Tax justice agenda for the Brexit negotiations

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Executive Summary

In this report[i] we argue that the fight against tax havens, tax evasion and tax avoidance should be at the centre of Brexit negotiations.

It has long been clear that the UK is at the heart of the world's largest financial secrecy and corporate tax haven network, which spans its Crown dependencies and overseas territories, and centres on the City of London.

Many of the UK's Crown dependencies and overseas territories operate fiscal and legal frameworks explicitly designed to attract corporate investors. Their fiscal package often includes zero percent corporate income tax rates.

Recent research by Amsterdam University identified the UK to one of two of the world´s major players in channelling the biggest shares of corporate offshore investment. The research illustrates the global network of offshore financial centres and how their roles in attracting foreign capital to, and routing international investments through, tax havens. It shows the UK provides a conduit for 14% of corporate investments that ended up in a tax haven.

The latest Paradise Papers tax leaks scandal shows there is an urgent need for the EU to take defensive action against the UK's pursuit of deepening its role as a global tax haven following its EU departure.

The recent announcement by the European Commission of an investigation into the UK's Controlled Foreign Companies rules (CFC) demonstrates the Commission's understanding of this opportunity.

The EU has also shown its readiness to include the UK's Crown dependencies and overseas territories on the EU blacklist.

While the UK has been a member of the EU, the scope for restricting the UK's tax-aggressive policies has been limited; following Brexit there is no reason to accept this any longer. The reality is that the UK will be in the role of supplicant to the EU in seeking either a European Economic Area (EEA) arrangement or a new Free Trade Agreement (FTA).

The UK has explicitly stated that being one of the world's major tax competitors is a cornerstone of its economic strategy, particularly after leaving the EU. It is clear that the UK sees Brexit as an opportunity to escape EU rules, including in the area of tax competition.

In the past, the UK has blocked progress towards tax justice on two fronts: by watering down legislation as an EU member and by working with its offshore territories. The UK worked along with other member states to weaken the Anti-Tax Avoidance Directive

(ATAD 2) and supported weaker CFC rules. Also, it has been opposing the EU Blacklist of non-cooperative jurisdictions and has not wanted the inclusion of zero corporate tax rates in its criteria.

Although the UK can be taken as one of the leaders in the agenda of public register of beneficial owners for companies, it was not supportive of inclusion of trusts to public reporting. Also, the UK was not supportive to the idea of establishing a Common Consolidated Corporate Tax Base in the EU.

Outside the EU, the UK will no longer have any influence on EU law, which is likely to make faster progress as a consequence. But crucially, the EU can also challenge the UK's tax haven activities as a condition of any close economic relationship to be agreed after Brexit.

The EU should make it clear that the UK's continued right to operate its financial services in the EU would be conditional on ending its role as a centre of one of the world's largest networks of tax havens. In the future status negotiations the EU should request:

1. The UK´s Crown dependencies and overseas territories should comply with the EU´s anti-money laundering as well as financial regulation and transparency standards.

2. The UK should end its zero tax preferential regimes in the UK´s Crown dependencies and overseas territories.

3. The UK should end its other tax practices such as the dubious non-domicile status and to reform its patent box regimes as well as CFC rules.

Also, the EU must take the situation seriously and speed-up its own tax reforms to put its own house in order:

1. The EU Member States must stop blocking progressive tax reforms in the Council. They need to approve quickly public country by country reporting in the EU as well as the EU public registers of beneficial owners for both companies and trusts in order to create more corporate transparency in the EU.

2. The EU Member States need to approve the regulation of intermediaries and their reporting obligation for cross border tax savings schemes as well as to agree on a strong blacklist of non-cooperative jurisdictions.

The aim of any Brexit agreement must be to secure a partnership that is based on stronger regulations and standards on tax cooperation and governance and that advances tax justice to the benefit of all. Ultimately, it is citizens – in the UK, EU and around the world – who bear the cost of tax haven policies.

Introduction

Along with the many political, economic and social challenges for all parties by the prospect of the UK's withdrawal from the European Union (EU), the Brexit negotiations themselves provide several opportunities to secure progressive action. This is especially the case in the area of tax cooperation and governance. The UK has traditionally had a dominant voice and influence on shaping EU policy on financial affairs, particularly those related to international taxation. This is not surprising since historically the UK has been a global trailblazer for creating an open, competitive and low tax environment to attract foreign wealth. The UK is able to do this because it heads the world's biggest financial secrecy and corporate tax haven network, which spans across its Crown dependencies and overseas territories, and centres on the City of London.[ii] The UK has always been fiercely protective of its financial sector; shielding it where possible from perceived damaging changes in international tax policy at domestic EU and transnational level.

However, with the UK withdrawing from the EU, and its influence on EU rules and enforcement diminishing, the remaining 27 member states can take the opportunity to get tougher with the UK on tax standards. The UK may be one of the most obvious member states responsible for driving harmful tax competition and sustaining financial secrecy because of the extent of its formal links to tax havens. But many other member states also adopt harmful tax practices, and maintain financial secrecy. The EU-27 will not be in a strong position to impose stricter standards related to tax governance on the UK if their own houses are not in order. It is in both the negotiating parties' interests – and the interests of tax justice – to make equivalent commitments on improving tax cooperation and governance. The UK Prime Minister Theresa May has already signalled[iii] the government's ambition to increase its tax competitiveness once it has left the EU, which could potentially accelerate the global race to the bottom, resulting in a reduction in vital tax receipts for all EU governments – and not only the UK. An opportunity therefore exist to call for greater tax cooperation across the Union as a response to Brexit, turning a challenge into an opportunity for an agenda that has strong support amongst citizens.

There is an ongoing deadlock in the first phase of the negotiations related to the terms of the UK's exit: the financial settlement, the Northern Irish border, and EU citizens' rights. According to the agreed scheduling, these must be resolved before the negotiators move onto the more substantive second stage – the future relationship – which would include negotiations on tax cooperation. If the second phase commences following the European Council meeting in December as is intended, then there will only be just over a year remaining until March 2019 to negotiate the terms of the future relationship. While the UK has indicated that it accepts that there will need to be a two-year transition period to hammer out the detail and to prepare for full withdrawal, the type of relationship sought is still unknown. In her Florence speech,[iv] Theresa May states that the UK neither seeks a trading relationship based on the European Economic Area (EEA), nor a Free Trade Agreement (similar to that which the EU has with Canada), nor the Single European Market and Customs Union, which it seeks to leave. She instead stated that negotiators should 'demonstrate that creativity, that innovation, that ambition that we need to shape a new partnership to the benefits of all our people'.

While having a degree on nuance this is predictably vague. However, the lack of a blueprint can also open a possibility for all negotiators to secure agreement on a partnership that is based on stronger regulations and standards on tax cooperation and governance that advances tax justice – and 'benefit all our people'. Ultimately, it is citizens – in the UK, EU and around the world – who will bear the cost of policies encouraging tax havens t. When governments are deprived of tax revenues, because not everyone pays their fair share, they are less able to invest in public services, infrastructure or invest in job creation and sustainable and equitable growth. Often the shortfall in revenues is then compensated by governments levying higher taxes, such as value-added tax (VAT), which hit poorer sections of society relatively harder. The result is a wedge driven into society and widening economic inequality.

This report explains the UK's role in facilitating tax abuse, and promoting tax dodging and the race to the bottom in the taxation of corporations and wealthy individuals. It identifies policies where the UK has been involved – with other member states – in either blocking or watering down progress towards tax regulation and governance. It also proposes an agenda for how the Brexit negotiations can secure commitments that will enable and enhance tax justice.

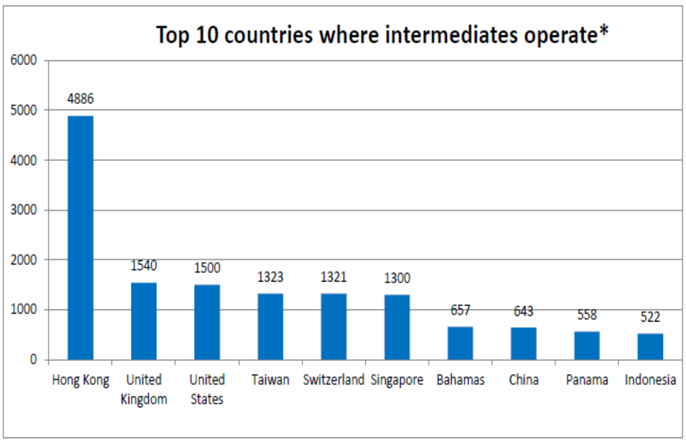
1. How the UK facilitates tax abuse

Promoting a tax environment that is attractive to foreign corporations was an explicit policy choice made by governments in the UK following the financial crash in 2008. However, this did not mark an ideological shift for the UK. Historically the UK has established itself as a place to do business for global corporations and wealthy individuals keen to reduce their tax bills. The theory behind the approach of tax-aggressive economies is that they attract investors and businesses to invest or operate in a country.

The evidence supporting this theory – in particular evidence indicating good quality investment - is patchy at best.[v] Some claim, for example Professor Joseph Stiglitz, that it undermines sustainable growth and widens inequality.[vi] In effect, when tax incentives are used in this way, they create a government trade-off, designed to subsidise large corporations and therefore their owners to the detriment of citizens' social welfare and the provision of public goods. The UK, often with the help of its network of Crown dependencies and overseas territories, and the City of London [vii], offers a preferential tax regime such that a country with an otherwise 'normal' tax system offers special treatment to certain categories of incoming capital. In theory, and in practice, the UK operates as a tax haven.

Recent research reveals the extent to which the UK is enmeshed in the global network of offshore financial centres (OFCs) that operate as vehicles to reduce the tax bills of global corporations and the wealthy. For example, the University of Amsterdam,[viii] identified the world's two major players in channelling the biggest shares of corporate offshore investment: the Netherlands and the UK. The research) illustrates the global network of OFCs, and their roles in attracting foreign capital to, and routing international investments through, tax havens. It shows how the UK provides a conduit for 14% of corporate investments that ended up in a tax haven, while for the Netherlands it is 23%.

Similarly, the Greens/EFA report, *''Usual Suspects? Co-conspirators in the business of tax dodging''* found by analysing data from the various recent tax scandal leaks (Panama papers, Offshore Leaks, Bahamas Leaks)[ix], that the UK was second only to Hong Kong as a favourite base for 'intermediaries' (e.g. banks, accountancy firms, law firms) that operate to facilitate tax dodging using tax havens.[x] It should be noted that Hong Kong is also a former UK British Dependent Territory and historically part of the same financial network.



