Key Financial Secrecy Indicators
9: Avoids Promoting Tax Evasion

What is being measured?

This indicator shows whether a jurisdiction grants unilateral tax credits for foreign tax paid on certain foreign capital income when remitted home. The types of capital income included are interest and dividend payments.

Three different payment scenarios are analysed. First, payments received by an independent legal person. Second, payments received by a related party legal person. Third, payments received by a natural person.

A 50% transparency score is awarded for jurisdictions which grant unilateral tax credits for all payment scenarios for one type of payment (dividend or interest). If unilateral tax credits are granted only in some payment scenarios, for each single payment scenario with a tax credit, a 10% transparency score is awarded.

No transparency score is given for situations in which a jurisdiction effectively exempts foreign income from domestic taxation, be it through a) a pure territorial tax system, or through exemptions; for b) specific payments (such as dividends); for c) specific legal entities (such as International Business Companies, IBCs); through d) deferral rules which disable taxation unless income is remitted; or through e) zero or near zero tax rates (e.g. on corporate income)[1].

The data[2] has been collected primarily through the IBFD-database[3]. A secondary source was our TJN-Survey 2013. In addition, the Worldwide Tax Summaries from PricewaterhouseCoopers[4] have been consulted as well as other websites.

Why is this important?

In a world of integrated international economic activity and cross-border financial flows, the question about who taxes what portion of income is increasingly complex. A basic conflict exists between the emphasis on taxing the income where it arises (i.e. at source), or taxing it where its recipient resides[5]. A mixture of both principles is implemented in practice.

However, this may lead to instances of so-called double taxation, when both countries claim the right to tax the same income (tax base). While the concept of "double taxation" is theoretically plausible, the real life occurrence is very rare[6] , especially since countries have resorted to unilateral relief provisions to avoid double taxation. In addition, countries may also conclude bilateral treaties in order to avoid double taxation, so-called double taxation avoidance agreements (DTA). A potential third option, a multilateral legal platform for the taxation of transnational corporations' income is currently being explored by OECD's Base

Erosion and Profit Shifting (BEPS)[7] project, but is unlikely to come into effect in the foreseeable future.

Assuming that cross-border trade and exchange can be mutually beneficial, the problem of overlapping tax claims (double taxation) needs to be addressed in one of both ways because it hinders cross-border economic activity. Bilateral treaties are expensive to negotiate, and often impose a cost on the weaker negotiating partner which is frequently required to concede lower tax rates in return for the prospect of more investment[8].

Home countries of investors or transnational companies offer unilateral relief from double taxation because they want to support outward investment. They do this primarily through two different mechanisms[9]:

a) By exempting all foreign income from tax liability at home (exemption);

b) By offering a credit for the taxes paid abroad on the taxes due at home (credit).

As the tables included in the database[10] indicate, in most cases it is a myth that bilateral treaties are necessary to provide relief from double taxation. Countries that are home to investors and transnationals typically offer provisions in their own laws to prevent or reduce double taxation[11]. Where (especially capital exporting) countries refrain from providing unilateral relief, or only provide deduction of foreign taxes from the domestic tax base, they contribute to a problem of double taxation and thus indirectly exert pressure on capital importing countries to conclude bilateral treaties with the other country. These treaties in turn can expose capital importing countries to risks and disadvantages (see Note 5 above). In addition, with more than 3000 double tax treaties in place today, the system has become overly complex and permissive in offering corporations scope to engage in profit shifting, treaty shopping and other practices resting on abuse at the margins of tax evasion (see TJN's report on unitary taxation[12] to address these issues and OECD's BEPS report[13]). These are the reasons why we analysed unilateral mechanisms to avoid double taxation in the first place. However, not all such mechanisms are equally useful[14].

When using a **unilateral exemption mechanism** to exempt all foreign income from liability to tax at home, this residence country is forcing other jurisdictions to compete for inwards investment by lowering their tax rates. Because investors or corporations will not need to pay any tax back home on the profit they declare in the foreign jurisdiction (source), they will look more seriously at the tax rates offered. This encourages countries to reduce tax rates on capital income paid to non-residents, such as withholding taxes on payments of dividends and interest.

