TAX HAVENS UNDER "STANDSTILL" AND "ROLLBACK" INSTRUCTIONS OF THE EU

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ABSTRACT

The European Union through its Code of Conduct for Business taxation urged its Member States and their associated territories to reshape their national tax legislations in order to tackle harmful tax competition. The two English Channel Islands (Guernsey and Jersey) and the Isle of Man, formerly known as "tax havens", had to amend their tax laws in order to become compliant to the provisions of the Code. The aim of this paper is to present a case study on the evolution of the three island's tax systems departing from the harmful measures which were not within the spirit of the EU's Code of Conduct and reaching the implementation of the "zero-ten tax system". An important result of the research performed on this evolution reveals the EU's position towards the 0% tax systems: these tax regimes are not condemned nor forbidden as long as harmful tax practices are eliminated.

Keywords: Tax haven, OECD, European Union, Guernsey, Jersey, Isle of Man

1. Introduction

Apart from the benefits presented by the process of globalization, among which we can mention: the integration of the markets, the technological development and the increased movement of human and capital resources, both individual economies and international organizations were put en garde in respect of reducing the negative aspects that might arise in the absence of a close supervision and coordination of the internal processes and outside influences.

In the context of globalization consideration has been given to the tax havens which have gained increasing importance since the mobile capital tends to be directed towards the low tax jurisdictions. In this case the problem relates to the potential harmful tax competition which could unbalance the states' budges and erode countries' tax basis. Concrete action in this respect was taken both by the European Union (EU) and the Organization for Economic Cooperation and Development (OECD).

In order to create better tax coordination at the level of the Community and a level playing field in the area of taxation, The European Union introduced in December 1997 the Code of Conduct for Business Taxation, which aimed at reducing distortions in the single market, preventing significant loss of tax revenue and helping states in creating tax structures that encourage employment (Official Journal of the European Communities, 1998). In this context both Member States and their dependent and associated territories had to adopt these principles and review their tax policies in order to eliminate any harmful measures. Assistance in this respect was to be accorded through the establishment of the Code of Conduct Group in 1998.

The OECD also had its standpoint in this tax matter. It was the most fervent opponent to the fiscal legislation promoted by the tax havens and addressed the two major problems found at these systems: the lack of transparency and exchange of information. In 2000 the organization published the list of the world's tax havens. Soon after this publication, the black listed jurisdictions took rapid steps in order to become tax compliant and to adopt the internationally agreed tax standards. The latest OECD's progress report from the 5th of December 2012 reveals the fact that at the moment there are only two jurisdictions that meet the tax haven criteria: Nauru and Niue (OECD, 2012).

The British crown dependencies: Guernsey, Jersey and Isle of Man were among the listed territories presented in 2000 by the OECD under the tax haven headline. Yet, commitment letters had been sent and adjustments in the key areas of transparency and exchange of information had been made in order for their fiscal administrative authorities to have tax information that was available, that could be accessed and exchanged upon request.

Having the status of dependent territories of The United Kingdom, the tax legislation of these islands had to be compliant to the principles of the EU's Code of Conduct for Business Taxation. Therefore, their tax legislation had to pass a review process of the EU's Code of Conduct Group and amendments had to be made in order to eliminate the harmful tax measures.

The first part of the paper introduces tax havens from two points of view: the specialty literature perspective and the OECD's perspective. The second part presents the Code of Conduct for business taxation within the framework of the EU's tax policy strategy, while the third part stands to bring a comprehensive presentation of the three British crown dependencies in terms of their tax system's development and the elimination of their offshore sectors. The conclusion comes to stress the idea that the European Union recognizes the fiscal sovereignty of each state and territory and it does not oppose the zero tax legislation, yet it imposes the alignment of these fiscal systems to the international standards in order to eliminate any harmful tax competition.

2. Tax havens today

According to Dharmapala and Hines (2009) tax haven jurisdictions present the following characteristics: Small countries, predominantly islands, with a population below 1 million; Good communication infrastructure; Few natural resources; British legal origins with English as an official language; Parliamentary systems; Proximity to the large capital-exporter countries; More affluent than other countries as they attract significant foreign investment due to the low tax rates and opportunities for tax avoidance; and High-quality governance institutions that can be translated in political stability, government effectiveness, rule of law and control of corruption. These country's features are important guidelines in the investment decisions since they provide credibility and assurance of a safe business environment. Another definition provided by Hines (2005) presents tax havens as locations with very low tax rates and numerous tax incentives meant to attract investors.

