# Opinion of the European Economic and Social Committee on 'Tax and financial havens: a threat to the EU's internal market' (own-initiative opinion)

(2012/C 229/02)

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On 14 July 2011 the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an opinion on

*Tax and financial havens: a threat to the EU's internal market* (own-initiative opinion).

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 8 May 2012.

At its 481st plenary session, held on 23 and 24 May 2012 (meeting of 24 May), the European Economic and Social Committee adopted the following opinion by 144 votes to 30, with 13 abstentions.

## 1. **Conclusions and recommendations**

1.1 The European Union must use every possible means to step up its action within the G-20, the OECD and the FATF (Financial Action Task Force) to eradicate opaque tax jurisdictions as quickly as possible and to oblige Member States to combat the crime originating in many of these jurisdictions.

1.2 The progress made in terms of fiscal governance in international fora, such as the OECD and the G-20, should not prevent the European Union from applying stricter rules making it easier to recover capital moved abroad through illegal activities to the detriment of the internal market.

1.3 The EESC calls on the Union's institutions to adopt measures to prevent abuse of the principle of 'residence' by means of ownership arrangements and fictitious residency, whereby holding companies not actively engaged in business, or bogus companies, allow the owners to avoid paying taxes in their country of domicile. It welcomes the Commission's decision to present a new proposal on tax and financial havens before the end of the year, and hopes that the resistance on the part of a number of Member States to an effective and incisive response to activities geared to avoiding or evading national tax systems will be overcome.

1.4 The Commission has published a proposal for a directive (COM(2012) 85 final) putting forward, for the first time, rules on the freezing and confiscation of the proceeds of crime in the European Union. The EESC strongly recommends including tax-related crime arising from the exploitation of tax havens within the scope of the directive. The proposal comes as part of a broader political initiative aimed at protecting the licit economy from criminal infiltration, and is based on Articles 82(2) and 83(1) of the Treaty on the Functioning of the European Union (TFEU).

1.5 It is common knowledge that tax havens exist in a large number of territories – 44 in all – either linked to a sovereign state or themselves constituting sovereign states. Even when they are not sovereign states, they enjoy substantial administrative autonomy, apply opaque rules on information, tax exemptions and reductions, on the ownership and source of capital and the operation of financial bodies and commercial companies established within their borders.

1.6 It is, in the Committee's view, particularly reprehensible that legal and tax advisors and some consultancies offer to set up legal entities – and indeed advertise such services – in order to use tax and financial havens as a means of avoiding the obligations incumbent upon companies operating in the Union. This applies in particular to their obligations regarding company tax and transparency of company transactions and financing.

1.7 Tax havens distort the internal market: effective EU action is therefore needed that can ensure fiscal justice and prevent destabilising opacity, tax evasion and corruption through tax havens. The introduction of criminal offences in this area should not be ruled out.

1.8 All obstacles to the automatic exchange of bank information must be removed so that the authors of transactions and owners of bank accounts can be easily identified. Multinational companies must be required to draw up statements of account, broken down by country, stating the scale of their activities, the number of employees and the profits made in each country.

1.9 Progress must be made in all these areas, subject to any advances that may be made as a result of global initiatives by multilateral international organisations, especially the UN and OECD. These aims should be pursued in a climate of trust, seeking equivalence of laws and new and higher international cooperation standards regarding tax havens.

1.10 The EESC hopes to see a strategy coordinated with the leading countries, first and foremost the United States, for adopting an approach to regulating this area that is as global as possible. At the same time, however, the EESC emphasises that the difficulty involved in establishing an agreed international plan of action must under no circumstances slow down or delay action by the European Union. European standards, such as those laid down in the European Savings Directive, are among the best in the world. The Foreign Account Tax Compliance Act represents a significant stepping-up of efforts by the United States to increase compliance with the tax rules for US citizens holding foreign financial instruments and accounts. The US tax authorities are calling on foreign financial institutions to 'automatically' notify them of the identities of citizens with business overseas.