Many countries provide tax exemption on capital income payable to non-residents, especially on interest payments on bank deposits and government debt obligations, or dividends. This has an important collateral effect: countries not offering an exemption mechanism to their residents nonetheless see their resident taxpayers move their assets and legal structures (such as holding companies) into those countries where capital income is not taxed or taxed lowly. By doing so, and because information sharing between states is weak, taxpayers can easily evade the taxes due at home on their foreign income. As a consequence, a country offering low or no taxes to non-residents promotes tax evasion in the rest of the world.

To summarise the logic:

First, unilateral tax exemption on foreign income creates incentives for host countries to reduce tax rates on investments by non-residents in a process of tax competition. Second, citizens and corporations from other countries make use of the low tax rates by shifting assets into these low-tax countries for the purpose of committing tax evasion. Third, in the medium term, the tax exemption of foreign income acts as an incentive for ruinous tax competition that will eventually lead to the non-taxation of capital income.

In contrast, a unilateral **tax credit system** does not promote tax evasion and does not incentivise the host countries of investments to lower their tax rates. A tax credit system requires that income earned abroad must be taxed at home as if it was earned at home, **unless** it has already been taxed abroad. In the latter case, the effective amount of tax paid abroad on the income will be subtracted from the corresponding amount of tax due at home.

Therefore, for an investor the tax rate in a receiving country is no longer relevant to her investment decisions. Countries wishing to attract foreign investment will not feel compelled to lower the tax rates in the hope of increasing their inward stock of foreign investment. As a consequence, the tax evading opportunities of investors are reduced because fewer countries offer zero or very low taxation on capital income.

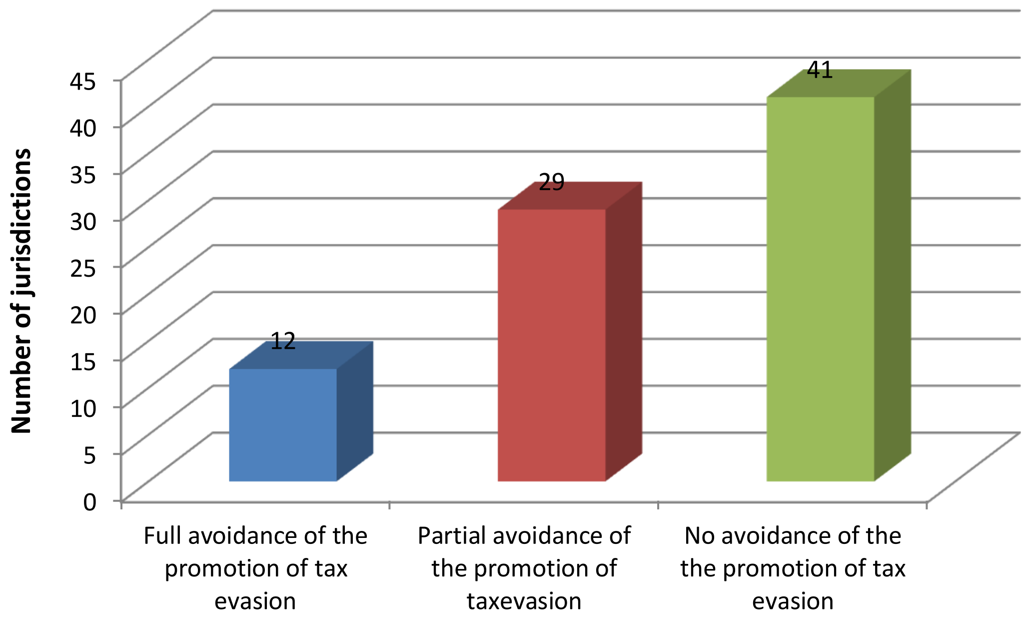
What are the crimes that might hide behind a lack of unilateral tax credits?

While no crimes are directly covered up, the indirect effect of an absence of unilateral tax credits is the promotion of tax competition and tax evasion in the rest of the world, as well as the facilitation of all other crimes (such as hiding the proceeds of corruption, drug trafficking, illegal arms trading) through reduced tax and reporting obligations in countries with no taxation of capital income. In addition, if a country promotes double tax treaties, the proliferation and number of bilateral tax treaties today is creating complexity to an extent that it is acting as corporate and financial secrecy. Under the cloak of such secrecy abusive treaty shopping and profit shifting can flourish.