* note that this figure only includes entries, which can clearly be assigned to one country only.

Tax havens operate by intentionally adopting fiscal and legal frameworks that allow non-residents (individuals or companies) to minimise the amount of tax they pay where they undertake substantial economic activity. The UK's financial services sector, which is based in the City of London and supported by the network of connected tax havens [xi], forms the UK's single most important economic sector.

Over the past decade, the surplus from the UK's trade in financial services has more than doubled to £58bn (€63bn).[xii] The City of London operates as the EU's main financial centre, and like all member states the UK enjoys 'passporting rights' (see box below) to offer financial services in other member states.[xiii] Half of all foreign direct investment into the UK comes from other members of the EU[xiv] and much of it is attracted to the UK because it provides favourable and unfettered access to EU markets.

Why is the UK a tax haven?

According to OECD common features of tax haven policies include some or all of the following:
(i) No or only nominal taxes, (ii) lack of effective exchange of information, (iii) lack of transparency, (iv) no substantial activities. The UK not only provides tax advantages to non-residents 'onshore', but controls or has a direct influence over a global network of 'offshore' territories operating as tax havens. This network encompasses the 14 Overseas Territories, including the Cayman Islands, the British Virgin Islands and Bermuda, and also the three Crown dependencies (Jersey, Guernsey and the Isle of Man), with the City of London at its hub.

Financial services are important because they are Britain's single largest source of export revenue and the biggest contributor of tax revenue – the estimated tax contribution of the financial services sector in 2016 was £71.4bn (£8.4bn of which was paid in corporation tax), contributing 11.5% of total UK Government tax receipts.[xvi] Despite this, research from the Tax Justice Network[xvii] shows that the UK and other EU countries are losing potential tax revenues because of the financial structures and tax rules which facilitate tax dodging and harmful tax competition.

What is ''passporting''?

So called 'passporting' enables firms that are authorised in any EU or EEA state to trade freely in any other with minimal additional authorisation. These passports are the foundation of the EU single market for financial services. Passporting allows EU-based banks to sell products and services across EU borders and to easily establish branches in other EU countries'.[xv]

EU legislation confers the right to 'passport' financial services in the EU and EEA, and passporting rights are critical to the business models of the banks and financial services businesses based in the UK. The UK relies on these rights more than any other member state, because it is the largest exporter of financial services inside the single market. In 2014, it exported over £20bn of services to customers in the rest of the EU, helping to provide hundreds of billions of euros in finance. This trade also supports all those services linked to the financial services sector (law firms, accountancy firms, business support etc.)

The newest research by Professor Gabriel Zucman shows that six European tax havens Luxembourg, Ireland, the Netherlands, Belgium, Malta and Cyprus siphon off a total of €350bn every year. More than €600bn is artificially shifted by multinationals to the world's tax havens each year. The research shows that the US and the bigger European countries including Germany, France, UK, Italy or Spain are the biggest losers. For the UK alone, the bill adds up to about €12.7bn.[xviii]

The UK's "non-domicile" rule: a tax privilege enjoyed by the super wealthy

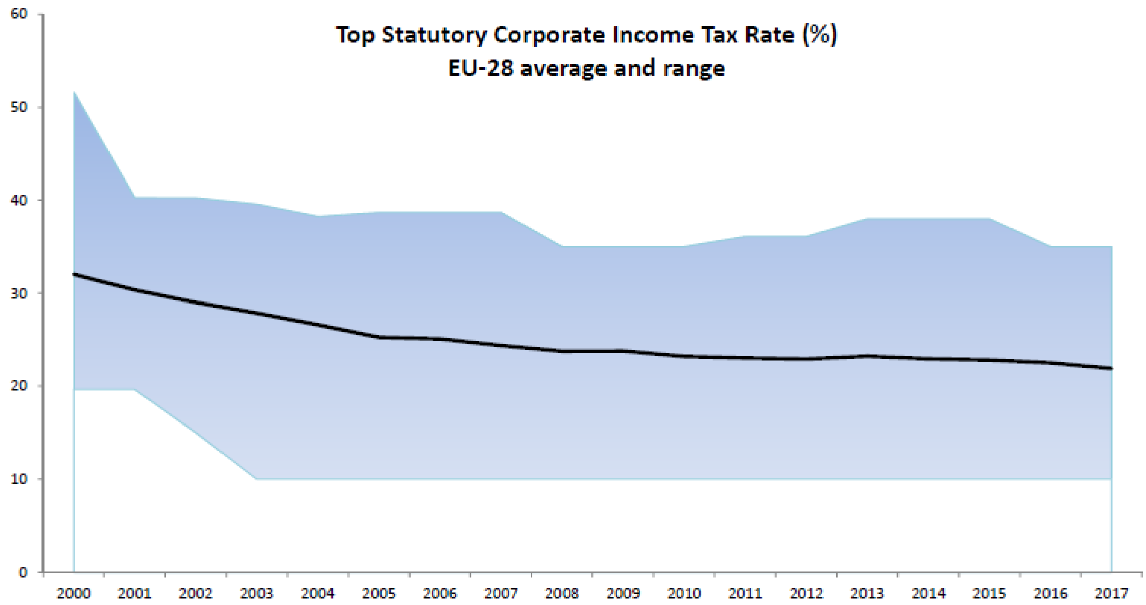
People claiming so-called 'non-dom' status can enjoy some very special tax privileges – making the UK one of the world's most attractive tax havens for certain people who are resident in the UK, but are not treated as domiciled in the UK for tax purposes. Their 'real' or permanent home should therefore be in another country. Non-doms can live in the UK and enjoy all its public services, but are treated as if they are not tax resident in the UK like everyone else who use pay for those services. In simple terms, non-doms are taxed only on the income earned domestically, and not on income earned overseas (although wealthy individuals often shift their income overseas to escape tax). In effect, it gives them a significantly lower tax marginal rate than UK-domiciled individuals.

The non-dom rule is a vestige of the colonial era, which successive governments have failed abolish because they believe it provides the UK with a real competitive advantage when it comes to attracting wealthy individuals. The UK Finance Bill 2017 introduced amendments to the non-dom rule. They include long-term non-doms (resident in the UK for 15 years or more of the previous 20 years) being subject to UK tax on their worldwide income, capital gains and estates. It will also be harder to stop many people being treated as a non-dom. Non-doms continue to enjoy the benefits of a loophole that exempts them from paying tax on profits from commercial property sales.. Additionally, they will get new tax reliefs for rebasing and the segregation of mixed offshore funds. In essence the non-dom rule remains intact.

It is not only global corporations that the UK encourages to benefit from its preferential tax, regime to channel profits to low tax jurisdictions but also wealthy individuals. The UK also offers a scheme within its domestic tax policy for individuals to minimise their tax contributions. One of the most notable of these, for which the UK is notorious, is the 'non-domicile' rules (see the box). Below are just a few examples which illustrate the broader international fiscal and legal framework that is operated by the UK and its dependent territories to shelter illicit finance and tax cheats, limit the tax contributions of multinational corporations and investors, while eroding the tax bases of other countries.

Low corporate tax rates

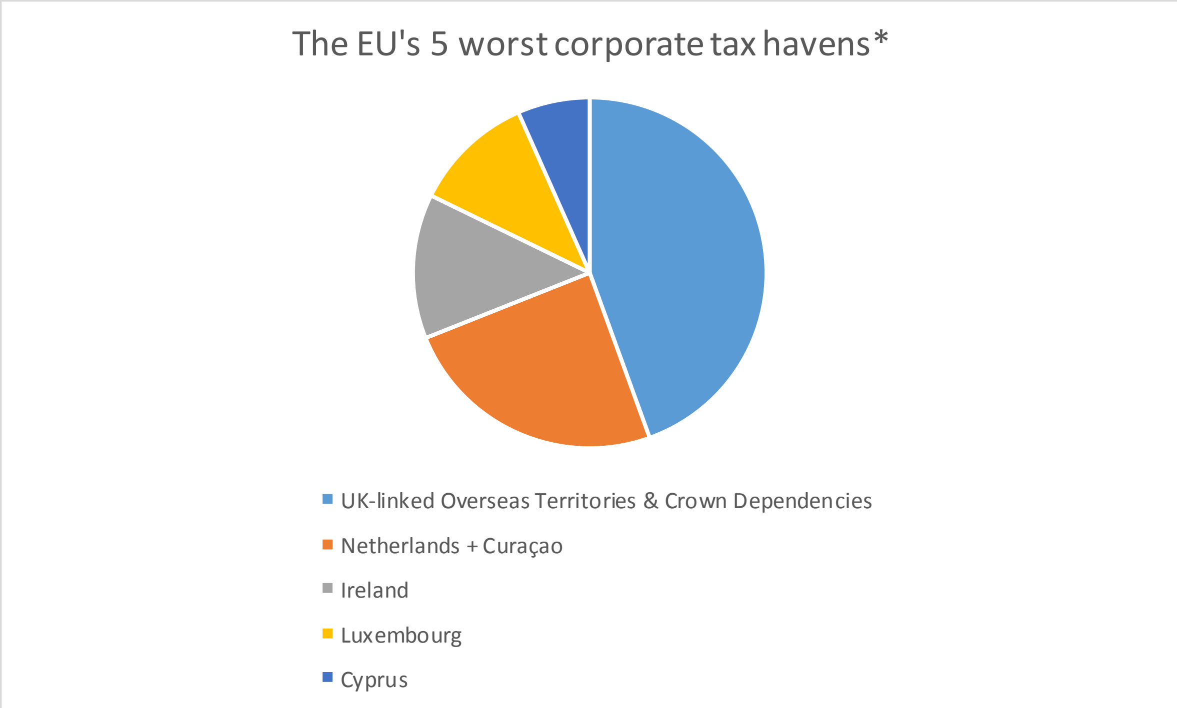
In the 2015 summer budget, the UK government announced legislation setting out a year on year reduction in the corporation tax rate, which will ultimately lead to 3% fall over the five-year period: from 20% in 2015, to a proposed 17% in 2020.[xix] It is currently 19% and will remain so until 2019. The current EU average corporate tax rate is 21.5%.[xx] The UK has the lowest corporation tax rate of the bigger EU member states (based on size of economy and population). Until last year, the consistent combined average rate for France, Germany and Italy for example hovered around 30%. However, both Italy and France have also recently announced corporate tax rate reductions in response to rate reductions by the UK, and other G20 competitors. This is classic example of a competitive race to the bottom in tax rates. (As illustrated by the European Commission´s figure on taxation rates in the EU. See graph below)[xxi]