Since the position of the tax havens has been questioned in relation to the effects they generate on a world-wide basis in terms of tax competition, a lot of attention has been focused on them. According to Hines (2005) these territories have attracted massive foreign investment and they have registered important growing rates in the last 25 years due to the very attractive fiscal systems. In terms of the profit shifting opportunities for the multinationals, Krautheim and Schmidt-Eisenlohr (2011) see tax havens as providing numerous tax planning options. Contrary believes also arise: on one hand tax havens are considered to divert activity from the high tax jurisdictions and create a tax competition that will eventually lead to a race to the bottom (Slemrod, 2004), on the other hand Desai, Foley and Hines (2006) provide evidence that tax haven's operations enhance activity in the nearby high-tax jurisdictions.

2.1. Tax havens under The OECD's supervision

The Organization for Economic Cooperation and Development (OECD) was the first to set the criteria in identifying tax havens. The report called "Harmful tax competition", released in 1998 presented the following characteristics of these territories: no or only nominal tax rates; lack of effective exchange of information; lack of transparency; and no substantial activities (OECD, 1998).

The aim of this report was to bring forward the potential threat posed by these tax systems to the other national economies in the context of globalization. The main two areas of concern were: the lack of effective exchange of information and the lack of transparency. The nominated territories meeting the tax haven criteria were required to make commitments to meet the internationally agreed tax standards.
The key principles in the area of transparency and exchange of information for tax purposes were based on: the implementation of a mechanism for the exchange of information for tax purposes between countries upon request; the strict confidentiality of the information exchange; the access of the state to reliable bank, ownership identity and accounting information and the power to exchange such information upon request (OECD, 2009). Although commitments for adherence to the tax standards had been made, their implementation differed from one state to another. The signing of agreements: Double Taxation Conventions (DTC) or Tax Information Exchange Agreements (TIEAs) that provided for the exchange of information upon request with at least 12 OECD countries was considered a good indicator of the fact that the nominated states had implemented the tax standards. The Progress report from the 5th of December 2012 presented the stage of implementation of the standards in terms of tax treaties signed between the countries. The new listing revealed only two stats left to meet the tax haven criteria – Nauru and Niue – (OECD, 2012).

3. EU's tax policy strategy

"National governments are responsible for raising taxes and setting tax rates. The amount of tax you pay is therefore decided by your national government, not the EU" (EU taxation, 2013) is the welcoming paragraph found under the Taxation headline on the EU's website. The principle behind this statement is found in the EU's tax policy strategy and it emphasizes the fact that Member States detain the fiscal autonomy of choosing the tax rates they think fit to respond to their internal necessities, but they are conditioned to respect Community's rules. At the same time the EU considers the harmonization of the Member State's tax systems neither necessary nor desirable (Commission of the European Communities, 2001).

Yet, given the effects of globalization, which can be translated in intensified trans-border operations, access to new markets and high capital mobility, the EU considered the need for a tax policy review while taking into account an aspect which triggered concern: harmful tax competition. To address this issue the Code of Conduct for Business taxation was introduced in 1997 in order to promote a fiscal climate that enhanced fair tax competition.

The European Union is also a promoter of good governance in the tax area which encompasses the principles of transparency, exchange of information and fair tax competition (Commission of the European Communities, 2009). In designing these principles consideration was given to the need to fight cross- border fraud and evasion while protecting the Member State's tax bases against erosion.

3.1. EU's Code of Conduct for business taxation

Acknowledging the threat posed by the harmful tax competition, the EU found it necessary to create a Code of Conduct whose scope was to cover business taxation and to fight the measures that affect the location of business activity in the Community. The following measures were considered to be harmful under the provisions of the Code:

"1. whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or

2. whether advantages are ring-fenced from the domestic market, so that they do not affect the national tax base, or

3. whether advantages are granted even without real economic activity and substantial economic presence within the Member State offering such tax advantages, or

4. whether the rules for profit determination in respect of activities within a multinational group of companies depart from the internationally accepted principles, notably the rules agreed upon within the OECD, or

5. whether the tax measures lack the transparency, including where legal provisions are relaxed at administrative level in a non-transparent way." (Official Journal of the European Communities, 1998)

The Code of Conduct Group was established in order to assess the harmful tax measures of the Member States and to draw attention on the need to make corrections in order to eliminate them. Progress in this respect is reported under the Standstill and Rollback status.