Results Overview

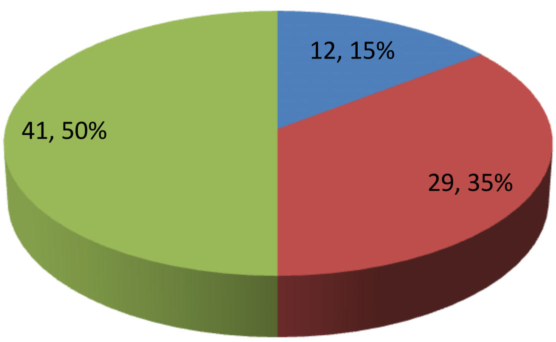
Table 1: Avoids Promoting Tax Evasion – Overview	
Full avoidance of promoting tax evasion	12
Partial avoidance promoting tax evasion	29
No avoidance of promoting tax evasion	41

Graph 1: Avoids Promoting Tax Evasion - Overview



Results Detail

Graph 2: Avoids Promoting Tax Evasion - Details



- Full avoidance of the promotion of tax evasion: BR; BW; DK; DO; GH; IL; IN; KR; MV; NO; PH; SE
- Partial avoidance of the promotion of taxevasion: AT; AU; BE; CA; CK; CY; DE; DM; ES; GB; GG; HU; IE; IM; IT; JP; LC; LU; LV; MC; MT; NZ; PT; RU; SM; US; VI; WS; ZA
- No avoidance of the the promotion of tax evasion: All other jurisdictions

Table 2: Unilateral Tax Credits and Cross-Border Payment Scenario – Details	
Unilateral tax credit given for dividends paid to an independent person	19
Unilateral tax credit given for dividends paid to a related party legal person	15
Unilateral tax credit given for dividends paid to a natural person	30
Unilateral tax credit given for interest paid to an independent person	32
Unilateral tax credit given for interest paid to a related party legal person	32
Unilateral tax credit given for interest paid to a natural person	35

