
EU expands list of non-cooperative tax countries to 15 jurisdictions

25 March 2019

In brief

The EU, via the Economic and Financial Affairs Council (Ecofin), has updated its so-called 'blacklist' of non-cooperative tax jurisdictions to encompass 15 countries, including Bermuda, Barbados and the United Arab Emirates (UAE). A number of jurisdictions have been added to the blacklist for failing to satisfy, by 31 December 2018, what the EU bodies considered adequate in-country substance requirements in order for entities to qualify for their beneficial tax systems.

Jurisdictions on the blacklist face consequences including restrictions on accessing various EU funding, and more stringent reporting requirements by intermediaries and taxpayers of arrangements that involve deductible payments to these jurisdictions. EU bodies (see below) have also discussed, but not yet agreed on, the potential introduction of income inclusion rules, withholding tax requirements for payments to entities in the blacklisted jurisdictions, and other defensive measures. The substance requirements introduced in different jurisdictions follow a broad EU template and guidance but vary in certain respects. Entities operating in these jurisdictions will need to consider the implications of the substance requirements and a jurisdiction being on the blacklist, even if it's for a short time.

In detail

Jurisdictions on the blacklist

The current list of 12 March 2019 is based on:

- screening by the European Commission of jurisdictions' commitments
- meeting criteria recommended by the EU's inter-governmental Code of Conduct Group (Business Taxation) (CoCG) and
- endorsement by the Council,
- with particular deadlines.

Further background on the blacklist was discussed in our [Tax Policy Bulletin of 26 July 2018](#).

In particular, a number of jurisdictions have been added to the blacklist for failing to satisfy, by 31 December 2018, what the EU bodies considered adequate in-country substance requirements in order for entities to qualify for their beneficial tax systems. Of those:

- five have made no commitments and were on

the first blacklist adopted in 2017: American Samoa, Guam, Samoa, Trinidad and Tobago, and the US Virgin Islands

- three others were on the 2017 blacklist but were moved to the grey list following their commitments made, but have been blacklisted again for not following up in time: Barbados, UAE and Marshall Islands, and
- seven further countries were not on the original

blacklist because of commitments previously made, but have now been moved from the grey list to the blacklist for not following up in time: Aruba, Belize, Bermuda, Fiji, Oman, Vanuatu and Dominica.

Observations: The blacklist has changed frequently since its introduction. The Council may remove some jurisdictions in the next month or two, including in particular Barbados, Bermuda and UAE. These jurisdictions had introduced, or were on the verge of introducing, substance regimes following active discussions with the CoCG and likely will correct any perceived technical deficiencies imminently.

Substance requirements

The non-cooperative tax criteria include the following item focused on substance:

“2.2 Existence of tax regimes that facilitate offshore structures that attract profits without real economic activity”.

The EU identified a number of low-tax jurisdictions that didn't satisfy this need for entities to have sufficient substance in the jurisdiction. Those that made no commitment to change were put on the blacklist. A number made commitments to introduce substance requirements by 31 December 2018 and were put on the grey list.

The objective of these new requirements is to prevent low-tax jurisdictions from attracting profits from certain mobile activities without corresponding economic activity. The CoCG provided guidance that varied according to the nature of an entity's core income-generating activities. In follow-up work related to BEPS Action 5 on harmful tax practices, the OECD Inclusive Framework (IF), also released similar new global

requirements that apply to 'no or only nominal tax' jurisdictions.

The activities covered are broadly categorised as headquarters, distribution centres, service centres, financing, leasing, fund management, banking, insurance, shipping, holding companies, and the provision of intangibles.

A number of jurisdictions introduced substance requirements broadly effective from 1 January 2019. These requirements apparently were sufficient to keep these countries off of the latest blacklist: Anguilla, Bahamas, British Virgin Islands, Cayman Islands, Jersey, Guernsey and the Isle of Man.

There are differences in the substance requirements introduced in these jurisdictions (and Bermuda and Barbados). For example:

- some jurisdictions only scope in entities that are tax resident in their jurisdiction
- some jurisdictions only scope in corporate entities
- in some jurisdictions, economic substance rules are deemed not to apply if there is no income in the entity for the accounting period
- the ways in which entities must be directed and managed in or from within a jurisdiction vary
- the definition of 'adequate in relation to the amount of operating expense, physical presence and quality/ number of people is often to be determined in individual cases with, as yet, little guidance
- fines for entities not meeting the criteria in any particular year vary, as does spontaneous exchange of entity information, and the number of years of non-compliance before an entity may be prevented from

doing business in a jurisdiction (and the criminal proceedings that may be taken against individuals for various offences).