1.11 Within Europe, Belgium has very advanced legislation based on the principle of confidentiality in exchange for anticrime policy. Secrecy serves as an alibi for sidelining the tax agenda and the development of an anti-evasion policy.

1.12 Integrated policies must be developed to link up the various areas of work. International accounting standards were designed to protect the interests of investors and markets: the focus must now be on the public interest. The role of the IASB – a private body – needs to be rethought, as does its function in laying down accounting rules, which should be far simpler and readily and clearly comprehensible.

1.13 The EESC deplores the fact that all police, judicial and economic authorities have long been aware that most cases of misappropriating public funds, defrauding public finances and diverting the proceeds to tax havens, concealing assets behind front companies and laundering money if they were not part of a technical and legal set-up that masks these activities, derives a very healthy profit from them and in some cases ends up overseeing them. European Union action is thus called for in this area.

1.14 The EESC calls for a coordinated strategy to step up the fight against tax evasion and particularly against *abusive practices*, and to restrict the right to free establishment in the case of completely bogus businesses set up exclusively for tax purposes.

## 2. **Introduction**

2.1 Tax havens are places where senior executives of the world's largest financial and industrial corporations mix with figures from the artistic or social 'jet-set', together with multimillionaires who combine business with pleasure. They all rub shoulders with somewhat dubious individuals and use the same money that has been gained not only by legal means, but also from crime and economic offences, including even the most serious crimes such as murder, extortion, arms and drugs trafficking, counterfeiting, fraud, embezzlement, trafficking in human beings and illicit gaming. These territories display a number of common features, such as the lack of transparency on how they function and the low levels of taxation for non-residents who, in fact, do not carry out any activity there. This gives rise to harmful competition with a hidden structure, creating a legal status entirely lacking in transparency.

2.2 The question of tax havens must be analysed in terms of three main dimensions: the tax rules and the ensuing opportunities for tax evasion; the opening-up of breaches in the structure of financial legislation with the resulting threat to financial stability; the lack of transparent information with the possibility of criminal activity using havens as a platform. The common denominator of these dimensions, which are respectively overseen by the OECD, the FSB and the FATF, is secrecy or the difficulty of accessing information. Abolishing or curtailing this concealment of information would allow the problems and dangers of tax havens to be significantly diminished. The debate on standards under way within the OECD should continue, with the aim of reducing the burden of the tax and judicial authorities. The real risk is of agreement being reached on standards that are too weak and complex, simply as window-dressing to satisfy public opinion. The simplest solution for dealing with these problems would be automatic exchange of information.

2.3 Tax and finance havens are part of the history of capitalism, with examples dating back as far as the late Middle Ages. The French and industrial revolutions were milestones for speeding up the creation and consolidation of tax havens.

2.4 The phenomenon has now ballooned to massive proportions, having spread to every part of the world – the Pacific, the Caribbean and islands in the Atlantic – since the Second World War, including small and micro-states in Europe. It is estimated that one million companies, and twice that number of trusts, have been set up in the tax, financial and business havens spread across Europe alone. According to Raymond Baker, director of Global Finance Integrity, 619 916 companies are registered in the British Virgin Islands alone, which equates to 20 per inhabitant.

2.5 The current economic scene is marked by the globalisation of the trade in goods and services, the free movement of capital and across-the-board use of new technology applications in international financial transactions and trade. Although most financial institutions have compliance departments, there are not enough rules governing the enormous volume of daily transactions.

2.6 Europe's internal market, the well-being of the financial and commercial market and the sound development of an economy that keeps to the common rules adopted in order to safeguard the general interest must face up to the huge amounts of money salted away in areas and countries of convenience. They are protected by vast interests and are able to corrupt and bend entire governments to their purposes.