Under the standstill status the Member States commit not to introduce new tax measures which are harmful and they will respect the principles underlying the code when determining new tax policy. The rollback status means that Member States need to re-examine their tax policies and establish new practices taking into account the provisions specified by the code (Official Journal of the European Communities, 1998).

The provisions of the Code were also extended to the tax legislation of the Member States' dependent or associated territories.

4. Guernsey, Jersey and the Isle of Man

The two English Channel Islands (Guernsey and Jersey) and the Isle of Man are self-governing dependencies of the British Crown. They are neither part of the United Kingdom (UK) nor The European Union (EU). Yet, the UK is responsible for the islands' international affairs and defense, while the relation to the EU is governed by the terms of Protocol 3 to the UK's Act of Accession 1972. This protocol places the three islands within the Common Custom territory of the Community and the Common External Tariff of the European Economic Community (States of Guernsey, 2013).

In terms of taxation the three islands are fully autonomous, yet their fiscal system must convey to the OECD's internationally agreed tax standard and to the EU's Code of Conduct for business taxation.

4.1. Testing the islands' tax haven status

According to Dharmapala and Hines' (2009) features of tax havens, the two English Channel Islands (Guernsey and Jersey) as well as the Isle of Man meet many of the characteristics:

- The Bailiwick of Guernsey is made up of a group of islands located in the English Channel; It is the 26th smallest country in the world; It is geographically closer to France than to The United Kingdom but it is dependant to the latter. It has a population of 65.000; It has few natural resources and the economy is dominated by the finance sector which accounts for 48% of the GDP; The legal system has English Common law influences; English is the official language (OECD Guernsey, 2013);
- Jersey is also an island located in the English Channel, in the proximity of the coast France; It's population is estimated at 99.000 (States of Jersey, 2013); It's legal system has common law influences; It's economy is dominated by the financial service industry which produces half of Jersey's total economic activity (OECD Jersey, 2013); It has a world-wide transport network, excellent telecommunication coverage and world –wide IT infrastructure (Jersey: Open for Business, 2013);
- The Isle of Man is located in the Irish Sea; It has a population of 84.497 (Isle of Man, 2013); English is the official language; Its legal system is based on the common law principles; The Queen of England is the head of state; Its economy relies heavily on the financial sector which accounts 60% of the GDP (OECD Isle of Man, 2013);

At the same time both the former offshore sector characterized by the tax exempt juridical structures and the later introduction of the 0/10 tax system, have favored the inflow of capital and investment in the islands. The low tax status of the three territories can be considered a major incentive.

In respect of the criteria set by the OECD in 1998, the three islands were listed under the tax haven headline in the OECD's Report from 2000 (OECD, 2000). The Isle of Man was the first among the three to send the Commitment letter to the OECD in December 2000, claiming adherence to the tax principles and two years after, in February 2002, both Guernsey and Jersey initiated the same action. The OECD's Progress Report from December 2012 (OECD, 2012) placed the three states under the white listed jurisdictions since they had met the minimum threshold of 12 tax treaties being signed. Up to the moment the Isle of Man has established exchange of information relationships with 81 jurisdictions (Exchange of Tax Information Portal – Isle of Man, 2013); Guernsey with 57 jurisdictions (Exchange of Tax Information Portal – Guernsey, 2013) and Jersey with 41 jurisdictions (Exchange of Tax Information Portal – Jersey, 2013).

Regarding the degree of implementation of the internationally agreed tax standard in terms of transparency and exchange of information for tax matters, the Peer review Reports from November 2013, reveal the islands' progress as presented in Table no.1.