Further downward pressure on global corporation tax rates is also likely to emanate from the UK if the Northern Ireland Assembly uses its devolved power on corporate tax rate setting.[xxii] The Assembly is considering reducing corporation tax rate to 12.5% in 2020, equivalent to that in the Republic of Ireland. This would be the lowest statutory rate in the G20, and would also mean that Northern Ireland would have the lowest effective average corporate tax rate[xxiii] in the G20. In 2020, the rest of the UK would have a lower effective average tax rate than all other G20 countries. With an effective average tax rate of 15.8%the rest of the UK would rank second to Northern Ireland, together positioned well above main competitors in the EU, such as France (11th), Germany (16th) in the G20 ranking.[xxiv]

However, These ‘onshore’ corporate rates stand well above the zero corporate rates offered by the world’s leading corporate tax havens. Many of the UK’s and Crown dependencies and overseas territories operate fiscal and legal frameworks explicitly designed to attract corporate investors. Their fiscal package often includes zero percent corporate income tax rates. Bermuda, for example ranked first on Oxfam’s list[xxv] of the world’s worst corporate tax havens. The Cayman Islands was second. The chart below shows the top five corporate tax havens in the EU using Oxfam’s methodology for ranking the world’s worst tax havens. They are however not alone in providing zero percent. Many of the UK’s Crown dependencies and overseas territories or that operate as offshore financial centres have zero percent corporate income tax. Oxfam has also analysed[xxvi] the first set of published country-by-country reports of the banking sector which are now required under the EU Capital Requirements Directive. They found that the EU subsidiaries of four US banks made between 87 percent and 96 percent of their revenues in the UK, which is home to the City of London, Europe’s leading financial hub. They reported paying an effective tax rate of just 0.5

percent in the UK - well below the country's statutory rate of 20 percent. The reasons for paying such a low effective tax rate are complex. Deferred taxes, losses carried forward from the financial crisis and possible profit shifting may all contribute to this low rate.



*Expressed in this chart by the relative weighting of the scoring of aggressive tax planning indicators for each jurisdiction.[xxvii] Nine of Oxfam's top 15 worst corporate tax havens are either EU member states, or are linked to EU member states (i.e. the UK and the Netherlands).

The patent box

The UK government was an early adopter of a more tax-aggressive version of the special tax regime for intellectual property revenues, the so-called 'innovation', 'patent' or Intellectual Property (IP) box. The UK Patent Box regime aims to encourage companies to commercialise their patents in the UK. First proposed in 2009, it now forms part of the UK's Corporation Tax Act 2010, and Finance Bills (2012/16). Patent boxes are designed to incentivise firms carrying out innovative patent-based research and development to locate their activity in the country offering the preferential tax treatment for profits based on the research carried out within the jurisdiction.

The UK's patent box was accused (mainly by Germany) of 'promoting unfair [or] harmful trade competition' by being excessively generous. It was said that the regime was 'encouraging companies to artificially shift their profits to the UK to the detriment of other [EU member] states' tax collections.'[xxviii] The UK has agreed amendments to its patent box in response to criticism.[xxix] Companies that opted into the regime prior to 30th June 2016 will continue to enjoy the full advantages offered, as rules will not be applied retrospectively. However, the UK Patent Box will be abolished by 2021. This is in line with the G20's ''modified nexus'' approach to patent boxes. In November 2014, the UK and Germany brokered the "modified nexus" approach, which set out a new approach for patent boxes around the world and was subsequently agreed by the G20 in 2015. This means tax relief will now be restricted to profits generated from IP initially developed within the home country. With this approach the scope for profit shifting is limited but loopholes remain.

The EU[xxx] and the Organization for Economic Cooperation and Development (OECD) have declared that these boxes are liable to result in harmful tax competition by encouraging companies to artificially shift their profits to the country offering the incentive to the detriment of other states' tax collections. This is similar to how the tax haven described above operates. The UK is not the only EU country to have patent box regimes. In 2015, a total of ten EU member states had them, including the Netherlands, Belgium, Luxembourg, and Cyprus.[xxxi] These are all countries which feature prominently in the European Commission's 2015 "*Study on Structures of Aggressive Tax Planning and Indicators"* which identify harmful tax practices adopted by EU member states that allow multinational companies to avoid tax.[xxxii] Ireland recently reintroduced its Patent Box, and Italy has announced it will introduce one, following international agreement on new less distorting parameters for the regime. This demonstrates 'if-you-can't-beat-them-join-them' logic. The UK, however, will always offer the most preferential IP based tax regime for those global patent-based corporations that registered in the UK between 2012 and 2016.

Controlled Foreign Companies (CFC) rules

The UK's tax regime also has loopholes ready for exploitation by corporations seeking to minimise tax contributions. One such loophole exists within the UK's controlled foreign company (CFC) rules (see box below). The main aim of CFC rules is to actually discourage profit-shifting to tax havens. These rules can reduce tax abuse in the country where the company's head office is registered, and when well-designed, can disincentives those companies from shifting their profits out of other countries in which they operate and into tax havens.

In the UK in 2012, HM Treasury changes to CFC rules systematically removed these protections for other countries, and at the same time made it easier for multinational companies to shift profits out of the UK.[xxxiii] The express purpose of doing this was to make the UK 'tax system as competitive as possible'.[xxxiv] In those jurisdictions where there are zero percent corporate tax rates, CFC rules cannot be applied. One of the action items under the OECD Base Erosion Profit Shifting (BEPS) action plan is the strengthening of CFC rules so they are used as a counter measure to profit-shifting. The OECD issued guidelines to this effect. However, due to lobbying on behalf of vested interests - led by the UK[xxxv] - these guidelines are voluntary. Margrethe Vestager, the EU competition commissioner, recently announced she is opening an in-depth investigation into the UK's CFC rules. The special exemption for multinationals may be in breach of EU competition rules by allowing them to pay less tax than domestic-only rivals.[xxxvi]

Changes to the UK’s Controlled Foreign Companies (CFC) rules[xxxvii]

The UK proposed changes in the 2012 budget that would water down Controlled Foreign Company (CFC) rules. Instead of tightening them further to deter British multinational companies from exploiting the low tax rates offered by tax havens, changes made it easier for internal financing arms of multinational to operate in tax havens. Under previous CFC rules, if a multinational shifts its profits into a tax haven to lower its bills anywhere in the world, the UK would top up its tax bill at home, bringing it into line with the standard UK rate. This covered all UK companies, and the rules worked if a multinational is trying to avoid its tax in the UK, or elsewhere. The changes mean that CFC rules only apply if the tax dodge is costing the UK money. They will no longer apply when British companies try to avoid tax in other countries, which will make it easier and more lucrative to do so the lower the UK CIT is. The internal financing arms of multinationals operate in tax havens through a ‘partial finance company exemption’. Under this, only 25% of the profits of the overseas finance company are taxable in the UK, instead of the full amount. A ‘full’ finance company exemption is also available in some situations. The CFC rule changes move the UK away from a ‘worldwide’ tax regime, under which British-based companies are liable to tax on profits made anywhere in the world, towards a more ‘territorial’ regime which taxes them only on profits made in the UK. International organisations like the IMF, the OECD, and the UN have raised concerns about this type of reform’s potential to hurt developing countries. However, the opportunity to tighten CFC rules to ensure they do what they are supposed to do was not taken under the OECD BEPS process because of resistance from its members.

Withholding tax

Withholding taxes are those deducted at source, commonly on interest, dividends, or royalties paid to a company (or person) resident outside that country. Withholding tax at source is designed to stop tax avoidance. The UK, and UK-linked jurisdictions, have been at the forefront of driving the race to the bottom because of an array of schemes not to levy withholding taxes at source on interest, dividends or royalties. In 1999, the then UK’s Chancellor, Gordon Brown (Labour) notoriously blocked plans for a Europe-wide withholding tax of 20% on earnings from savings.

The withholding tax measure proposed in the Savings Directive was designed to stop tax avoidance. Tax authorities in Germany, France and Italy were particularly suffering, as thousands of savers moved their money to accounts in London and Luxembourg, where they do not have to pay tax on interest earned.[xxxviii] Likewise, these member states were used for tax evasion by tax payers from other member states and third countries. The UK government and City of London lobbyists feared losing billions of pounds of investment, claiming the business would move from London to outside of Europe.[xxxix]

Consequently, the EU and many countries have suffered tax revenue losses, and withholding tax on non-residents as a revenue raising mechanism has reduced in prevalence because governments fear losing out on foreign investments. One of the more egregious is ‘dividend stripping’, (see box below) a practice the City of London has been interrogated about over recent years.[xl]

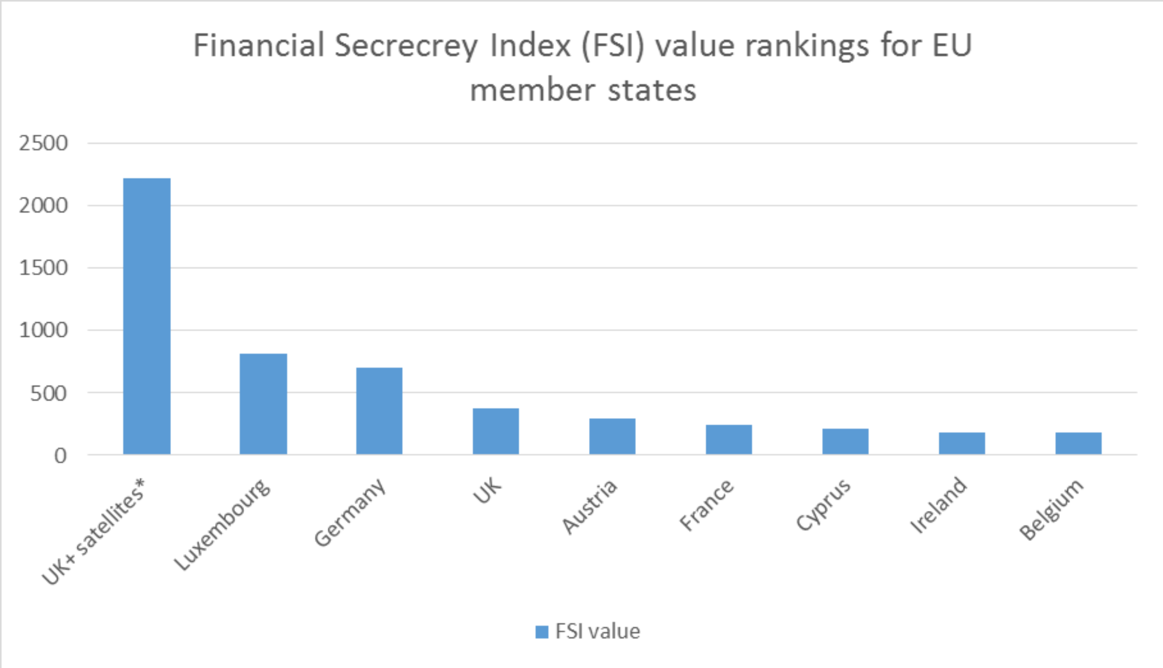
What is dividend stripping?

