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EU Blacklisting of Tax Havens

After months of screening global tax policies by the European Council's Code of Conduct Group, the EU has finalised its tax-haven blacklist – a list of non-cooperative jurisdictions for tax purposes, which currently comprises the following 17 jurisdictions: American Samoa, Bahrain, Barbados, Grenada, Guam, Macao SAR, Marshall Islands, Mongolia, Namibia, Palau, Panama, Saint Lucia, Samoa, South Korea, Trinidad and Tobago, Tunisia and United Arab Emirates.

The list is the EU's latest initiative to crack down on aggressive tax avoidance, made more crucial by the recent Panama and Paradise paper information leak.

In addition to the blacklist, there is also a "grey list" comprising a further 47 jurisdictions, including Bermuda, Cayman Islands, Guernsey, Isle of Man and Jersey. These jurisdictions have committed to addressing the deficiencies in their tax systems by the end of 2018 (or 2019 for developing countries) and will be regularly monitored by the EU. The EU has extracted promises from most of those jurisdictions to make changes to their rules; in particular, Jersey, Guernsey, Bermuda and the Cayman Islands have apparently committed to introducing substance requirements, which appears to relate to the EU's concern that these jurisdictions "facilitate offshore structures which attract profits without real economic activity." Whilst it remains to be seen what form this commitment will take, it highlights ways in which jurisdictions on the grey list can avoid being placed on the blacklist in the future. The European Commissioner for Tax, Pierre Moscovici, has called on member states to set a precise timetable to examine the grey-listed countries' commitments in six months.

In determining which jurisdictions were put on the black and grey lists, the European Commission produced a scoreboard under which country jurisdictions were examined against objective economic, financial, stability and tax governance indicators. Risk indicators include transparency and exchange of information, preferential tax regimes and no corporate income tax or a zero corporate tax rate. The European Commission's scoreboard was a first basis for the European Council's Code of Conduct Group to decide which jurisdictions would be relevant to screen in more detail. The European Council's Code of Conduct Group then further measured the transparency of the selected country's tax regime, their tax rates and whether their tax systems encourage multinationals to unfairly shift profits to low tax regimes to avoid higher duties in other jurisdictions.

In order to avoid being placed on the blacklist in the future, all jurisdictions must comply with the EU fair taxation rules, and must not offer preferential measures or arrangements that enable companies to move profits to avoid levies. Companies must also implement anti-profit-shifting measures and meet the transparency standards previously set by the Organisation for Economic Co-operation and Development (the "OECD").

These new measures will have an impact on the conduct of anti-money laundering diligence in circumstances where entities are based in or have significant operations in blacklisted jurisdictions, and to a lesser extent the same is true for operations in jurisdictions on the grey list (that could be put on the blacklist within six to 12 months). The new measures are significant given that tax evasion is a predicate offence to money laundering under EU rules and will also be relevant to any AML risk assessment under the Fourth Anti-Money Laundering Directive. Although sanctions and other penalties have yet to be designated for blacklisted countries, certain dealings with blacklisted countries could raise both tax evasion and money laundering concerns.

The European Fund for Sustainable Development legislation includes reference to the blacklist, and the EU is due to release specific detail on any potential enforcement mechanism in the coming weeks, with one possible penalty being that blacklisted countries may no longer be eligible to receive funds from the EU (save for aid development). Member states are likely to also be encouraged to apply their own enforcement measures in order to add real teeth to being on the blacklist.

However, some critics argue that being placed on the blacklist will have little consequence without being backed by significant sanctions or other financial penalties. Whatever enforcement regime the EU decides on for blacklisted countries, however, reputation damage and a higher level of scrutiny will be inevitable. Moscovici added that the blacklisting regime is an important step, but an "insufficient response to the scale of tax evasion worldwide."

The regime has been further criticised for its lack of transparency and questions about whether or not some countries effectively used their political and economic leverage to keep themselves off the lists, or at least off the blacklist.

Interestingly, EU Member States were not screened as potential jurisdictions to be included on the black or grey lists, and some anti-poverty and fair tax groups have heavily criticised this approach. The charity Oxfam also said the blacklist "has to include at least 35 countries, including notorious tax havens such as Switzerland and Bermuda, in order to be effective…at least four EU countries would be blacklisted if the EU were to apply its own criteria to member states."

International authorities have previously published similar blacklists, but most have struggled for credibility. The OECD's tax haven list published in June 2016 contained only Trinidad & Tobago. Meanwhile, several European jurisdictions already have blacklists, penalising specified low tax jurisdictions. However, these lists are often narrow in scope and do not include major offshore jurisdictions such as the Cayman Islands and Jersey.

Ropes & Gray will continue to monitor developments in this area and provide updates on the regime as they are announced by the Commission. For more detailed analysis of the issues, please contact your usual Ropes & Gray partner. For additional resources, please refer to the Ropes & Gray Risk Mitigation & Management Model webpage.