2.7 Tax havens introduce distortions at both the macroeconomic and microeconomic levels. As pointed out previously, at the macroeconomic level they can threaten the stability of financial systems. Moreover, the possibility of evading or avoiding tax on real and/or financial investment reduces state revenue, which must inevitably be clawed back through income tax: tax havens consequently distort the proper balance between tax on capital and on labour. At the microeconomic level, distortion occurs between large, small and micro-enterprises: for these three types of actor, the possibility of taking advantage of opportunities for evasion – or at least, for aggressive tax planning – diminishes with their size.

2.8 In the wake of the dual disasters that struck the United States of America – the criminal attacks of 11 September 2001 on New York and Washington, and the financial crisis triggered by the Lehman Brothers collapse in September 2008 – the international community took steps during the first decade of the 21st century to regulate how so-called tax and financial havens work.

## 3. **Tax and financial havens**

3.1 The harmful effects of these arrangements have, in many cases, led to criminal proceedings in relation to the funding of international terrorism and organised crime, tax evasion and money laundering. They have created systemic risks on the financial markets and undermined the founding principles of free competition, amongst others.

3.2 Consequently, as indicated above, steps have been taken around the world in recent years and it has been decided to introduce structures and mechanisms in a joint response to the threat to the national security of states and the well-being of their citizens.

The various international-level decisions taken represent, perhaps, a substantial shift away from the approaches used prior to the agreement reached at the London G-20 summit on 2 April 2009.

3.3 The EESC is in favour of drafting measures to help combat tax evasion and other illegal activities that harm the EU's and Member States' financial interests and to ensure cooperation between administrations via the exchange of information on tax issues. It would also like the EU to be authorised to begin negotiations to reach an agreement with the Swiss Confederation on combating direct tax fraud and evasion and on guaranteeing administrative cooperation via the exchange of information on tax matters.

3.4 Since the G-20 agreement, the analysis and recommendation method – typical of the earlier practice of the bodies and forums tackling this issue – has given way to calls for condemnation of 'non-cooperative jurisdictions', including all tax and financial havens. This includes presenting proposals for unilateral, bilateral and multilateral sanctions, the progressive abolition of banking secrecy and the regular publication of lists of non-complying territories.

3.5 The subsequent implementation of these commitments given by the G-20 has, however, been highly disappointing. A variety of reasons for this have been put forward.

3.6 Many areas have escaped being rated as non-cooperative jurisdictions simply by signing at least 12 bilateral tax agreements between each other (such as the agreement between Liechtenstein and Monaco).

3.7 In brief, exchange of information can be ensured simply by means of a request from the authority applying the relevant measures (tax, criminal law, etc.). The authorities of the territory concerned cannot refuse such a request on the grounds of national interest, banking secrecy or similar.

3.8 It is clear that the bilateral action model is ineffective in these cases; efforts must therefore concentrate on improving international (multilateral) and supranational action.

This is borne out by the report published by the Tax Justice Network on 4 October 2011, which deems virtually all the bilateral agreements signed since 2009 to be of no worth. The organisation has thus drawn up a financial secrecy index based on two criteria: barriers to requests for information from the relevant authorities in another country and the weight of the jurisdictions suspected of opacity in the global financial market.

3.9 Moreover, as pointed out in a number of specialist reports (such as the Global Financial Integrity report), illicit capital flows have continued to rise by more than 10 % annually, with disastrous implications that are, for example, worsening the on-going sovereign debt crises in many members of the international community, notably certain EU Member States.

3.10 Unfortunately, only the EU has outlined a credible framework for action in this area, which it might be added is not adequately implemented.

3.11 A glaring example is provided by Directive 2003/48 on taxation of savings income in the form of interest payments, which covers non-residents (natural persons).

3.12 This is despite that fact that since the directive came into force, systems have been set up for the automatic exchange of information between all the Member States, and agreements have been signed with the four European countries previously considered to be financial and tax havens: Andorra, Liechtenstein, Monaco and San Marino.

