CBC:

- 1. General country-by-country reporting by multinational companies.** The main goals of such disclosure would be: (a) to help investors to better assess the different national activities of multinational companies and; (b) to enhance transparency about capital flows, for instance, to better enforce tax rules.

50 Commission Staff Working Document. Review of the Operation of Directive 2004/109/EC (TOD): Emerging Issues, 27 May 2010, COM (2010) 243, Para.14.17, p.107.

51 http://ec.europa.eu/internal_market/consultations/2010/financial-reporting_en.htm.

2. Specific transparency obligations for companies which are active in the extractive industry (minerals, oil, and gas) in third countries. The main goal of such disclosure would be to provide more transparency about the payments made by the extractive industry to governments in third countries.

This consultation process may lead to a Commission communication in September 2011.

In some European countries a debate has started about transparency in MNCs accounts and CBC reporting. **In Spain**, it is important to highlight the recommendations of the transactional proposal with parliamentary groups, approved by the Spanish Parliament in September 2009, urging the government to “encourage the regulatory changes appropriate to European and international legislation and consequently in our country, so that extractive companies in the stock exchange market report on the payments and revenues obtained from the exploitation of natural resources”⁵².

Measures covered by this transactional proposal include **modifying Law 24/1988 governing the stock market, to make it obligatory for listed extractive industry companies to publish all payments made to resource-rich countries. The review process is expected to commence in 2011.**

In France President, Nicolas Sarkozy has been the first EU leader to go on record publicly in support of incorporating CBC reporting into EU legislation⁵³. During the latest G20 Finance Ministers’ meeting in Paris (February 2011), George Osborne, **British Chancellor of Exchequer**, came out in support of proposal by Nicolas Sarkozy backing CBC reporting in the extractive industries sector⁵⁴.

On the other hand, a provision on transparency of all French banks was included in the law of merger of Caisse d’Epargne-Banque Populaire, voted in May 2009. **The law provides that banks must publish “information” appended to their annual accounts about their establishment and activities in tax havens.**

The French government is seeking the support of its partners to introduce such transparency standards in the banking sector in other countries. The declaration of

52 The Spanish Commission for International Development Cooperation, in a session on 24 September 2009, agreed to approve two motions, published in the Boletín Oficial de Las Cortes on 22 December 2009 (Series D, No. 128).

53 The commitment comes in a letter addressed to Bono which has been published on the Elysée website: <http://www.elysee.fr/president/les-actualites/communiqués-de-presse/2011/lettre-adressee-a-bono-en-reponse-de-sa-tribune.10545.html>.

54 See <http://www.guardian.co.uk/business/2011/feb/20/george-osborne-oil-mining-africa>.

19 states meeting in Berlin in 2009 raised the need for greater transparency in the financial sector, but it is not certain that European countries or G20 members will agree to disclose the presence and activities of their banks in tax havens.

In the USA, a historical provision was included in the recent **Dodd-Frank Wall Street Reform and Consumer Protection Act** (also known as the Financial Reform Bill), passed by the US Congress on 15 July 2010. **Provision 1504 requires that all oil, gas and mining companies registered with the Securities and Exchange Commission (SEC) publish payments made to US and foreign governments as part of their annual compulsory filings. This effectively means that, in order to access US capital markets, US and foreign companies must publicly disclose all payments made to governments, “project by project and country by country”.**

Although the report required by this law is not fully comprehensive, its provisions represent an important step forward in creating a global standard for transparency, given that nearly all internationally competitive oil, gas and mining companies are registered with the SEC.

The US government has announced that it is actively seeking to work with other jurisdictions to ensure that similar requirements are enacted. It is worth remembering that the **Hong Kong Stock Exchange** had previously adopted a listing requirement for company payment disclosure⁵⁵. Accordingly, all extractive industries are obliged to disclose the taxes they pay in states where they operate on a CBC basis. The requirement is compulsory for all companies publicly listed in the Hong Kong Stock Exchange, which is the largest in annual trade in Asia. In light of those developments, it seems clear that the EU is trailing behind the US and Hong Kong in the standard of transparency it enforces for companies listed within its territory. **Therefore, if under the current review, the TOD were amended to align its legal requirements with those of the US and Hong Kong requirements, it would result, in practice, in the enforcement of CBC reporting by all major companies in the extractive sector across the world.** Moreover, the EU and its member states could even adopt a more ambitious approach if we bear in mind that, in reality, the Dodd-Frank Act was introduced as a way of ensuring greater transparency and not specifically with a view to tackling tax avoidance and evasion. **The EU needs to go a step further than simply replicating the US financial bill, by also promoting an extension of CBC reporting to all industrial sectors.**

55 Amendments to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, 3 June 2010.

Proposal

- Take advantage of the current review being carried out of the TOD to include Recital 14 in the main body of the directive, thus converting CBC reporting into a compulsory requirement for extractive industry MNCs that participate in EU capital markets, in harmony with stock market legislation in the USA and Hong Kong. Use this review of the TOD, which is already under way, as an opportunity to introduce comprehensive CBC reporting applicable to all sectors. During 2011, promote approval of reform of Spanish Law 24/1988 on the stock market to make it mandatory for listed extractive industry companies to publish, for each country, all payments made to resource-rich states.

