EUROPEAN EFFORTS AGAINST TAX EVASION TAKE CENTER STAGE – WHERE ARE WE HEADED?

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OVERVIEW

A globalized economy has been the driving force behind cross-border tax transparency and increased dissemination of tax information in recent years. With the enactment of the Foreign Account Tax Compliance Act ("F.A.T.C.A.") in 2010,[1] the U.S. started a movement towards global reporting requirements targeted at halting tax evasion through the use of tax havens and other means. This effort, which was directed principally at recalcitrant individuals with access to cash generated overseas, has inspired adoption by numerous countries of the Common Reporting Standard ("C.R.S.") as well as consideration of other measures targeted at expanding disclosure and transparency.

Heeding the comments of U.S. multinational groups with operations in Europe, the U.S. Treasury Department has recently moved forward with steps that would allow U.S.-based groups a means of providing country-by-country ("CbC") reporting on a voluntary basis.[2] With the term of the Obama Administration coming to an end, little is known about the future of U.S. participation in the far-reaching B.E.P.S. Action Plan of the O.E.C.D. and cooperation in the implementation of the E.U. anti-tax avoidance directive. It is expected that the next wave of attacks against global base erosion and profit shifting will be led from Europe, as stakeholders face increased pressure from the academic community and the press.

One major factor stimulating the need for change is the Panama Papers revelations by the International Consortium of Investigative Journalists ("I.C.I.J."), a global network of more than 190 investigative journalists in more than 65 countries. Eleven million, five hundred thousand documents were leaked that detailed financial and attorney-client information for more than 214,488 offshore entities created by a Panamanian law firm and various corporate service providers.[3]

Following the release, a committee was empaneled to probe the I.C.I.J. database and suggest regulatory reforms that could be adopted in Panama to prevent the facilitation of tax evasion in other countries. Joseph Stiglitz, a Nobel Prize winner in economics and committee lead for the government of Panama, and several other committee members recently resigned after the Panamanian government failed to publish the committee's report. The report was intended to be a template of regulatory measures to be adopted by jurisdictions in the offshore community.

Despite his resignation from the Panamanian committee, Mr. Stiglitz has continued to make recommendations for adoption by the offshore community. Specifically,

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1 Code §§1471-1474.

2 *E.g.*, T.D. 9773, Country-by-Country Reporting (July 18, 2016).

3 *E.g.*, "The Panama Papers," I.C.I.J.

he has gone on to recommend that noncompliant tax havens should be frozen out of the global financial system and that low-tax jurisdictions should be required to create a publicly searchable registry of companies and beneficial owners.

TAX EVASION – WHO IS TO BLAME?

Among tax authorities, politicians, professors, and journalists in Europe, a consensus is growing that money laundering and tax evasion are facilitated by outdated concepts of privacy rights for beneficial owners and the rights of investors and companies to structure direct investment in ways that are free of all tax, pejoratively called double non-taxation. Under this view, tax planning is conflated with tax evasion, and secrecy and low tax are seen as important factors that contribute to crime and terrorism. Furthermore, it is believed that high levels of global wealth concentrated in limited hands deprive stakeholders, such as governments and nongovernmental organizations ("N.G.O.'s"), of funds to carry out plans for social welfare on a global basis.

Although F.A.T.C.A. put a dent in the wall of secrecy maintained by banks, investment companies, custodial companies, and some insurance companies around the world, pressure for transparency continues to mount. According to some, the blame for the presence of tax havens goes beyond the jurisdictions that impose little or no tax. It falls on European countries that have contributed to evasion through residency rules and the territorial reporting system, which limits taxation to only domestic income and exempts foreign income. The European system encourages individuals and companies to invest money in jurisdictions with favorable tax rules. Locally-generated income is avoided.

This should be compared to the U.S. system, which imposes global tax on citizens, resident individuals, and local corporations. The U.S. has adopted the controlled foreign corporation[4] ("C.F.C") and passive foreign investment company[5] regimes to protect its worldwide tax system. However, whether the C.F.C. regime is effective as a means of protecting the tax base is not entirely clear for large multinational companies. These companies have the capacity to plan around the pitfalls of Subpart F.[6] Moreover, the U.S. system encourages the retention outside the U.S. of accumulated funds from foreign operations in order to defer U.S. tax on a permanent basis.

Recognizing that profits of foreign subsidiaries are locked up outside the U.S., proposals have been offered in the U.S. to enable foreign accumulated earnings to be repatriated on a tax-favored basis.[7] If adopted, the plan is measured as a significant revenue loser for the Federal government – but current law is not raising Federal taxes from large corporations with global operations and locked-up profits. Consequently, potential tax revenue will not be lost if the law is changed. Rather, what is being lost is more akin to a tax wish held by Congress and current administrations.

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[4] Code §§951-960.

[5] Code §§1291-1298.

[6] Code §§951-964.

[7] Kyle Pomerleau, *Details and Analysis of the 2016 House Republican Tax Reform Plan* (Tax Foundation, 2016).

In the U.S., competition among the states to attract companies has led to low state taxes in jurisdictions such as Delaware and Nevada. The European Parliament and several E.U. Member States have even gone so far as to contend that the U.S. facilitates B.E.P.S. by the absence of ownership registries at the Federal or state levels.[8] In this regard, the Financial Secrecy Index, which ranks jurisdictions according to secrecy and the scale of offshore financial activities,[9] lists Switzerland, Hong Kong, the Cayman Islands, and Panama in the top 15 list of secrecy countries. The U.S., Germany, and the U.K. are also part of that top 15 list.