3.13 These European countries, however, like Switzerland, have differing ties with the Union, making the application of these conventions a highly complex matter. Liechtenstein, for example, has joined the European Economic Area agreement but is not obliged to cooperate with the respective administrative authorities in civil and commercial judicial matters, because it is not a signatory to the Lugano II Convention of 30 October 2007 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

3.14 It is our hope that this change in legal status will produce the expected changes soon, given the entry into force of the Lisbon Treaty which, in Article 8(2) of the Treaty on European Union and the annexed declaration No 3, provides for the establishment of structural relations with small-sized neighbouring countries.

3.15 The ideal instrument for governing this issue would clearly be a multilateral partnership, in order to bring these non-cooperative jurisdictions together within a single model in a natural geopolitical, legal and economic area.

3.16 Similarly, four Member States have been taken to the Court of Justice by the European Commission for failing to transpose Directive 2005/60 on the prevention of money laundering.

3.17 In order to promote action with a real supranational impact, the EESC should adopt the vigorous line taken by the European Parliament in its April 2011 resolution [1], which included support for stepping up the fight to ensure more transparent information regarding international financial transactions. A whistle-blowing mechanism could also be introduced along the lines of the pardon granted in the area of competition, in order to encourage reporting of such behaviour, rewarding whistle-blowers financially by reducing the penalty they would otherwise pay.

3.18 In addition to this measure, there is a pressing need for agreed G-20 mechanisms to close the offshore legislative loopholes by which the tax laws in the world's main financial centres can be circumvented.

3.19 Even within the strict framework of EU competences, binding ad-hoc rules in the form of secondary legislation must be adopted as a matter of urgency, and should include provisions prohibiting any persons, natural or legal, who control funds or entities domiciled in tax or financial havens from receiving public funds.

3.20 In 2009, the OECD calculated that between USD 1 700 billion and USD 11 000 billion had been placed in these havens. It drew up a list which the G-20 used as a starting-point for a tough confrontation with those states that were not applying any or only some of the international conventions on banking and tax transparency.

3.21 The OECD report raised a storm of protest, in particular from Switzerland, Luxembourg and, of course, Uruguay. The case of Delaware in the United States was hotly debated.

3.22 Americans are well aware that Delaware is a sort of tax haven: almost half of companies quoted on Wall Street and Nasdaq are established in US Vice-President Joe Biden's home state, as they pay lower local taxes and profits are not taxable. Fewer people are aware that this small state, south of Pennsylvania, offers major benefits to offshore companies, presenting itself as an alternative to the Cayman Islands or Bermuda, but those working in the sector have long been in the know. The profits of companies established in Delaware are, on the grounds of transparency, deemed to belong to owners who, if not US citizens and provided the company's business is conducted outside the USA, are not subject to tax in the United States.

(1) European Parliament Resolution of 6 April 2011 on protecting the European Union's financial interests – Combating fraud – 2009 Annual Report (2010/2247(INI)).

3.23 The most important and widespread driving forces for these havens are money laundering, tax evasion, and funds for corruption or for diverting money to own companies. They are the launching pad for attacks on sovereign debts in difficulty, and for large-scale campaigns to protect the untrammelled free movement of capital, drawing in the media, political parties and representatives of institutions.

3.24 Poor fiscal governance encourages tax evasion and fraud and has serious consequences for national budgets and the European Union's own resources system.

3.25 Many multinational companies are structured in such a way as to take advantage of tax avoidance opportunities in the various jurisdictions under which they operate. Different tax arrangements in the various jurisdictions benefit the large, international or well-established companies more than the small, domestic or new companies (in their start-up phase). These tax avoidance strategies are at odds with the principle of fair competition and corporate responsibility. These territories are also used by organisations and companies as operating bases from which to put goods onto the internal market without proper certification of origin or guarantees demanded by the EU: this is seriously detrimental to consumers' interests and sometimes to public health. One such practice is to misuse transfer pricing, setting the prices of transactions within a group by applying evaluation criteria that reflect the group's tax needs rather than normal market conditions.