5.5 Voluntary initiatives to introduce country-by-country reporting

The Extractive Industries Transparency Initiative (EITI) is a voluntary multi-stakeholder public-private initiative launched in 2003 and supported by governments (among them Spain), companies (REPSOL YPF is the only Spanish one), international institutions (World Bank and the IMF, among others), investors and civil society networks. **Its objective is to set a standard of transparency for companies to publish what they pay and for governments to disclose what they receive.**

The EITI has developed a methodology for supervising and reconciling company payments with government revenues, which is implemented at the country level in a process which places the emphasis on the voluntary participation of the many interested stakeholders.

Twenty-eight resource-rich developing countries have applied or are considered candidate countries for the EITI standard, although only five countries have been validated as fully compliant⁵⁶.

Through its voluntary compliance and its process of reconciling payments with revenues - which need to be validated by civil society - EITI is making important progress in enhancing transparency in many countries and in promoting enhanced accountability of governments to their citizens.

56 Azerbaijan, Ghana, Liberia, Mongolia and East Timor.

However, seven years since its inception, this initiative is also facing some difficulties, partly due to the institutional weaknesses of many developing countries to comply with EITI requirements and the lack of political will of other countries. As a result, **many candidate countries have failed to meet a crucial deadline set in 2010 for complying with the EITI standard** and two of them (Equatorial Guinea and São Tomé and Príncipe) were expelled from the initiative. The reluctance shown by the stakeholders involved jeopardizes the EITI's credibility.

Some observers feel that the recently approved US Financial Reform Bill, by making payments disclosure a compulsory requirement for companies listed in the SEC, undermines EITI's objective which is based on voluntary requirements and multi-stakeholder participation. Overall, EITI is making an important contribution towards enhancing transparency and accountability in resource-rich developing countries. Yet, EITI's voluntary approach could be reinforced through supplementary mandatory requirements to create transparency and a level playing field for companies in the extractive industries. In this regard, **EITI can be seen as a complement to the US legislation in areas and countries which fall beyond the scope of the latter.**

The Spanish government joined the EITI initiative in 2008 as a donor country. As mentioned above, several non-legislative proposals presented by different parties in the Spanish Parliament encouraged the government to promote and advance the initiative, particularly in Latin America. After an initial period of active participation by the Spanish government - it even hosted a meeting of the EITI International Board in 2008 – the initiative seems to have dropped down the list of priorities of the Minister of Foreign Affairs. It is also necessary to highlight the suggestion made by the EU Foreign Affairs Council, when it supported the EITI initiative, namely, “to consider expanding similar practices to other sectors, beyond the extractive industries”.

Finally, the **OECD is currently considering incorporating CBC reporting through a review of its Guidelines for Multinational Enterprises.** This work was initiated after the UK-France summit held in July 2009 at Evian. The issue was discussed at the 3rd Plenary Meeting of the OECD Global Forum on Development in January 2010, where it was decided to set up a Task Force on Tax and Development to look more closely into the issue of transparency. **Both the OECD and the EU have therefore made clear commitments in this area of CBC reporting and the EU Foreign Affairs Council's conclusions of 14 June 2010 encourage the OECD to pursue its work.**

As a result of voluntary initiatives, some extractive industries have made a commitment to transparency. Thus, Newmont, Río Tinto and Anglo American report their financial information in most of the countries in which they operate. Others, like Talisman Energy and Statoil, report their activities and production in certain countries.

6. Recommendations for the Spanish government in the fight against tax evasion, tax avoidance and capital flight

The Spanish government must continue to maintain the leading role it played in matters of tax havens and development during Spain's rotating EU Presidency, reflected in the conclusions of the EU Foreign Affairs Council of 14 June 2010, in order to guarantee that the measures introduced in these conclusions are adequately developed in forthcoming European and International forums, namely at the forthcoming G20 summits and EU Council meetings. In this regard, the following proposals for action should be taken into account:

- 1. Speed up the creation of a new list of tax havens, taking advantage of the work done in the Global Forum of Taxation's peer review process** which will conclude in 2014. The new list should be more complete and objective than the current one proposed by the OECD (signature of 12 tax information agreements) and it should be based on assessment criteria that are not limited to tax cooperation but which include financial regulation and money laundering. The tax havens included in the list should be categorized according to the risk level they pose.
- 2. Promote at the European level the application of sanctions on non-cooperative jurisdictions.** Following the spirit of the G20 London Summit, the EU should draw up a list of sanctions against non-cooperative jurisdictions and show clear signs of intending to implement them. They should include, among others, the review of tax treaty policies, denying deductions in respect of expense payments to payees in a non-cooperative jurisdiction, asking international institutions and regional investment banks to review their investment policies, cutting off development aid, removing tariff preferences or restricting European banks'

operations within those jurisdictions. Stronger sanctions should be applied to EU off-shore territories that do not implement European legislation.