Dividend stripping usually involves buying a share which is likely to declare a dividend shortly. Once the dividend is received, the share is sold and becomes ex-dividend. This usually results in a short-term capital loss which is available to off-set against capital gains tax. Dividend stripping can be used for tax avoidance when a company distributes company profits to its owners as a capital sum, instead of as a dividend, which offers tax benefits if the effective tax rate on capital gains is lower than for dividends. Dividend stripping can be used for large-scale tax avoidance. For example, it works when a bank or hedge fund lends equities in say often high yielding French, German or Italian companies to another institution, which then passes the equities through a tax haven with withholding tax rate of zero, before returning the equities to the original owner using a subsidiary in another tax haven. In this way, banks can avoid the 15% average withholding tax levied on dividends in European countries and can even claim back tax rebates. European countries were losing hundreds of millions of euros because of the scheme. For example, in the years from 2001 to 2016, taxpayers in Germany reportedly lost at least €24.6 billion due to a method called *cum-cum,* a legally disputed dividend-stripping practice in which a bank assists foreign investors in receiving a tax refund to which they do not have a claim.[xli] In 2016, the German government introduced a draft Bill to shut down *cum-cum* transactions.[xlii]

Financial secrecy

Secrecy jurisdictions offer anonymous company ownership. Financial secrecy facilitates large corruption, money laundering and the hiding of political conflicts of interest. Tax haven secrecy has a significant impact on the ability of financial regulators to identify and mitigate risk in capital markets. Secrecy jurisdictions also do not yet exchange adequate financial information with most other countries. This secrecy shields anonymous owners of companies and trusts from their home countries' tax authorities preventing them from collecting the tax dues from their residents. Overall, the City of London and these off shore satellites constitute by far the most important part of the global off-shore world of secrecy jurisdictions.

According to the Tax Justice Network (TJN), the UK accounts for 17 percent of the global market in offshore financial services. TJN's Financial Secrecy Index (FSI) xliii shows how the UK's network of satellite territories dominate global financial secrecy. Together, they account for nearly a quarter of global financial services provided (in terms of percentage shares of global financial services exports) in one jurisdiction to those not resident in that jurisdiction. If the UK, with the network it directs, were to be treated as a single entity, then this entity would sit at the top of the FSI by a considerable margin (see chart below). The reasons for this are manifold; at the crux is the relationship between the UK's City of London and the dependent territories, and their reluctance to adopt or practice international transparency standards supporting strong financial regulation.



* TJN explains that if the value calculation here for the UK plus satellites was literally treated as one country, then each indicator on the weakest scoring sub-jurisdiction should be assessed. This has not been done to reach this calculation. Instead, two alternatives are offered: "with their average secrecy score of 65.90 (63.62 with the UK) or their lowest common denominator score of 71.27 (Turks and Caicos Islands), the United Kingdom with its satellite secrecy jurisdictions would be ranked first in the FSI by a large margin with a FSI score of 1580 or 2221". This chart uses the higher value option of 2221.[xliv] See results table and its footnote for the UK and satellites here: http://www.financialsecrecyindex.com/introduction/fsi-2015-results

The UK's responsibility for this global financial secrecy network derives from its historic and determined efforts to establish secretive financial services sectors to play host to 'offshore' companies and trusts. The City of London is a tax haven for some financial market instruments, and it is also responsible for the international affairs of a number of Crown dependencies and UK overseas territories that operate as tax havens. London has been the largest and most important centre of Eurocurrency (any currency deposited by any national government or corporation in banks outside their home market) operations since the 1950s. The favourable regulatory environment in London has ensured that international banks continue to carry out a large share of their international lending and deposit-gathering there. Despite the rise of other financial centres London is also the focal point of the Eurobond (denominated in a currency other than the home currency of the country or market in which it is issued) market.

Financial secrecy (for example secrecy on bank account information, or the beneficiaries of assets held in tax havens)[xlv] is damaging for a number of reasons. It helps facilitate the race to the bottom, attracting investment from non-domiciled wealthy individuals at the expense of countries of permanent residence, and as well as facilitating corruption, money laundering, and other illicit financial flows. Financial secrecy also hampers the ability of financial regulators to identify and mitigate risk in capital markets. This contributed to the financial crash in 2007, and needs holding in check given the subsequent volatility of global financial markets. The 'Swiss' and 'Panama' leaks, among others, have exposed now welldocumented cases showing how assets have been sheltered by a network of private banking, legal, accounting and investment industries exploiting the secrecy provided by offshore financial centres, including UK dependent territories and the City of London, on behalf of their clients.

Some examples of how poor financial transparency and regulation is exploited in the UK include:

- In September 2017, the Organised Crime and Corruption Reporting Project (OCCRP) exposed the 'Azerbaijani Laundromat' money laundering operation.[xlvi] The major money laundering and lobbying scheme involved Azerbaijan's ruling elite, European politicians, and a network of anonymous British shell companies. Together they facilitated more than 16,000 covert payments totalling €2.5bn. These partnerships were made up of anonymous companies from other secretive jurisdictions such as the British Virgin Islands, Seychelles and Belize. This allowed those involved to hide the true owners of the UK companies, many of which remain unknown.

- Prince Jefri Bolkiah, ex-Finance Minister of Brunei and the Brunei Investment Agency (BIA) was charged with siphoning €12.5bn out of the fund into his personal bank accounts in the 1980s and 90s. He bought an exclusive property in the heart of London's Mayfair using an offshore company, owned by a Jersey trust. By using the trust to hide his ownership he may have been able to hide the property from the BIA to prevent it from being returned to the Brunei government.[xlvii] Legal battles surrounding this case were settled in Brunei in 2014.[xlviii]

- The case of Madiyar Ablyazov was exposed in one of the dozens of Ablyazov fraud cases[xlix] that reached the UK high court last year. Madiyar was granted a Tier 1 visa in 2009 and then indefinite leave to remain in 2013. Yet his father, Mukhtar Ablyazov, chair of BTA Bank since 2005, was being investigated for fraud - and was later found guilty. Despite the global media coverage of the case, the UK Home Office either did not know about it, or did not take into account, his father and the allegations made against him by the bank.[l] Immigrant investor schemes that fast-track citizenship or residence to wealthy foreign clients, such as the UK's tier 1 visa scheme, protect clients identity making public scrutiny related to beneficiaries' security or financial risk difficult. Due diligence for client risk is not assumed by the bank acting for the client, or the Home Office.

  In 2011, the UK signed an agreement with Switzerland under which Swiss banks would withhold some taxes on undisclosed accounts held by UK taxpayers and remit them to the UK, whilst maintaining the secrecy of account holders. This provided effective immunity for criminals.[li] In 2015, Her Majesty's Revenue and Customs (HMRC) told the Public Accounts Committee that from SwissLeaks data on 6,800 entities it had identified 1,000 tax evaders but had secured just a single conviction.[lii]

UK Overseas Territories and UK Crown Dependencies

The Panama Papers highlighted the role played in the offshore financial sector by some British Overseas territories, particularly the British Virgin Islands (BVI), Bermuda and the Cayman Islands. More than 100 000 companies for which Mossack Fonseca acted as a registered agent were based in the BVI.[liii] The UK Overseas territories comprise of 14 separate jurisdictions overseas territories (see the map by EPRS).

Figure 1: The United Kingdom Overseas Territories

Source: Map produced by Christian Dietrich, EPRS.

The territories are not part of the EU and therefore are not directly subject to EU law. They have an associate status – under Part IV of the Treaty on the Functioning of the EU. Articles 198 to 203 set out the underlying basis of the relationship. The EU Treaties do not contain any specific legal obligations for Member States to ensure the implementation of EU law – including laws relevant to countering tax evasion and money laundering and boosting tax transparency – in their OCTs. However, the special relationship between the Member States and their OCTs is an argument often used to call on the political responsibility of Member States to play a role in this area. [liv] A special case is of Gibraltar, an important centre for financial services including funds and insurance. Its territory is covered by the Article 355 of the Treaty of Functioning of the European Union. EU law therefore applies directly to the territory, but it is excluded from the common customs area.[lv]

Regarding UK Crown dependencies, including islands of Jersey and Guernsey and the Isle of Man, it needs to be noted that these are a separate category with autonomous status and therefore with a different governance structure. The taxation matters such as agreements on tax information exchange within the OECD framework are concluded by their governments directly. In relation to the EU legislation on financial services the status of Crown dependencies is considered that of 'third countries'. [lvi] The UK should take responsibility and pressure heir offshore industry to improve regulation and standards.

Jersey

Jersey is a leading offshore financial centre with a strong banking sector. It applies 0 % corporate income tax and also 0 % withholding taxes. In 2008, Jersey eliminated all taxes for corporations doing business there. No taxes are levied on capital gains and capital transfers [lvii] There is a substantial evidence of profit shifting. It scored the twelfth place on the list of biggest tax havens produced by Oxfam.[lviii]

Guernsey

Guernsey is also a leading offshore financial centre. Guernsey also applies a 0 % corporate income tax rate. There is also no VAT and no tax on capital gains, transfers or general withholding taxes.[lix] Its finance industry includes a banking sector, fiduciary, captive insurance and fund management.