3.26 Multinational companies certainly have the resources to provide, without incurring a serious administrative overload, public country-by-country reporting on their sales, operating profits, infragroup transactions, pre-tax profits and taxes. If this information were placed in the public domain, the identity of those misusing transfer pricing or pursuing aggressive tax planning would become clearer.

3.27 The absence of fiscal controls or existence of weak prudential oversight, the opacity of information for identifying natural or legal persons or any other legal or administrative circumstance, enable companies operating from these territories to enjoy almost total impunity, unacceptable competitive advantages, and immunity against action by the judicial and administrative authorities of third countries.

3.28 The EESC expressly condemns the role played by tax havens in encouraging and taking advantage of tax avoidance, tax evasion and capital flight. The EU should step up its measures to combat these practices and enforce sanctions.

3.29 The international community, aware of the serious damage caused by the existence of such territories to international trade, the interests of national treasuries, to security and public order and, as shown by the crisis that erupted in 2008, to the very stability of financial systems, has taken a few timid steps towards identifying them and seeking their progressive disappearance.

3.30 The results yielded by the combined efforts of the G-20 and the United Nations, together with the efforts undertaken as part of OECD initiatives, are still not enough to meet the challenges posed by tax havens and offshore financial centres and should be followed up with decisive, effective and joined-up initiatives.

3.31 The action of the G-20, FATF and OECD, amongst others, has however so far only alleviated the grave damage caused by tax and financial havens.

3.32 It is essential to identify those jurisdictions that are not cooperating, assess compliance with the rules, and enforce deterrent measures. Furthermore, the EESC believes that the OECD is not a satisfactory framework for combating tax havens and that it is necessary to improve the indicator used to establish the status of cooperating countries, by giving it a qualitative value. Also, the OECD should not allow governments to be removed from their blacklist simply by promising to fulfil the exchange of information principles without guaranteeing that they will effectively enforce them.

3.33 There are reasonable grounds for stating that the financial crisis has been driven in part by complex and opaque transactions carried out by financial operators domiciled in jurisdictions that maintain financial secrecy, causing serious loss for investors and the purchasers of such financial products. Tax havens host off-balance sheet transactions by financial institutions, as well as complex financial products that have contributed nothing to innovation in the financial sector, but generate financial instability. There is clear evidence that much foreign direct investment, especially in developing countries, comes from tax havens.

3.34 The European Union, mindful of this situation, has on occasion denounced such regimes through various institutional authorities. Unfortunately, it has proved unable to promote a supranational administrative legal framework that would help narrow the scope for impunity.

3.35 The EU's work has centred on abolishing some 100 harmful regimes situated within Member State jurisdictions with scanty financial controls, or externally on third-country territory. In this respect, the European Commission adopted two communications on good fiscal governance in 2009 and 2010, together with a code of conduct. There are also three directives in force, on the proceeds recovered from tax evasion, administrative cooperation, and the taxation of savings (currently being revised). Moreover, the inclusion of clauses requiring compliance with best practices or good governance in the tax field is very widespread in EU association, trade and cooperation agreements with third countries.

3.36 Nevertheless, very little progress has been made because the powers of investigation and sanction lie with the Member States.

3.37 According to banking companies, those US rules have shown that unilateral adoption of this type of measure can create problems for financial institutions due to the incompatibility of the communication, withholding and closure of accounts obligations imposed by the FATCA with EU rules and/or the domestic rules of financial institutions' countries of residence.

3.38 On 4 March 2009, the then British Prime Minister delivered a major speech to the US Congress, urging his ally to join in the common task of creating a globally regulated economic system, and striving against the use of financial resources for personal enrichment only.

Brussels, 24 May 2012.

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