ENFORCEMENT AND TRANSPARENCY EFFECTS ON EUROPE: STEPS NEEDED TO IMPROVE

Tax Competition and Transparency

Those attacking cross-border tax planning point to a series of recommendations by the Independent Commission for the Reform of International Corporate Taxation ("I.C.R.I.C.T."), a panel of N.G.O. leaders and academics, including Mr. Stiglitz. Picking up a battle cry from the E.U. Ruding Committee in 1992,[10] I.C.R.I.C.T. maintains the view that tax competition among countries is leading a race to the bottom. Preventive measures to offset the downward spiral include the following:

- A minimum corporate tax rate
- Elimination of special treatment for foreign companies such as the benefits provided by Ireland to Apple Inc.
- Elimination of tax breaks on profits and other forms of illegal State Aid

I.C.R.I.C.T. believes that taxing corporate profits is economically beneficial since it is an important source of revenue, promotes infrastructure development, and reflects a concept of social justice.[11] It notes that the Code of Conduct Group for Business Taxation has failed to prevent the harmful competition and abuses created by illegal State Aid. Encouragement towards whistleblowers and transparency of tax rulings can offset the effects.

I.C.R.I.C.T. recommends the creation of a Common Corporate Tax Base ("C.C.T.B.") for E.U. countries to resolve patent box conflicts and fix potential transfer pricing disputes. It proposes a two-step legislative approach in which the first phase would implement the C.C.T.B. The base would be mandatory for multinational companies with a turnover of €750 million (approximately $800 million at current exchange rates). The second phase would adopt a Common Consolidated Corporate Tax Base ("C.C.C.T.B.") that involves a formulary apportionment approach to tax sharing among countries.

The C.C.C.T.B. may offer a solution to eliminate transfer pricing disputes. However,

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[8] Beate Erwin and Christine Long, "U.S. on the Blacklist – Is Delaware a Tax Haven?," *Insights* 5 (2016).

[9] "Financial Secrecy Index," Tax Justice Network.

[10] *Report of the Committee of Independent Experts on Company Taxation* (E.U. Commission, 1992).

[11] *Four Ways to Tackle International Tax Competition* (I.C.R.I.C.T., 2016).

it would also require some member countries to transfer tax collected on corporate profits to the treasuries of other countries. Of course, the U.S. experience of formulary apportionment among states suggests that apportionment under a common base is not the panacea anticipated by academics. The base may be standard, more or less, but the tax authority in each jurisdiction is local.

In a separate report, Mr. Stiglitz and Mark Pieth proffer that the following steps are required to eliminate untoward global tax planning: [12]

- The identification of beneficial owners of accounts and companies
- Automatic exchange of tax information
- Supervision of banks and business entities
- Supervision of intermediary service providers such as the legal industry

Common Reporting Standard

On July 15, 2014, the O.E.C.D. approved the C.R.S., which calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. The C.R.S. sets out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as the common due diligence procedures to be followed by financial institutions.[13] To that end, more than 100 jurisdictions have concluded negotiations on the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* that, *inter alia*, enables exchanges of information contemplated by the C.R.S. A signing ceremony will be held in June 2017 in Paris.[14]

The C.R.S. will result in a mass transfer of data and has inspired a bevy of privacy-related concerns. Already, public access to beneficial ownership registers has been found to violate constitutional rights to privacy in France, and similar legal challenges are anticipated in other countries. Hacker access to data regarding family wealth also poses a concern to certain Latin American clients, who have expressed fear of being targeted by kidnappers. Data protection and privacy safeguards must be implemented to prevent hacking.

European Parliament Panama Papers Investigative Committee

The European Parliament has empaneled an investigative committee to examine the role of law firms, banks, and accounting firms. In testimony given on January 24, the panel heard from academics, bankers, and members of the professions. Looking to head off regulation, one witness described an internal code of conduct for professionals; another cautioned about taking the mistaken view that the formation of an offshore company is evidence of criminal conduct. However, witnesses from academia and N.G.O.'s pointed out that the estimated $12 trillion in offshore bank

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12 Joseph Stiglitz and Mark Pieth, *Overcoming the Shadow Economy*, (Berlin, Germany: Friedrich-Ebert-Stiftung, 2016).

13 "Automatic Exchange Portal," O.E.C.D.

14 "Countries Adopt Multilateral Convention to Close Tax Treaty Loopholes and Improve Functioning of International Tax System," O.E.C.D., November 24, 2016.

accounts would be significantly reduced without the active participation of accountants and bankers.

WHERE WILL IT TAKE EUROPE AND THE U.S.?

So, what does the future hold in the next four years?

- A new administration taking office this January will likely emphasize expansion of the domestic economy accompanied by deregulation, as over-regulation is viewed to be a handmaiden of mediocre growth. U.S. participation in B.E.P.S. implementation efforts likely will not be an important part of U.S. international tax policy. Instead, international tax reform will likely move to the front of the line for consideration in 2017 by the White House, Congress, and the U.S. Treasury Department.
- Europe appears to be headed towards more regulation, more transparency, and a greater tax burden in the economy. Academics and professional experts believe that greater tax burdens will inure to the benefit of European economies. The European Commission seems to be in agreement. Tax planning will continue to be vilified.

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Recognizing that the U.S. and Europe appear to be taking divergent paths, only one outcome seems certain. As the U.S. withdraws from multilateral policies that overregulate business and investment, another flashpoint of tension between the U.S. and Europe will be encountered.

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