Isle of Man

The Isle of Man is another jurisdiction with a 0% corporate tax rate. The Paradise Papers shed light on the Isle of Man as a leading tax haven. In the past, it introduced legislation that enabled tax dodging by circumventing the EU's Savings Directive.[lx] The Paradise Papers also exposed Isle of Man tax schemes that enabled the super-rich to reclaim VAT for their personal good, such as private jets.[1lxi]

Seven of the UK Overseas Territories are recognized as secrecy jurisdictions. These are Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Montserrat and the Turks & Caicos.[lxii] It should be noted that the offshore financial centres differ in different territories both regarding the size and services provided. Anguilla, Bermuda, the British Virgin Islands and the Cayman Islands are particularly known inter alia for their low tax rate.[lxiii] Also, the latter three of these are considered typical "sinks" financial centres meaning these are territories where the wealth ends (in the contrast to "conduits" such as Netherlands, Ireland or the UK).[lxiv]Despite differences, these offshore centres share common regulatory flaws. There are weak rules in financial reporting and record keeping as well as very limited access to beneficial ownership information and lack of effective penalties. The prevalence of reporting suspicious activity reports is extremely low and incidence of local prosecution even lower. This creates risks of tax evasion and money laundering. [lxv]

British Virgin Islands

With more than 400 000 companies registered, the British Virgin Islands (BVIs) is the main offshore centre for incorporation on the planet. BVI apply 0 % tax rate on corporate income and 0 % withholding taxes. There is a lack of participation in multilateral anti-abuse and transparency initiatives.[lxvi] According to the IMF (2010) these companies hold more the $US600 bn. With a population of 29,500, the BVI averages 30 124 EUR GDP per capita. The financial sector is central to the BVIs' economy, with more than 60% of the BVIs' annual revenue deriving from offshore financial services.[lxvii] The BVI is specialized in domiciles for mutual funds, shipping registration, hedge funds ad captive insurance.[lxviii]

Bermuda

Bermuda is another significant UK´s Oversea Territory with an extensive share of the offshore financial industry. Bermuda also apply 0% tax rate on corporate tax and 0% withholding taxes. There is a lack of participation in multilateral anti/abuse, information exchange and transparency initiatives.[lxix]It recently received a global attention thanks to the Paradise Papers scandal. The scandal is grounded on leaked documents from the prominent offshore law firm Appleby established in Bermuda.[lxx] With population of 65 000 it scores 80 441 EUR GDP per capita. Bermuda focuses on insurance, reinsurance and captive insurance business with financial services providing about 40% of its GDP. It is the world´s the third largest reinsurance centre and the second largest captive insurance domicile.[lxxi]

The Cayman Islands

The Cayman Islands is another leading offshore financial centre. The Cayman Islands also apply 0% tax rate on corporate tax and 0% withholding taxes. There is also a lack of participation in multilateral anti/abuse, information exchange and transparency initiatives.[lxxii] With a population of 58,000 people, it has 55 966 EUR per capita. The Cayman Islands' financial services contribute around 50 % to its GDP. It is also the world´s sixth largest banking centre, specialized in hedge funds and captive insurance companies with banking assets worth 1.4 trillion of US dollars in 2015. The Cayman Islands is the world's leading centre for hedge funds. [lxxiii]

Anguilla, Monserrat and Turks & Caicos

These three territories have much smaller and less developed offshore sectors. Anguilla and Turks & Taicos also are of the low tax rates jurisdictions. Anguilla specializes in the captive insurance market. Monserrat specializes in the banking sector with four offshore banks in its territory. Turks & Caicos on the other hand gained popularity as a domicile for US manufacturer owned offshore reinsurance companies.[lxxiv]

2. UK progress and loopholes on tax financial secrecy

In response to the various leaks of files related to the offshore financial centres, progress has been made at the EU and G20 levels to improve financial transparency. The G8 Lough Erne Summit in 2013 has also contributed to improved tax transparency. For example, new commitments have been agreed to automate the exchange of bank account information between tax administrations to enable monitoring of where residents hold wealth and income, more transparent and detailed information about beneficial owners of assets (companies, trusts, foundations) and increased information exchange, for example on beneficial owners. The UK has delivered on many transparency commitments at home, and in some areas, has made more progress than other EU member states. However, flaws and loopholes still exist in financial transparency that enable circumvention of financial regulation in any state or territory. In the case of the UK, and the network it controls, they include following.

Transparency around the real owners of companies and trusts

Following UK efforts to drive progress on improving international tax transparency at the G8 in Lough Erne in 2013, and the Anti-Corruption Summit in London in 2016, the UK government was the first to commit – and act on - establishing a public register of the real - or beneficial - owners, recording information about who owns and controls UK companies. It has already opened up data held at Companies House, including company accounts and annual returns. The UK is now developing legislation on a new register for the beneficial owners of not only overseas companies but of *any* overseas legal entity owning or wanting to buy property in the UK. While important details are yet to be finalised, the UK has shown leadership across the EU in improving transparency in this area. Establishing central registers (although not yet public) of beneficial owners of companies and trusts are a requirement of the EU's recent 4th Anti-Money Laundering Directive (AMLD).

A further requirement of the directive is establishing a central register of the beneficial owners of trusts. The UK has consistently resisted making the real owners of trusts public. The Panama leaks, and others, have revealed the extent to which trusts are used by the wealthy to hide money. Trusts are used more in the UK than elsewhere in the EU, and form a lucrative part of the UK's wealth management industry. However, despite UK lobbying, trusts are to be included in registers of beneficial owners. The UK is required to implement a central register of trusts by June 2017, which will apply to worldwide trusts with UK assets that generate a tax consequence. The Directive leaves it to each member state to decide the level of transparency to be applied and the UK has confirmed that access to this register will be limited to law enforcement agencies on the grounds of privacy.[lxxv] National registers on the continent would include funds set up in the UK for people based in the EU. Regrettably, though, much of the new transparency regulation bypasses the offshore financial centres hosted by, or with direct links to, the UK. The Corporation of the

City of London, a separate and independent enclave within London that runs its own affairs, and the independent jurisdiction of the UK's Crown dependencies (Jersey, Guernsey, Isle of Man), and Overseas territories (Cayman Islands, British Virgin Islands, Bermuda etc.) have not made the equivalent commitments to the UK mainland on financial transparency. In response to international pressure to improve transparency, UK-linked offshore territories have committed to establish registers of beneficial owners, but they will not be made public.[lxxvi]

Transparency around the real owners of companies and trusts

A further area where relatively good progress has been made to improve tax transparency at both the UK, EU and global levels relates to the automatic information exchange between states' tax authorities. Information is shared between the tax authorities of countries that have automatic exchange of information (AEI) agreements on financial accounts and investments to help stop tax evasion. All EU member states are regulated by the EU Revised Directive on Administrative Cooperation[lxxvii] to improve tax compliance within the EU and with non-EU jurisdictions with which member states have an AEI agreement using the Common Reporting Standard. The Common Reporting Standard (CRS) was produced by the Organisation for Economic Co-operation and Development (OECD), responding to a request by G20 finance ministers.[lxxviii] It sets out the requirements for the information that will need to be exchanged. The UK has also entered into AEI agreements with the Crown dependencies and overseas territories.

There are however a number of flaws and loopholes with the CRS.[lxxix] For example, there are various complexities that provide trusts with ways to circumvent reporting requirements. Beyond those, importantly public registers of companies' beneficial ownership are not a requirement of the CRS. If the register is public, and automatically exchanged with other tax authorities, investigators from around the world, journalists, and civil society are more able to uncover the layers of ambiguous ownership that anonymous companies create. Tax authorities will also be more likely to identify, track and collect tax from residents offshoring their wealth elsewhere. Financial secrecy across the UK's global offshore network is still largely protected by loose regulation.

Public reporting of multinational companies' and intermediaries' financial activities

Exposing cases of corporate tax avoidance is extremely difficult without publicly reported accounts of companies' financial activities in the countries they operate. The EU has responded with legislation that requires European banks,[lxxx] and extractive industries[lxxxi] to undertake country-by-country-reporting (CBCR). Most European banks published their accounts for 2015 in 2016, and domestic country-by-country disclosure requirements for extractives began in the UK[lxxxii] and France in 2016. The European Commission has also proposed[lxxxiii] a directive which, if approved by the European Parliament and Council of Ministers, will require public country-by-country reporting of tax and other financial data by large EU registered companies. The UK government has again taken a lead among many EU partners to prepare for, or transpose these directives into UK law. The principle requiring public CBCR for all large companies operating in the UK, for example, has already been accepted by the government for inclusion in to the UK's Finance Bill. [lxxxiv] Other EU governments, especially Germany, have consistently resisted moves towards greater transparency in CBCR reporting. However, that UK leadership does not extend to acting to unilaterally implement public CBCR,[lxxxv] given the public CBCR negotiations at the EU have stalled. There is therefore currently no date or agreement for public CBCR for all large companies at either the EU or UK levels.

Despite meaningful steps taken at both UK and EU levels, the flaws and loopholes remain in the sector-specific legislation and its roll-out, and the new proposal for public CBCR. On public CBCR for banks for example, analysis of publicly available data is restricted because information related to shell companies set up by bank subsidiaries located in the City of London are excluded from reporting. This is because the reporting is insufficiently detailed to identify which subsidiaries and activities are linked to the City. Banks – and eventually all multinational companies - will need to be required to publish data broken down on a country-by-country basis for each country and jurisdiction of operation, both inside and outside the EU (not only on operations in EU countries and yet-to-be defined tax havens) to close this loophole.

The European Commission has also recently proposed mandatory disclosure rules for intermediaries. Intermediaries (tax advisors, accountants, banks and lawyers) will be required to label or flag to authorities any advice they give to clients that could be considered as enabling cross-border tax avoidance. EU national governments will be obliged to share this information with each other and apply sanctions on any advisers who fail to report the information within five days of providing the advice to clients. The UK has taken a welcome and progressive lead by adopting legislation requiring those who market tax schemes to report them to HMRC since 2004. Portugal and Ireland have similar rules. However, the European Commission's proposals would have tighter requirements than those of HMRC,[lxxxvi] since all EU member states will be obliged to share with each other, and a central directory of avoidance schemes will be created, to which all member states will have access.

3. The role of the UK in weakening 'good tax governance' initiatives at the EU level

In response to the succession of leaks exposing the financial recklessness and murky tax rules that contributed to the financial crisis, EU national budget deficits, and criminal activity, the EU has made some strides in improving tax governance. Various pieces of legislation related to economic and financial affairs have been amended, or new legislation introduced, in an attempt to clamp down on tax evasion, tax avoidance, and harmful tax competition. This has both been initiated by the EU, or as part of G20- (and OECD) led action. The UK has taken leadership at home, within the EU and G20 on many of these efforts; at times being the first to introduce new laws that fight secrecy and tax avoidance. At the same time, the UK has fiercely resisted change to arrangements that benefit vested interests, or has introduced new regimes that exacerbate tax abuse and harmful tax competition. The UK is not alone among the EU (or G20) member states in doing this. Those EU member states that have fiscal regimes characteristic of corporate tax havens (e.g. the Netherlands, Luxembourg, Ireland), or are keen to protect the secrecy of corporations (e.g. Germany) and wealthy individuals, have all worked to water down proposals for more robust legislation.