3. **Launch an initiative aimed at multilateral tax cooperation based on the OECD and Council of Europe Convention on Mutual Administrative Assistance in Tax Matters**, in which both developed and developing countries could participate. Strongly urge tax havens to sign the convention, so that those that refuse to do so will be considered uncooperative.
4. **Establish a system of multilateral sanctions** to replace the current system that leaves the initiative of imposing sanctions up to individual governments, meaning that only the most powerful countries have sufficient leverage to force tax havens to cooperate.
5. **Support the implementation of an automatic system of information exchange to replace the OECD's current on-request model**, which places the tax fraud burden of evidence on the administration requesting the information and leaves the decision to accept the request in the hands of the tax haven.
6. **Speed up the EU Savings Tax Directive review**, which already contains a model of automatic information exchange, with the aim of broadening its scope of application to all legal entities and other legal structures (like trusts).
 - End, as soon as possible, the remaining temporary tax-withholding exemptions of some jurisdictions covered by the STD and promote extension to other still excluded jurisdictions.
 - Implement the ECOFIN agreement of 7 December 2010 (which has already approved the extension to five new categories for 2015) to extend automatic tax information exchange between states to eight main categories of income and capital by 2017, namely, income from employment, directors' fees, dividends, capital gains, royalties, life insurance products, pensions and ownership of and income from immovable property.
 - Suppress the provision that information should be "readily available" for tax information automatic exchange referring to the new categories, so as to overcome the problem of requesting countries being unable to obtain tax information as a result of the creation of opaque legal structures (companies, trusts and foundations) in tax havens.
 - Promote the internationalization of the STD and 77/799/EEC Directive to other as yet excluded jurisdictions, placing pressure on tax havens to which

the directives do not apply to comply with the same standards regarding information exchange.

7. **Promote the mandatory establishment of a national register of trusts, companies, foundations and other legal entities created in their territories in all EU member states**, with information on accounts, beneficial owners, nominee intermediaries, managers, trustees and settlors. This information should be made available to any fiscal authority that requests it.
8. **Create a European register of companies and trusts for all the EU member states** that can be consulted by any interested fiscal authority and any interested party
9. **Request the Financial Action Task Force (FATF) to review Recommendations 33 and 34 regarding beneficial ownership**, so as to make sure that no trust would be enforceable against the trustee unless it was placed on public record.
10. **Promote the creation of a Multilateral Tax Agency to fight against tax evasion, capital flight and tax competition:**
 - A first step could be to grant the UN Tax Committee a political mandate by UN member states and ensure that the tax evasion and capital flight code of conduct is adopted and upheld by countries and companies.
 - The creation of an EU Tax Authority, with its own human resources, which would cooperate with national administrations in prosecution of cross-border fiscal crimes.
11. **Promote greater transparency in MNC accounts presentation to make the fight against harmful tax practices more effective.** This action should include the following measures:
 - Urge the European Commission to advance in developing the Common Consolidated Corporate Tax Base (CCCTB) initiative to fight against transfer mispricing more efficiently, in line with what has been expressed by the European Parliament resolution of 10 February 2010.
 - Ensure that the review process initiated by the IASB to create a new international accounting standard applicable to MNCs in the extractive industry (IFRS 6) continues to progress and leads to the establishment of a fully fledged, comprehensive and systematic CBC reporting standard, without ex-

emptions, that takes into account the information needs of tax authorities and all stakeholders.

- Promote the extension of a similar CBC reporting standard to all sectors by means of a review of IFRS 8 on operating segments. Ensure that the IASB does not delay the start of the review process beyond 2011, in line with the wish expressed by the European Parliament to supervise the IFRS 8 calendar of reforms.
- Take advantage of the current review being carried out of the TOD to include Recital 14 in the main body of the directive, thus converting CBC reporting into a compulsory requirement for extractive industry MNCs that participate in EU capital markets, in harmony with stock market legislation in the USA and Hong Kong. Use this review of the TOD, which is already under way, as an opportunity to introduce comprehensive CBC reporting applicable to all sectors. During 2011, promote approval of reform of Spanish Law 24/1988 on the stock market to make it mandatory for listed extractive industry companies to publish, for each country, all payments made to resource-rich states.

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