Objectives	Guernsey	Jersey	Isle of Man
Jurisdictions should ensure that ownership and identity information for all relevant entities and arrangements is available to their competent authorities.	Compliant	Compliant	Compliant
Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements.	Largely compliant	Partially compliant	Compliant
Banking information should be available for all account-holders.	Compliant	Compliant	Compliant
Competent authorities should have the power to obtain and provide information that is the subject of a request under an exchange of information arrangement from any person within their territorial jurisdiction who is in possession or control of such information	Compliant	Largely Compliant	Compliant
The rights and safeguards that apply to persons in the requested jurisdiction should be compatible with effective exchange of information	Compliant	Compliant	Compliant
Exchange of information mechanisms should allow for effective exchange of information	Compliant	Largely Compliant	Compliant
The jurisdictions` network of information exchange mechanisms should cover all relevant partners	Compliant	Compliant	Compliant
The jurisdictions` mechanisms for exchange of information should have adequate provisions to ensure the confidentiality of information received	Largely Compliant	Compliant	Largely Compliant
The exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties	Compliant	Compliant	Compliant
The jurisdiction should provide information under its network of agreements in a timely manner.	Compliant	Compliant	Compliant

Table no.1: Degree of Implementation of the Internationally Agreed Tax Standards (OECD Guernsey, 2013); (OECD Jersey, 2013); (OECD Isle of Man, 2013)

The level of implementation of the standard differs between the three islands. The Isle of Man proved compliance in nine out of ten areas, whereas Guernsey and Jersey meet eight respectively, seven objectives related to transparency and exchange of information. Within the Reports, recommendations are made in order for the tax standards to be fully adopted.

Therefore, the three islands no longer meet the OECD's tax haven criteria, since numerous amendments to both commercial and tax legislation have been made and improvement in the area of transparency and exchange of information for tax purposes has been reached.

4.2. The islands' harmful tax measures and the 0/10 tax system

In November 1999, The Code of Conduct Group presented to the Economic and Financial Affairs (ECOFIN) Council a report comprising of a list of measures that might fall under the Scope of the Code of Conduct for business taxation. Also, the report covered tax measures adopted by the dependent and associated territories of the EU's Member states, which were providing for the partial or complete exemption from tax of corporate profits or other profits arising from offshore activities, in the following conditions: The benefits were granted to companies which were foreign owned; The activities were not conducted with local residents; The measures were meant to target the mobile capital (Council of The European Union, 1999).

The two English Channel Islands (Guernsey, Jersey) and the Isle of Man were found to have tax measures which were not Code compliant.

4.2.1. Guernsey before the 0/10 tax system

At the time of the report, in Guernsey a company was subject to income tax at a rate of 20%, in the same way as an individual and all the companies incorporated in the island were resident for tax purposes, unless it applied for a tax-exempt status. The following structures were considered to fall under the provisions of the Code of Conduct for business taxation:

The Exempt companies. A Guernsey company applying for this status had all the income which arose from outside Guernsey exempted from tax. Such a company had to be foreign-owned and it was subject to an annual fee payable to the Income Tax Authority of £600.

International loan business. Both banks and companies carrying on international loan businesses could deduct from the profits arising out of international loan business a 90% management charge, which could reduce the overall tax rate at 2%.

International Bodies (IBCs). This type of company was owned by non-residents and it was not allowed to trade with Guernsey residents. The tax rate could be agreed upon and it ranged between more than 0% and less than 30%. It was subject to review every 5 years.

Offshore insurance companies. These companies could elect to be taxed either as an exempt company or an international company or on a sliding scale.

Insurance companies. The business results were registered according to the commercial principles while the payment of the tax liability could be deferred until the claims were finalized or the period of risk expired (Council of The European Union, 1999).

4.2.2. Jersey before the 0/10 tax system

Just like in Guernsey, a Jersey company was subject to the same income tax rate as individuals (20%). A company was a tax resident of the island as long as it was incorporated there or it had the central management and control exercised by Jersey resident directors. The following structures were considered to fall under the provisions of the Code:

Tax exempt companies. This type of company was owned by non-residents or by a collective investment fund. Income arising outside Jersey was tax exempt as well as the bank interest arising in Jersey. A tax exempt company was due a £600 fee per year.

International Treasury operations represented by a branch of an international bank was entitled to deduct a percentage of profits deemed to be applicable to the costs of outside expertise and other costs.

International Business Companies. The profits realized outside Jersey were taxed at the following rates: up to £3 million (2%); between £3-4.5 million (1.5%); between £4.5-10 million (1%); over 10 million (0.5%). These companies were totally foreign-owned.