It has been the UK, however, that has been particularly artful at designing tax schemes that can accelerate harmful tax competition – the UK government's corporate tax road-map[lxxxvii] released in 2010 includes the CFC and Patent Box examples covered above for example. It is the UK that has for decades led the world in designing an array of tax avoidance regimes, supported by the biggest global network of tax havens. It is also the UK that has explicitly stated that being one of the world's major tax competitors is a cornerstone of its economic strategy, particularly after leaving the EU. This section examines some of the areas where the UK (often working with other EU member states) has blocked the introduction of meaningful rules to curb tax abuse and harmful tax competition.

Anti-Tax Avoidance (ATAD) Package

- ### ATAD II Directive

The EU has adopted several legally binding rules, and common actions as part of its tax avoidance package.[lxxxviii] The Anti-Tax Avoidance Directive (ATAD) II was presented by the European Commission in January 2016.[lxxxix] Its purpose was to adopt a common European approach on several aspects of the Base Erosion and Profit Shifting (BEPS) OECD Action Plan adopted by the members of the OECD and G20 in November 2015. It included six actions, including new rules on hybrid mismatches (to ensure companies are not taxed twice (double taxation) for the same activity when operating in different EU countries, and conversely to prevent corporations exploiting national mismatches to avoid taxation altogether (double non-taxation), and Controlled Foreign Companies (CFC) which are a critical counter-measure to profit-shifting. However, the final directive agreed by the Council of Ministers for legislation was far weaker than the already modest proposals from the European Commission.

On **hybrid mismatches**, the Council completely changed the approach by the European Commission proposing member states use the same arrangement for third country where a subsidiary operates. The European Parliament wanted to go beyond the scope of hybrid mismatches covered by the European Commission proposal. Mismatches such as hybrid permanent establishment mismatches, hybrid transfers, so-called imported mismatches and dual resident mismatches, which are not yet addressed in the Anti-Tax Avoidance Directive, should be included in order to minimising opportunities for corporate tax avoidance. The UK, working with Ireland in particular, led within the Council to counter the Commission's proposal with weaker wording. The final text concentrates more heavily on only preventing non-double taxation of corporations, compromising the anti-avoidance intentions of the package.

Moreover, it does not yet address hybrid mismatches with countries outside the EU. Member states were not able to reach agreement on text for this Directive in 2016, with the UK holding out for exemptions for the application of the rules on the financial sector to satisfy the banking sector and protect business carried out in the City of London. This was opposed by Austria, France, Greece, Italy, and the Netherlands. The Netherlands meanwhile is pushing for a delay in the date of implementation from 2019 to 2024, as the new measures would have an impact on the US companies present in the country. However, a number member states are keen to apply rules from 2019. The Directive was agreed in May 2017,[xc] with an exclusion for banks' intra-group instruments, and delays in some provisions of the directive beyond 2019.

Strong **Controlled Foreign Company (CFC) rules** are a critical tool for discouraging profit-shifting to tax havens, which should benefit both developed and developing countries. CFC rules can enable the tax authority of a company's home country to tax the income of the foreign subsidiary if the income of that company's subsidiary abroad is taxed at a low effective rate or not taxed at all. Stronger CFC rules are needed within the EU and between EU countries and countries outside the EU. As part of the ATAD directive, the European Commission proposed new CFC rules, since intra-EU CFC rules did not exist, nor EU CFC rules with third countries. The Commission proposed that a subsidiary (based outside the EU) of an EU company can still be taxed by the EU country in question (if untaxed in the country where the subsidiary is based) to at least 40% of the statutory tax rate of the EU country.

Some member states rejected this proposal and proposed alternatives, including a proposal from Germany to adopt even stronger CFC rules than proposed, while Ireland opposed the introduction of any CFC rules. The UK proposed the EU adopt the UK's CFC model. UK CFC rules are weak (see box above on CFC rules) in that they do not apply to UK companies avoiding paying tax in third countries, and encourage UK companies to operate in tax havens.[xci] In the end, the EU agreed a flexible set of optional CFC rules. They include tax administrations being obliged to prove that profits parked, for example, in Bermuda or the Cayman Islands, are completely artificial. Companies can avoid paying taxes often by simply employing a single person in a tax haven, so this measure can be easily circumvented.

EU tax haven blacklist

Creating an **EU list of non-cooperative jurisdictions ('EU tax haven blacklist')** was proposed as a non-legally binding part of the wider tax avoidance package. Both the EU and the OECD committed to produce tax haven blacklists. Without a clear list identifying the worst tax havens, based on objective criteria, meaningful action can never be taken to counter the role tax havens play to facilitate tax abuse and harmful tax competition. Negotiations on the process for selecting countries – or jurisdictions – to be screened, and guidelines for screening process are ongoing, but are expected to conclude with the publication of an EU blacklist towards the end of 2017. The EU will only assess and list countries outside the EU, despite a number of EU countries own record of practicing as tax havens. A number of member states, most notably the UK, were opposed to the principle of having an EU blacklist altogether. Many of them favour a focus only on criteria related to financial transparency, excluding the many key tax policies that facilitate corporate tax dodging and harmful tax competition, such as zero corporate tax rates.

Nevertheless, the Council assigned the Code of Conduct Group on Business Taxation to develop criteria on three areas: To avoid being blacklisted, third-country jurisdictions will have to comply with 1) tax transparency criteria, 2) fair taxation criteria and 3) OECD's anti-BEPS (base erosion and profit- shifting) measures. EU finance ministers (ECOFIN) have vacillated over the inclusion of a zero or almost zero nominal corporate tax rate in the fair taxation criteria. The UK was reportedly amongst the leading opponents for having the zero rate as a criterion – protecting the interests of its Crown dependencies and overseas territories.

More promisingly, other countries – France, Germany, and Austria – want an 'economic substance test' (assessing whether real economic activity takes place in a jurisdiction, and not the provision of offshore tax structures). This should have zero or near zero corporate tax rate as an indicator. They also want to look at the amount of foreign direct investments in countries as another indicator. The usefulness of the list will also depend on being linked to common sanctions, which should accompany the upcoming blacklist. The final criteria and list is still likely to be more ambitious than the blacklist published by the OECD. It only looks at financial transparency criteria, and rather absurdly includes just one country on its list: Trinidad and Tobago.

Other measures to limit the erosion of member states' tax bases

A further step the European Commission has taken to curb profit-shifting by companies to avoid tax is to re-launch **Common Consolidated Corporate Tax Base (CCCTB).** The CCCTB was originally proposed in 2011 to enhance cross-border trade and simplify the corporate tax system across the EU. Cross-border companies would only have to comply with one, single EU system for calculating their taxable income, rather than many different set of national tax rules. However, the proposal met with resistance from a number of member states, claiming it was too ambitious to harmonise the corporate tax system across the EU. The 2011 proposal also implied a 29th regime, rather than a binding measure, which would not be effective against aggressive tax avoidance. Multinational corporations that adopt aggressive tax-planning strategies rely on separate branches in group in different member states to indebt a subsidiary in a high tax country to pay less in tax. They also exploit mismatches and gaps that exist between the tax rules of different member states making taxable profits 'disappear' by shifting profits to zero to low-tax operations, even if there may be little or no genuine economic or profit-making activity. In October 2016, Commissioner Moscovici breathed new life into the CCCTB proposal, linking it to the EU's overall anti-tax avoidance agenda. The CCCTB is now framed as an initiative to limit profit-shifting across the EU, and ensure profits are shared between the EU member states in which a company is active.

The latest proposal comprises two directives: one on a common corporate tax base (CCTB) and one on a common consolidated corporate tax base (CCCTB), planned for a two-stage roll out. In essence, the proposed (C)CCTB formula splits profits between member states (once the consolidation will be in place), based on three equal factors: labour (payroll and number of employees), assets and sales by destination). Subsidiaries will be considered part of a group. The (C)CCTB will be mandatory for companies with a turnover higher than € 750 million a year. Similar to the 2011 corporate tax harmonisation scheme, the (C)CCTB proposal has met with significant resistance from many member states, concerned that it restricts their flexibility to offer competitive tax regimes to companies. Some fear, for example, that the CCCTB might extend beyond a measure to limit tax base erosion, and evolve to a commitment to a minimum effective corporate tax rate. Corporate tax rate reduction is a tool used by governments to attract business. Global competitive rate reduction is also a contributory factor in the race to the bottom in corporate taxation. Setting a minimum rate would help limit rate competition in Europe – and globally.

Those countries that rely on tax competitiveness as part of their growth strategies – the UK, Ireland, the Netherlands for example – are among the most hostile to (C)CCTB. However, those efforts by Commissioner Moscovici to unblock resistance and find compromises between harmonisation and flexibility has led to some positive movement from some member states.[xcii] An internal report from the European Parliament's Economic and Monetary Affairs Committee in December 2016, speculates that, "While it is expected that the UK would oppose the CCCTB proposal (as was the case for the 2011 CCCTB proposal), the UK's departure from the EU may increase chances of reaching the required unanimity in council – although the UK is not the only member state to have opposed the CCCTB, and opposition from other member states is likely to remain."[xciii]

Under the (C)CCTB, the Commission wants to grant tax allowance for expenses for research and development (R&D) investments. The objective is to at least maintain (and at best enhance) existing **R&D tax incentives**. The OECD's compromise agreement for 'modification' of patent or innovation tax that proved harmful, like the UK's controversial patent box. Rather than calling for their withdrawal from use in members' tax regimes, champions of the patent box (e.g. the UK), seem to have achieved the regularising of their use. The tax allowance for R&D under the (C)CCTB would permanently bind incentives for R&D into EU tax legislation, despite there being little evidence on the link between R&D tax incentives and the impact on innovation. The proposal would however end the misuse of these incentives for profit shifting. Also, under a CCCTB system companies will no longer be able to use national R&D incentives, like patent boxes, which should help prevent the tendency towards more harmful tax competition through innovation related incentives – at least at the EU level.

The CCCTB also proposes the introduction of modest **withholding tax** provision for some interest and royalty payments, which might help to restore some source country taxation powers and limit the erosion of the tax base and help re-establish withholding tax as an anti-avoidance measure. It is likely however that any progress in this area is likely to be met with fierce opposition from some member states, such as the UK, considering it has historically successfully blocked attempts to introduce any withholding tax that would adversely affect business in the UK's financial centre.