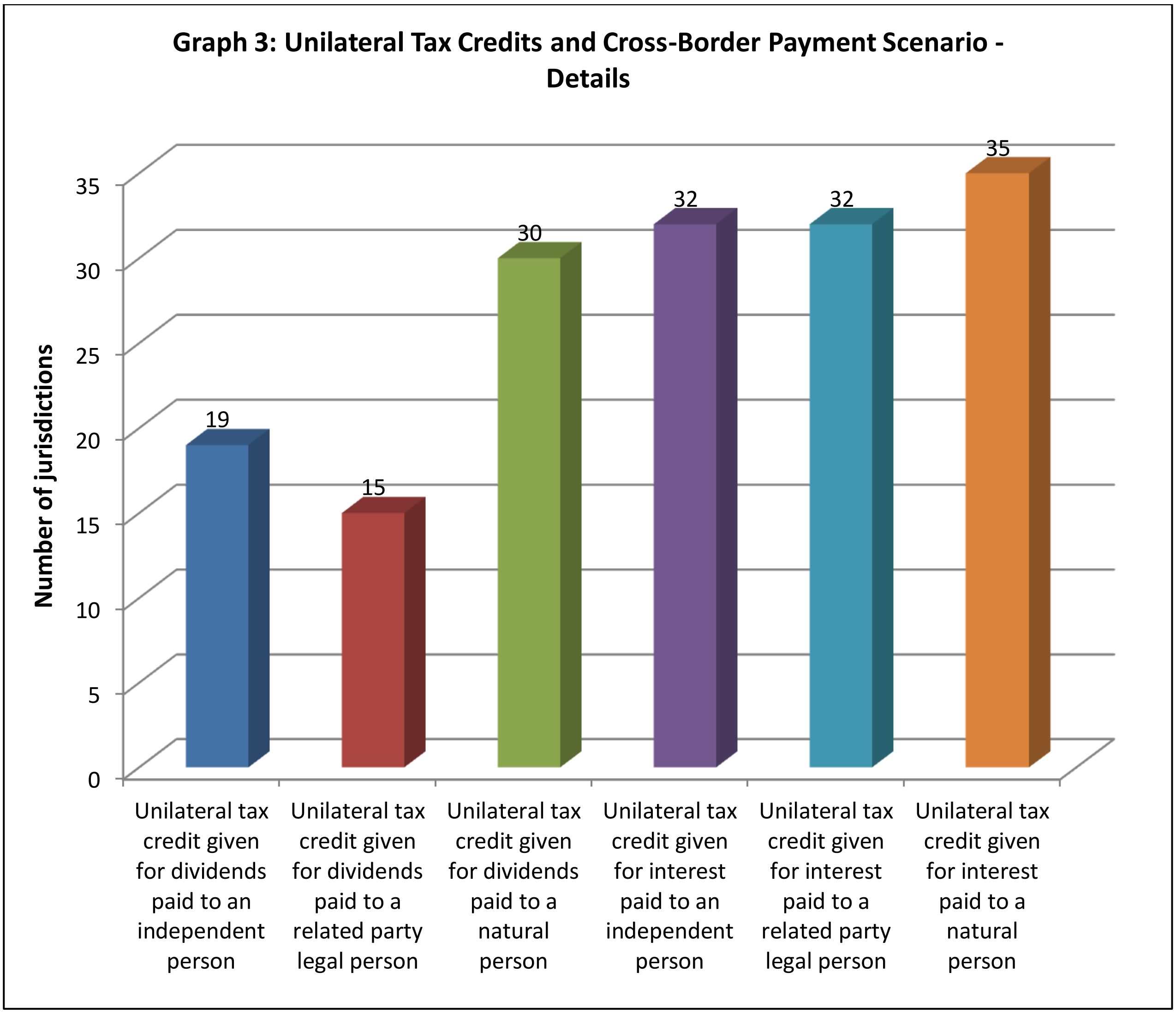


Table 3: Avoids Promoting Tax Evasion - Transparency Credits

ID	Country	ISO	Credits	ID	Country	ISO	Credits
1	Andorra	AD	0	42	Korea	KR	1
2	Anguilla	AI	0	43	Latvia	LV	0.6
3	Antigua & Barbuda	AG	0	44	Lebanon	LB	0
4	Aruba	AW	0	45	Liberia	LR	0
5	Australia	AU	0.5	46	Liechtenstein	LI	0
6	Austria	AT	0.7	47	Luxembourg	LU	0.2
7	Bahamas	BS	0	48	Macau	MO	0
8	Bahrain	BH	0	49	Malaysia (Labuan)	MY	0
9	Barbados	BB	0	50	Maldives	MV	1
10	Belgium	BE	0.2	51	Malta	MT	0.6
11	Belize	BZ	0	52	Marshall Islands	MH	0
12	Bermuda	BM	0	53	Mauritius	MU	0
13	Botswana	BW	1	54	Monaco	MC	0.3
14	Brazil	BR	1	55	Montserrat	MS	0
15	British Virgin Islands	VG	0	56	Nauru	NR	0
16	Brunei	BN	0	57	Netherlands	NL	0
17	Canada	CA	0.4	58	New Zealand	NZ	0.6
18	Cayman Islands	KY	0	59	Norway	NO	1
19	Cook Islands	CK	0.2	60	Panama	PA	0
20	Costa Rica	CR	0	61	Philippines	PH	1
21	Curacao	CW	0	62	Portugal (Madeira)	PT	0.7
22	Cyprus	CY	0.5	63	Russia	RU	0.2
23	Denmark	DK	1	64	Samoa	WS	0.2
24	Dominica	DM	0.2	65	San Marino	SM	0.2
25	Dominican Republic	DO	1	66	Saudi Arabia	SA	0
26	France	FR	0	67	Seychelles	SC	0
27	Germany	DE	0.7	68	Singapore	SG	0
28	Ghana	GH	1	69	South Africa	ZA	0.6
29	Gibraltar	GI	0	70	Spain	ES	0.7
30	Grenada	GD	0	71	St Kitts and Nevis	KN	0
31	Guatemala	GT	0	72	St Lucia	LC	0.1
32	Guernsey	GG	0.2	73	St Vincent & Grenadines	VC	0
33	Hong Kong	HK	0	74	Sweden	SE	1
34	Hungary	HU	0.6	75	Switzerland	CH	0
35	India	IN	1	76	Turks & Caicos Islands	TC	0
36	Ireland	IE	0.1	77	United Arab Emirates (Dubai)	AE	0
37	Isle of Man	IM	0.2	78	United Kingdom	GB	0.6
38	Israel	IL	1	79	Uruguay	UY	0
39	Italy	IT	0.5	80	US Virgin Islands	VI	0.2
40	Japan	JP	0.7	81	USA	US	0.6
41	Jersey	JE	0	82	Vanuatu	VU	0

[1] Examples of pure territorial tax systems (a) include Panama and Hong Kong; examples of selective payment exemptions (b) include Cyprus and the United Kingdom; examples of specific legal entity exemption (c) include Luxembourg and Saint Kitts and Nevis; examples of exemption of income except if remitted (d) include the USA and Liberia; examples of countries applying a zero or near zero tax rate resulting in exemption (e) include Jersey and Guernsey. In practice, some of the aforementioned mechanisms may be combined to achieve non-taxation of foreign income.