Observations: Businesses will need to look closely at the substance requirements introduced or being introduced in jurisdictions in which they operate or want to operate. The extent of compliance and reporting obligations will impose additional burdens and there could be short, medium and long-term consequences for having insufficient substance to support business activities.

Consequences for being on the blacklist

On the introduction of the blacklist, Finance Ministers agreed that EU Member States may pursue defensive measures in order to encourage these jurisdictions to comply with the key criteria. Some defensive measures were taken in the non-tax area, e.g. in relation to denying access to the European Fund for Sustainable Development. But, it was also stated, defensive measures could be pursued in the tax area, e.g. increased audits, disallowed deductions for costs, withholding tax measures, application of controlled foreign company (CFC) rules, reversal of the burden of proof, limitation of participation exemptions and switch-over clauses, among others (see [our EUDTG Newsalert of 16 December 2017](#)).

The introduction of a *Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements* (DAC6) gave Member States the chance to include a specific tax consequence for jurisdictions on the list. Hallmark C1(b)(ii) of DAC6 applies when there is an arrangement that involves deductible cross-border payments between at least two associated enterprises where the recipient of

such payments is resident in one of the listed jurisdictions. There is no 'main benefit test' override to this hallmark. Therefore, broadly, an intra group arrangement payment made to a resident of such a territory is potentially disclosable to the taxpayer's tax administration and details of the arrangement may be shared with other Member States.

The general impact of DAC6 is relevant for disclosures which may be required in August 2020, following the transitional period. The timing as to when it is necessary to see whether a jurisdiction is on the list will depend on the domestic laws that each Member State introduces. The Directive could be interpreted to mean that the status of the list at the date of the first 'trigger' event would be relevant – with no need to amend that if, for example, a jurisdiction subsequently were to be added to the list. But there is some uncertainty, even where a jurisdiction is on the list for a relatively short time.

Poland has introduced a mandatory disclosure regime (MDR) implementing DAC6, but also extending it for various domestic hallmarks and bringing in all the rules from 1 January 2019. That includes a 30-day disclosure deadline. The list status needs to be considered now in relation to this regime.

Observations: Given that Dubai and the other Emirates are significant sources of investment into EU businesses and are becoming more prevalent as destinations for many global businesses, the UAE's inclusion on the list potentially means more arrangements may be

disclosable on implementation of DAC6 (including as regards the extended Polish regime). In addition, many businesses with operations in Bermuda and Barbados - in particular insurance businesses in the former - may need to be aware of increased disclosure obligations.

Further action versus EU bodies' perceived benefits of the listing initiative

The CoCG is still considering producing guidance on further co-ordinated defensive measures in the tax area in relation to listed jurisdictions (see [agreed Work Programme for the CoCG under the Romania Presidency](#) for the first half of 2019).

Pressure for action continues to grow from certain stakeholders. The threat of action at the EU level continues despite the consideration of a minimum tax for payments to low-tax jurisdictions (income inclusion/ base erosion provisions) as Pillar II in the OECD proposals on digitalisation (see [our Tax Policy Bulletin of 15 February 2019](#)). For example, the European Parliament's Special Committee on financial crimes, tax evasion and tax avoidance (TAX3) has produced a [final report of 8 March 2019](#) that calls on the Member States to adopt a single set of strong countermeasures, such as withholding taxes, exclusion from calls for public procurement tenders, increased auditing requirements and automatic CFC rules.

However, the Commission has highlighted a number of the initiative's

benefits without the need for such defensive measures (see [Commission fact sheet, 12 March 2019](#)). These include:

- 60 countries acting on the Commission's concerns and eliminating over 100 harmful regimes
- an unspecified number of zero-tax countries introducing new measures to ensure a proper level of economic substance and information exchange
- over 20 jurisdictions taking steps to bring their tax transparency standards into line with international norms, and even more expected to do so by the end of 2019.

The takeaway

The EU's non-cooperative tax blacklist has resulted in action by many jurisdictions. The list continues to clearly impact the behaviours of jurisdictions and, as a result, organisations that do business in those jurisdictions.

Businesses should consider the raft of new substance requirements that have been introduced in various jurisdictions if they have not already started doing so.

Multinationals and tax administrations will need to consider the impact on disclosure requirements of the existence on the list of a number of jurisdictions commonly found in commercial arrangements, without the carve-out of a main benefit test.

Let's talk

For a deeper discussion of how these issues might affect your business, please call your usual PwC contact. If you don't have one or would otherwise prefer to speak to one of our global specialists, please contact one of the people whose details are set out below:

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