Barriers to effective transparency

Despite significant progress in improving tax transparency, loopholes and flaws still exist in tax reporting that are exploited for continued tax avoidance and evasion. For example, data from **public CBCR** on EU-based banks has revealed important information on banks' activities in some tax havens, it is insufficiently detailed to identify which subsidiaries are linked to the City of London. Profit-shifting by banks with activities and subsidiaries linked to the City cannot be monitored, or counter-measures imposed, without that information in the public domain..

Progress towards greater tax transparency for multinational corporations has hit a snag more generally. The process of extending public CBCR to all multilateral corporations may include a significant loophole which could undermine the entire proposal if supported by member states. An amendment voted in the European Parliament[xciv] provides multinationals with a get-out clause that will allow them to avoid disclosing crucial information they consider "commercially sensitive". Member states seem now likely to support weakened reporting requirements for EU multinational corporations. Concerning public CBCR, it is not the UK that is at the forefront of member states in opposition to improvements in EU tax governance; it is Germany, Sweden and others.[xcv] Adopting legislation is also being slowed by several factors including whether public CBCR is a tax issue (which requires Council unanimity) or an internal market issue (which allows Council to vote by means of a qualified majority).[xcvi]

Financial secrecy protecting information about private wealth is also an area where, as already discussed, transparency improvements have been made, but further progress is still required. For example, the Anti-Money Laundering Directive negotiations related to central registers of beneficial owners of companies and trusts were frustrated by protecting national interests. The UK has consistently opposed the proposed wide scope of registration of trusts; and countries led by Germany resisted the public nature of the registry.[xcvii] The UK managed to win concessions in the Council to exclude trusts from the register of beneficial owners following a personal intervention by the former UK Prime Minister, David Cameron. However, the European Parliament amended the proposal to include trusts, countering the concessions on trusts secured by the UK. The UK is likely to strive to limit the level of transparency to the minimum requirement permitted. Nevertheless, the EU may also take Britain's compliance with the new rules into account when evaluating what market access the UK financial services industry should be granted after Brexit.[xcviii]

Tax Justice: An agenda for Brexit

A series of corporate tax scandals, and leaks of documents uncovering hidden billions of private wealth stashed in tax havens, have lifted the lid on the pervasiveness of illegal and 'legal' tax dodging. They also further exposed the flaws, loopholes and lax financial and tax regulation and policing at the global level, and within the EU's own legislative and regulatory framework. The reason for the EU's poor performance in this area is not down to mishap, but the result of political choice. EU governments have chosen to compromise on financial and tax regulatory legislation that on balance continues to protect national commercial and powerful vested interest. Few EU member states are immune to acting to protect these interests, particularly on the vexed issue of taxation. The UK, with a long-established global marketing identity of being highly tax competitive and open for business, and a post-colonial system of offshore tax havens under its jurisdiction, has often been at the forefront of resisting or weakening any regulation that places limitations on a competitive advantage which relies heavily on, and is driven by, its financial services industry.

The EU has nevertheless made some progress in tightening taxation and transparency rules in response to criticism. The anti-tax avoidance package of policy, tightening of anti-money laundering legislation, and new public financial reporting of EU banks and extractive companies' activities all represent degrees of tighter regulation. However, the watering down of proposals to improve the system, and loopholes have been successfully negotiated to protect self-perceived national interests, often the UK's. The fundamental flaws that underpin the EU's common tax system are yet to be fixed. The negotiations on the UK's withdrawal from the EU provides an opportunity for the EU to conclude unfinished business on tax reforms. This is necessary to put an end to the sordid and economically wasteful business of tax dodging by multinational companies and owners of private wealth. It is also in the interests of EU governments to prevent the UK from further extending its unfair agenda. By doing this, the EU will ensure that increasing investment and tax collection in the UK will not depend on the erosion of the tax bases of its European neighbours.

4. Making the most of the Brexit negotiations to ensure EU tax reform serves citizens' interests

As the UK starts the process of withdrawal from the EU, current indications are that the UK government intends to sharpen its edge in tax competition, and rely more on '*beggar-thy-neighbour'*[xcix] tax regimes[c]. Since this is the case, the EU needs to put in place measures to limit tax base erosion across the EU. The EU can take the opportunity of the withdrawal process to strengthen good tax governance at the EU level. In doing so, the EU can also help put a brake on the global race to the bottom in taxation on both corporate profits, and capital and financial assets. It can set the highest global standards in tax rules, financial regulation, and transparency and accountability. It can also create a strong boundary around access to financial businesses within the single market that requires compliance with the relevant aspects of the existing *acquis*.

The UK has also led the way in strengthening some aspects of tax governance, and recognises the benefits of upholding standards and reputation for foreign business and investors, and their consumers. It is in the interests of the EU and UK to adopt an agenda that promotes a race to the top in taxation standards. UK politicians and citizens need to pressure the UK government to ensure they work for tax arrangements under Brexit that do this too.

There are different options of routes and levels of Brexit, and the negotiations are yet to settle on any one scenario for departure. The agenda covers some of the key commitments the EU and UK should make under each Brexit scenario to promote good tax governance that serves citizens, not the vested interests of the minority. The commitments focus primarily on preventing UK-linked tax havens increasing harmful tax competition, rather than EU taxation legislation in its totality.

Basic Brexit scenarios

The UK will remain in the European Single market (SEM) until at least its official withdrawal deadline in March 2019, and possibly during a 2 years transition period. After this date, the different Brexit outcome scenarios are both complex and nebulous. Fiscal and financial legislation brings a more extreme level of detail and technicality, which make forecasting outcomes a difficult business. However, there are four broad scenarios around which different commitments can apply. The basic elements relevant for this agenda are described here, from the most integrated relationship to the least one.

Being part of the European Economic Area (EEA): The UK could however continue to access the SEM if it becomes a part of the EEA. The so-called 'Norway model' (also includes Iceland and Lichtenstein) grants access to the SEM (obliging member to guarantee the four freedoms), but EEA members are also required to implement EU laws without having any say in adopting them. The rules and laws governing the EEA are overseen by the European

Free Trade Association (EFTA). The EEA prohibits discrimination with regard to taxation, but Commission rules on harmonisation of taxes are outside the scope of the EEA Agreement. However, the EEA members are not part of the customs union (therefore they set their own tariffs on goods imported from outside the EU). The UK Prime Minister has, however, ruled out this option.

Association agreement (AA) with the EU: AAs establish an association between the EU and a third country based on “reciprocal rights and obligations, common actions and procedures”. The main difference with the Free Trade Agreement is that it also fosters political dialogue cooperation on foreign policy, and justice and home affairs, the fight against terrorism, and economic and sectorial cooperation. This leads to a more integrated relationship than an FTA and a high degree of inclusion in the single market.

Complete exit from the SEM and EU treaty of functioning of the EU in favour of a free trade agreement with the EU: If or when the UK completely exits the SEM and the EU treaties, it will become a third country and will need to negotiate a free trade agreement (similar to that between the EU and Canada) to forge a trade partnership. Under this option, the UK will not be bound by EU legislation that relates to common matters in taxation or the free movement of capital and financial markets. As a third country, the EU can apply counter-measures on the UK and discriminate with regard to taxation, and *vice versa*. But the EU can make it a condition of any continuing close trading relationship in financial services that the UK meets the *acquis* standards in tax policy or even go beyond it.

The no-deal scenario WTO Model: one cannot exclude a failure of negotiations which would lead to a disorderly withdrawal of the UK from the EU and no particular agreement on the future relationship. In such a scenario, the future trade relationship would rely on WTO rules which would imply, inter alia: no obligation to implement EU legislation relating to the single market and no conditions relating to the free movement of goods, services, persons and capital. This is by far the most problematic scenario. In that case, the EU will be in a very weak position to have any influence on the standards of UK’s tax policies.

An agenda for action

Flaws and loopholes still exist in the EU’s package of measures to crack down on tax evasion and avoidance, and improve financial transparency. For the EU’s efforts to make a meaningful difference, the EU must return to its unfinished business on tax reforms. If the EU is committed to strengthening good governance on tax, it should use the opportunity of the Brexit negotiations to tie up loopholes and flaws in its current initiatives to clamp down on tax dodging and harmful tax competition. The EU should work with the UK to broker a deal that ensures the UK meets those same standards to create a level playing field and not harmful competition. The EU should show its readiness to put the UK and the Crown dependencies and overseas territories on EU blacklist if they do not change profoundly and request an end of the practice of EU non-doms using the favourable tax regimes in the UK.

Also, the EU competition law should continue to apply including fiscal state aid rules and their enforcement mechanism to avoid the UK using tax rules to unfairly subsidise global corporations (as was found in the European Commission's state aid investigations into the tax ruling practices of Luxembourg, Ireland, the Netherlands and Belgium, resulting in four negative verdicts on the tax advantages provided by these countries to multiple companies). The EU should work with the UK to broker a deal that ensures the UK meets those same standards to create a level playing field and not harmful competition. The EU and UK should also make the following specific commitments on tax matters that relate to the UK's withdrawal process from the EU.

EU tax haven blacklist

EU Unfinished Business: The EU tax haven blacklist (EU list of non-cooperative jurisdictions) due out by the end of 2017, should include indicators that **at a minimum** assess 1) tax transparency criteria that include multilateral anti-abuse, exchange and transparency initiatives; 2) fair taxation criteria that include zero per cent corporate income tax, zero per cent withholding taxes; being listed as an offshore centre by the IMF, and it provides only for reduced accounting requirements; and 3) OECD's anti-BEPS (base erosion and profit-shifting) measures. The zero tax rate mentioned is important particularly because the UK, often with the help of its network of Crown dependencies and overseas territories, and the City of London offers a preferential tax regimes such that a country with an otherwise 'normal' tax system offers special treatment to certain categories of incoming capital. Many of the UK's Crown dependencies and overseas territories operate fiscal and legal frameworks explicitly designed to attract corporate investors. Their fiscal package often includes zero percent corporate income tax rates. Bermuda, for example ranked first on Oxfam's list of the world's worst corporate tax havens. The Cayman Islands was second.

EU-UK Brexit commitments: While the UK remains in the SEM (and/or the EEA if that route is followed eventually), the UK and UK-linked Crown dependencies or overseas territories could end up protected from inclusion on the blacklist. However, when the UK exits SEM, the EU should show its readiness to put the UK and its Crown dependencies and overseas territories on the EU blacklist if they do not change profoundly.

