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COVER STORY
TAX EVASION

Under the spotlight

In the wake of the Panama Papers scandal, **León Fernando del Canto** reviews the steps being taken by the EU to combat tax evasion and the use of offshore havens

Tax evasion is a key issue for global citizens and is naturally top of the agenda for tax authorities and officials. Fuelled by public opinion now more than ever, banks and professionals are under fire due to the exposure of many public figures involved in tax evasion, who are unintentionally becoming the featured stars in the media circus. The Panama Papers leak, along with the law firm behind the scandal, Mossack Fonseca, occupied the cover pages for weeks in newspapers around the world.

Following the WikiLeaks scandal, the Panama Papers was one of the top stories dominating social media and the traditional news outlets, pushing politicians towards transparency and, in this case, raising the profile of the problem of offshore tax havens.

That said, a recent report by Reuters revealed that Britain's offshore companies have continued to avoid new transparency restrictions. The new rules on maintaining a register of 'persons with significant control' that were introduced on 1 July 2016 state that British companies need to disclose any changes that have been made to directors or shareholders each year. Despite this, of the 22 companies that were identified by Reuters' research as having to make such disclosures by this point in the year, only one had actually done so. These changes are still new, though, and the government is confident that, in time, companies will adapt to and abide by these new transparency restrictions.

However, in reality, despite the widespread social anger generated as a result of these news stories about transparency rules not being met and issues surrounding offshore havens, there will be very little change to the regulatory framework as the Organisation for Economic Cooperation and Development (OECD) has already taken a strong stance in fighting against the issue of tax evasion.

In 2009, the last remaining European jurisdictions (which included Monaco, Andorra, and Liechtenstein) were removed from the OECD's Committee on Fiscal Affairs' list of uncooperative tax havens. This is because all three jurisdictions agreed to implement the OECD's transparency standards and the set timetable.

New inquiry committee

So, has the Panama Papers just been much ado about nothing? In short, no it hasn't, especially not in the UK. David Cameron's admission that he profited from his father's Panama offshore trust certainly generated a lot of anger in the country. Furthermore, our European neighbours are concerned that almost half of the 214,000 shelf companies represented by Mossack Fonseca were incorporated in the British Virgin Islands alone, while further companies were incorporated in British Anguilla, Crown dependencies and overseas territories such as the Isle of Man, Jersey, and Gibraltar, and the UK itself, as reported by the International Consortium of Investigative Journalists.

As a result, the former chancellor of the exchequer George Osborne is top of the witness list to be called by the European Parliament's newly formed inquiry committee to clarify the UK's involvement with this issue. Earlier this year, Molly Scott Cato, a spokesperson on tax affairs for the Green party in the European Parliament, placed the government under even more pressure when she was quoted questioning 'why we continue to have this bizarre limbo in the overseas territories'. She went on to express her view that 'we need to move into the 21st century and regularise the situation with regards to these overseas territories'.

According to the latest Eurobarometer survey commissioned by the European Parliament, 75 per cent of Europeans believe that the EU should be doing more in the fight against tax fraud. Roberto Gualtieri, a member of the Italian Socialists and Democrats Group and chair of the European Parliament's Economic and Monetary Affairs Committee, went on to highlight the importance of having a proper response in place to effectively tackle the problem and stated: 'We will continue to push member states to strengthen their tax policies, to close loopholes, and to improve coordination at the EU and international level.'

The European Parliament has been quick to respond to this issue by appointing an inquiry committee dedicated to investigating 'alleged contraventions and maladministration in the application of Union Law in relation to money laundering, tax avoidance, and tax evasion'. The newly appointed committee will have almost one year to investigate multinational businesses, public authorities, banks, and other financial institutions, and then to respond to its mandate and make recommendations on new tax policies. The committee is required to submit its final report by 8 June 2017, when its mandate from the European Parliament will expire.

Throughout Europe, there is no doubt that the establishment of this inquiry committee provides some kind of relief to the people who have >>

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>> exerted pressure on those implicated and raised awareness of the issue, especially in the UK. However, in practice, when the inquiry committee's report is submitted next year, it is debatable how much of an impact this will have. It is unlikely that much more will be done, given that the OECD has, for some time now, been fighting hard to tackle tax evasion, while the issue of the UK leaving the EU contributes to the uncertainty.

The committee is a good idea in theory, and a small victory in terms of steps being taken to combat this important issue, but not something that will have a huge impact in practice.

BEPS action plan

More likely to have an effect in reality are the OECD's latest recommendations on tackling base erosion and profit shifting (BEPS). Measures put forward by the OECD's BEPS project were fully incorporated by Directive 2016/1164 as of 12 July 2016, following the work of the European Parliament's special committee on tax rulings (TAXE), meaning that all member states will be required to incorporate its main principles in their tax policies.

However, the EU's deadline for adoption of this directive is 31 December 2018, which leaves some uncertainty as to the formal adoption of the recommendations, depending on when the UK formally exits the EU. Although the UK already enforces many of the suggested policies, Brexit could remove the requirement to enforce the directive into British law, potentially resulting in the recommendations being missed out of legislation, though this is unlikely.

Some of the main steps that the BEPS action plan focuses on include:

- **Addressing the tax challenges of the digital economy:** It is increasingly difficult to talk about an economy that is not digital, as digitisation now extends to almost every aspect of the market. The main challenges facing tax authorities are those related to the physical location of the companies and understanding where the taxable benefits are produced. The aim of the new regulations is to reach a consensus on a multilateral basis to localise business operations – a complex task that will require constant adaptation to the challenges presented by technological advancements.
- **Preventing the artificial avoidance of permanent establishment status:** Closely linked to the digital economy is the growing phenomenon of virtual businesses trying to remain non-resident in the territories in which they operate. Meanwhile, tax authorities are trying to qualify them as 'permanent establishments', a key concept in international taxation referring to the rules that determine the actual presence of the business activities of a company in a country.
- **Requiring taxpayers to disclose their aggressive tax planning arrangements:** This includes re-examining all transfer pricing documentation.
- **Neutralising the effects of hybrid mismatch arrangements:** In all international mergers and acquisitions, hybrid mechanisms are used to combine equity and debt with the purpose of optimising the subsequent extraction of benefits via interest or dividend repayments using various treaties and countries. The new regulations aim to consolidate procedures and rules to prevent the usage of multiple benefits simultaneously in several jurisdictions, and honestly reveal the true nature of each particular operation.
- **Strengthening controlled foreign corporation (CFC) rules:** Tax legislation has been focusing on the issue of CFCs for some time now. The purpose of the CFC legislation and anti-BEPS project is to limit the use of special purpose vehicles (SPVs) which were created with the sole purpose of eroding the tax base.
- **Limiting base erosion via interest deductions and other financial payments:** This aims to counter harmful tax practices more effectively by taking into account transparency and substance. It is also aimed at preventing treaty abuse, such as the establishment of subsidiaries or associated companies in countries with low taxation, the creation of SPVs or artificially shifting income to reduce taxes depending on the treaty, known as 'treaty shopping', or the search for the most favourable tax treaty combination.
- **Re-examining transfer pricing:** All transfer pricing documentation will need to be re-examined, with the aim of ensuring that the results of the prices charged between the different entities of the same business group are in line with the creation of real value in each jurisdiction.
- **Establishing methodologies to gather data on BEPS:** The purpose of this measure is to establish methods for the collection and analysis of data on BEPS and measures to address these issues among member countries. **SJ**

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