[2] To see the sources we are using for particular jurisdictions please check out the assessment logic table in Annex C here http://www.financialsecrecyindex.com/PDF/FSI-Methodology.pdf and the corresponding information for individual countries in our database, available at www.financialsecrecyindex.com/database/menu.xml.

[3] http://www.ibfd.org/IBFD-Tax-Portal/About-Tax-Research-Platform; 15.07.2013.

[4] http://www.pwc.com/taxsummaries; 15.07.2013.

[5] TJN-Briefing on source and residence-based taxation: http://www.taxjustice.net/cms/upload/pdf/Source_and_residence_taxation_-_SEP-2005.pdf; 15.07.2013.

[6] See pages 3 and 7 here: www.taxjustice.net/cms/upload/pdf/Unitary_Taxation_Responses-1.pdf; 15.07.2013.

[7] http://www.oecd.org/ctp/BEPSActionPlan.pdf; 19.7.2013.

[8] See, for instance, 1) the most recent example of Switzerland renegotiating its DTAs with developing countries, pages 23-24, here: www.taxjustice.net/cms/upload/GlobalForum2012-TJN-Briefing.pdf; 15.07.2013, or for more details on this case (in German): http://www.alliancesud.ch/de/publikationen/downloads/dokument-24-2013.pdf ;15.07.2013; 2) Neumayer, Eric 2007: Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?, in: Journal of Development Studies 43: 8, 1501–1519; and 3) Dagan, Tsilly 2000: The Tax Treaty Myth, in: New York University Journal of International Law and Politics 32: 939. A full literature review on the relationship between DTAs, development, growth and FSI can be found (in German) here: www.suz.uzh.ch/herkenrath/publikationen/workingpapers/FDI_EL-Forschungsnotiz-01-10.pdf; 15.07.2013.

[9] There is a third mechanism called "deduction" which is sometimes used to offer relief from double taxation. However, the deduction method does not offer full relief from double taxation. It allows deducting from foreign income (e.g. as a business expense) any taxes paid abroad before including this income in the domestic tax base. Therefore, we consider deduction to be similar to offering no mechanism for double taxation relief, since the incentives to conclude DTAs remain largely in place.

[10] http://www.financialsecrecyindex.com/database/menu.xml.

[11] It must be conceded, however, that unilateral provisions to avoid double taxation are not as effective at preventing double taxation as double tax treaties. For instance, there may be cases in which the rules determining the residency of taxpayers conflict between countries, leading to both claiming residence and full tax liability of one legal entity or taxpayer. However, for a number of reasons this argument is of limited relevance: a) these cases are the exception rather than the rule; b) pure economic "single taxation" is a theoretical concept derived from economic modelling that is only of limited value in real life. In many countries different types of taxes are levied on the same economic activity, for instance VAT is levied on the turnover of a company, then the profits stemming from the turnover are taxed through federal and state corporate income taxes, and in a third stage the investment income in form of dividends is again taxed in the hands of the shareholders. Nobody would reasonably speak about "triple taxation" in such a case. In a similar way, it is dubious to speak about double taxation in a cross-border context. To paraphrase Professor Sol Picciotto: "But double taxation is a dubious concept. First, it does not mean companies' tax bills doubling: it means that there may (rarely) be some overlap between states' taxing claims (think of this in terms of the overlap in a Venn diagram). Any overlap may result in a modestly higher overall effective tax rate, not a

'double' rate." (See page 3, here: www.taxjustice.net/cms/upload/pdf/Unitary_Taxation_Responses-1.pdf; 15.07.2013).

[12] www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf; 01.08.2013.

[13] http://www.oecd.org/ctp/BEPSActionPlan.pdf; 19.7.2013.

[14] We are not looking at deduction in more detail because deduction of foreign taxes from domestic tax bases only provides partial relief from double taxation whereas the credit and exemption method both have in principle the capacity to completely avoid double taxation. For details about the exemption and credit method, see for instance pages 19-22 in: United Nations Department of Economic & Social Affairs 2003: Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (ST/ESA/PAD/SER.E/37), New York, in: http://unpan1.un.org/intradoc/groups/public/documents/un/unpan008579.pdf; 15.07.2013.