Common Consolidated Corporate Tax Base (CCCTB)

EU Unfinished business: The EU's proposals on (C)CCTB are generally to be welcomed, since they represent a step closer towards ensuring that the EU's share of multinational corporations' taxable profits corresponds with the real economic activity taking place within the bloc. However, the CCCTB should be paired with a minimum effective corporate tax rate in Europe to stop competition on tax rates (not just on tax base). Introducing a common corporate tax base must only be the first step for tackling tax dodging in Europe. This policy would also hinder the UK's attempts to reduce corporate taxes to attract European business because it removes EU corporations' ability to shift their income to lower tax jurisdictions.

EU-UK Brexit commitments: It is likely that while the UK remains in the SEM, it would be bound by CCCTB. However, this proposal for a directive requires unanimity. The UK will not support this. Unanimity might be unlikely until all member states see it as an advantageous step once the UK leaves the EU. The EU should seize the advantage of Brexit to pass these rules internally and then impose them on the UK as a third state as a condition of any future FTA. The EU member states should urgently agree on Common Consolidated Corporate Tax Base. It is also possible that CCCTB will come under enhanced cooperation. Joining this enhanced cooperation could be made a condition to access the Single Market.

Controlled Foreign Company (CFC) rules

EU Unfinished business: The EU's approach to CFC rules is too weak, placing insufficient commitments on EU member states to ensure they do not use them to encourage EU corporations to operate in tax havens. Good tax governance measures should require all countries to at least implement strong controlled foreign company rules, which prevent multinationals based in those countries from artificially shifting profits into tax havens. EU companies – not tax administrations - should prove their taxable profits align with the level of economic activity in a jurisdiction operation to demonstrate they have not artificially shifted profits there for tax avoidance purposes.

EU-UK Brexit commitments: Ideally, the EU should ensure that tighter CFC rules form a measure in the anti-tax avoidance package while the UK belongs to the SEM to protect EU members against profit-shifting and base erosion. However, when and if the UK leaves the EU, the EU should show its readiness to put the UK and its Crown dependencies and overseas territories on EU blacklist if they do not change profoundly.

Public Country-by-Country Reporting

EU Unfinished business: EU member states are currently negotiating towards a public CBCR requirement for multinational companies. However, exempting disclosure of 'commercially sensitive' information should not be permitted. It is vital that CBCR information is made public so that countries can access the data (which many will be unable to under the OECD-proposed system), and citizens and civil society can hold corporations and governments to account for their tax practices. The latest proposals presented also need to be improved to ensure that companies publish data broken down on a country-by-country basis for each country and jurisdiction of operation, both inside and outside the EU (not only on operations in EU countries and yet-to-be determined tax havens). All necessary elements, such as intra-group sales, tangible assets, subsidies, and a list of subsidiaries should also be included in reports. The EU should also re-double efforts to unblock delays in the legislative process, to ensure this issue does not get stuck on the 'back burner'. UK must be obliged to meet EU's regulatory standards and financial transparency rules but also that it must take the compliance of UK and its Crown dependencies and overseas territories with the anti-money laundering rules into account when evaluating what market access the UK financial services industry should be granted after Brexit.

EU-UK Brexit commitments: The UK is more advanced than some member states in preparing for public CBCR, and can play a role in encouraging other EU member states to follow its lead. However, the EU should also improve CBCR reporting by including the breakdown for each country of operation to identify the role of financial centres and corporate tax havens (once a blacklist is agreed) to identify how UK-linked tax havens and financial structures are used by companies to avoid tax. With this information, the EU can take measures against the UK (or any other third country) if its tax and regulatory environment is facilitating or incentivising tax avoidance. This will prevent the UK becoming another Switzerland. Also, the EU should not allow any special relation à la Switzerland with the UK. The EU should also take into account that profit shifting by banks with activities and subsidiaries linked to the City cannot be monitored, or counter-measures imposed, without that information in the public domain. The EU should take this into account in negotiations relating to financial arrangements with the UK as part of the trade deal to be struck after its withdrawal from the Union.

Financial transparency

EU Unfinished business: The EU has taken a number of measures to improve tax transparency including adopting the standard for automatic exchange of financial account information, and is considering the establishment of public registers – the achievement of which relies upon compromise from Germany - of beneficial ownership for companies and trusts across all member states as part of the negotiations for the 5th Anti-Money Laundering Directive. However, EU member state dependencies that operate as tax havens have not adopted this full set of measures. The UK-linked tax havens for example, have not created public registers of beneficial owners of companies and trusts. Even where they have automatic exchange of information cooperation agreements with tax authorities in other countries, it is difficult to identify tax dodgers without a public register. The UK itself is also dragging its feet on disclosing information of the real beneficial owners of trusts in the UK. New rules on trusts could still constrain the UK even after it leaves the EU. As discussed above, the European Commission has also recently proposed mandatory disclosure rules for intermediaries. The UK has taken a welcome and progressive lead by adopting legislation requiring those who market tax schemes to report them to HMRC since 2004. However, the European Commission's proposals would have tighter requirements than those of HMRC[ci]. If, the UK opts out of the single market following the Brexit negotiations, but pursues a close future trading, the UK must be required to meet these.

EU-UK Brexit commitments: Since national registers set up in member states would include trust funds set up in the UK for people based in the EU. The EU should take the UK's compliance with the anti-money laundering rules into account when evaluating what market access the UK financial services industry should be granted after Brexit. The new rules on public registers mean the UK trusts cannot continue to operate in secret out of sight of tax authorities. The EU should ensure that the presence of a public register of the beneficial owners and trusts is included as an indicator in the transparency criteria in the tax havens blacklist if it wants to stop EU citizens hiding their wealth in UK-linked tax havens.

EU-UK Brexit commitments for 'passporting rights'

The commitments the EU and UK make to each other on tax governance and cooperation depend to a large degree on the outcome of the negotiations of 'passporting rights'. The EU could make the UK's continued right to operate its financial services in the SEM and/or the EEA conditional on meeting the EU's regulatory standards and financial transparency rules. With the UK being in a weaker position to water-down legislation that it sees as harming its interests, EU regulations should become more stringent. However, the City of London appears to favour seeking regulatory 'equivalence', which does not require both sides to mirror each other's rules and legislation. There is no agreed definition of equivalence, and no equivalence provision within EU laws in areas like commercial banking or primary insurance, which allows the Commission considerable room for manoeuvre when deciding whether to allow that certain financial activities and products can be allowed into the EU market under equivalence rules. Moreover, equivalence does not provide a strong foundation for long-term investment plans. This leaves open the possibility of the EU forcing the UK to implement rules it does not like, in order to remain equivalent.[cii]

If the EU is committed to strengthening good governance on tax, it should use the opportunity of the Brexit negotiations to tie up loopholes and flaws in its current initiatives to clamp down on tax dodging and harmful tax competition. The EU should work with the UK to broker a deal that ensures the UK meets those same standards to create a level playing field and not harmful competition. The EU should show its readiness to put the UK and its Crown dependencies and overseas territories on the EU blacklist if they do not change profoundly and request the end practice of EU non-doms using the favourable tax regimes in the UK. Also, the EU competition law should continue to apply including fiscal state aid rules and their enforcement mechanism. The EU should work with the UK to broker a deal that ensures the UK meets those same standards to create a level playing field and not harmful competition.

5. Conclusion

As the UK Prime Minister Theresa May has already signalled the government’s ambition to increase its tax competitiveness once it has left the EU, which could potentially accelerate the race to the bottom, **it is clear that the UK sees Brexit as an opportunity to escape EU rules, including the area of tax competition.**

UK’s record in the EU shows that it was also keen to use different instruments to compete with others through aggressive tax policy or blocking important policies. In the past, **the UK has blocked progress towards tax justice on two fronts: by watering down legislation as an EU member and by working with its offshore territories.**

Outside the EU it won't be able to do the first. The EU can block it in doing the second as a condition of any future close economic relationship. But for that EU needs to take the tax agenda in the Brexit negotiations seriously. The reality is that the UK will be in the role of supplicant to the EU in seeking either an EEA arrangement or a new FTA.

The EU should make a clear that the UK’s continued right to operate its financial services in the EU would be conditional on ending its tax havens business. Also it will have to meet the EU’s regulatory standards and financial transparency rules. Also, the EU should take the compliance of UK and its OCT’s with the anti-money laundering rules into account when evaluating what market access the UK financial services may have.

Also, the EU should take the Brexit as an opportunity get its own house in order, and complete its unfinished business in improving tax governance homework. The Member states should urgently agree on Common Consolidated Corporate Tax Base also in order to hinder the UK’s attempts to reduce corporate tax to attract European companies, and quickly approve on the public CBCR reporting and stronger CFC rules.

The aim of the Brexit agreement must be to secure agreement on a partnership that is based on stronger regulations and standards on tax cooperation and governance that advances tax justice and ‘benefit all our people’. Ultimately, it is citizens – in the UK, EU and around the world – who bear the cost of tax haven policies.

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[xc] http://data.consilium.europa.eu/doc/document/ST-6661-2017-INIT/en/pdf
[xci] https://www.actionaid.org.uk/sites/default/files/doc_lib/collateral_damage.pdf
[xcii] France and Germany announced their intention to draft a joint roadmap by July 2017 for further eurozone integration, in particular through corporate tax harmonisation.
[xciii] Impact of the UK withdrawal on Econ areas of competence, and dated 13 December (declassified/classified?), in https://www.theguardian.com/business/2017/feb/01/eu-brexit-deal-city-leaked-report-european-parliament-article-50
[xciv] https://transparency.eu/cbcr-ep-vote/
[xcv] https://www.bna.com/germany-others-question-m57982070292/
[xcvi] http://taxinsights.ey.com/archive/archive-news/european-parliament-votes-in-favor-of-public-country-by-country.aspx
[xcvii] http://www.taxjustice.net/wp-content/uploads/2013/04/Recent-progress-shell-cos-trusts-cbcr1.pdf
[xcviii] https://www.ft.com/content/0107db1a-fa92-11e6-9516-2d969e0d3b65
[xcix] **beggar-thy-neighbour** policy is an economic policy through which one country attempts to remedy its economic problems by means that tend to worsen the economic problems of other countries.
[c] https://www.welt.de/english-news/article161182946/Philip-Hammond-issues-threat-to-EU-partners.html
[ci] https://www.theguardian.com/business/2017/jun/18/european-commission-to-crackdown-on-offshore-tax-avoidance
[cii]https://www.ft.com/content/61221dd4-d8c4-11e6-944b-e7eb37a6aa8e