Captive insurance companies. According to the type of risk insured, the companies could be tax exempt or they could pay tax at a rate of 20% (Council of The European Union, 1999).

4.2.3. Isle of Man before the 0/10 tax system

Following the trend of the English Channel Islands, the Isle of Man had no separate system of corporation tax. A company was subject to a 20% tax, the same as individuals. All companies incorporated in the island were residents for tax purposes as well as those whose management and control was exercised from the island.

International business companies. They had to be foreign-owned and to have a resident director and a secretary. All the income was foreign sourced and it was taxed at a negotiated tax rate which ranged between 1% and 35%, but subject to a minimum tax charge of £1200.

Exemption for non-resident companies. The islands' resident companies which were foreign-owned and did

not trade in the Isle of Man were tax exempt but they were subject to an annual fee of £400.

Exempt insurance companies. This type of company was tax exempt as long as the profits arose from the risks outside the island. An annual standard fee of £2.000 plus a licence fee of £500 was payable.

International loan business. A 90% management charge deduction against international loan business profits could reduce the income tax from 20% to 2%.

Offshore banking business. These structures were granted tax exempt status yet, an annual fee of £35.000 had to be paid.

Fund management. 75% of the annual fee income was tax exempt (Council of The European Union, 1999).

4.2.4. The introduction of the 0/10 tax system

In response to the EU's Code of Conduct Group's review of the harmful measures presented by the three islands, steps had been taken in order to eliminate them and to create better tax systems meant to remain attractive to the potential investors and at the same time to be aligned to the international requirements in terms of good governance in tax matters.

With effect from the 6th of April 2006, The Isle of Man introduced a standard rate of 0% on corporate income generated by both resident and non-resident companies. Also, a 10% tax rate was to be applied to the income generated by the licensed banks, real estate, mining and quarrying (OECD Isle of Man, 2013). It was the first attempt of introducing the zero-ten tax system which came under a review process of the EU's Code of Conduct Group.

Although in November 2002, Guernsey and Jersey's Governments were announcing the introduction of the zero-ten tax system, it went into force on the 1st of January 2008. Before that date, both companies and individuals were charged a 20% tax rate. After that date, individuals' income continued to be charged a 20% tax rate, while companies were subject to the following tax rates: 0% corporate income tax; 10% applicable to the revenue generated by the financial services companies and 20% applicable to the utility companies and income from the ownership of land and building (States of Guernsey-Taxation, 2013).

Also, with the introduction of the 0/10 tax regime, the articles of the law concerning the formation of the exempt company and the international business company were abrogated. These forms of companies were considered to produce ring fencing effects, where non-residents were provided with more tax advantages than the residents.

The zero-ten tax system came with numerous amendments over the years and every time it came under a review process of the EU Code of Conduct Group. The latest review from the 4th of December 2012, revealed the fact that Guernsey's tax regime was Code compliant (Channel Islands – Guernsey, 2013). Also, on the 19th of December 2011, the amendments to the Jersey's 0/10 tax law were approved by the ECOFIN and seen as meeting the Code's requirements (Channel Islands – Jersey, 2013).

5. Conclusion

The EU through the introduction of the Code of Conduct for business taxation came to support the international initiative of the OECD to eliminate the harmful tax competition. The standards of good governance in tax matters had to be adopted on a worldwide basis, including the EU's Member States' dependent and associated territories. The adherence of the British crown dependencies: Guernsey, Jersey and the Isle of Man to the OECD's standards of transparency and exchange of information for tax purposes meant the elimination of these jurisdictions from the black list of tax havens. At the same time the elimination of their offshore sectors, characterized by the existence of the exempt companies or international business companies, resulted in the islands' tax legislation becoming compliant to the EU's Code of Conduct for business taxation. The introduction of the 0/10 tax system represented a reshaping process of the islands' fiscal system which, despite of an early scrutiny, it was finally accepted and considered in line with the international tax standards.

Therefore, the case study presented stand to emphasize on one hand that the European Union is not against the zero tax policies adopted by some states or territories, as it recognizes their fiscal sovereignty, yet it considers mandatory for all the EU Member States and their associated territories to eliminate any tax measures that may lead to a harmful tax competition.

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