Key Financial Secrecy Indicator 13: Avoids Promoting Tax Evasion

What is measured?

This indicator assesses whether a jurisdiction includes worldwide capital income in its income tax base and if it grants unilateral tax credits for foreign tax paid on certain foreign capital income. The types of capital income included are interest and dividend payments.

Three different payment scenarios are considered.

1. Payments received by an independent legal person.
2. Payments received by a related party legal person.
3. Payments received by a natural person.

A zero secrecy score is given if a jurisdiction grants unilateral tax credits for all payment scenarios for both type of payments (dividends and interest). A 50% secrecy score applies to 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, the secrecy score is reduced by 10%.

Accordingly, we have split this indicator into two components; the overall secrecy score for this indicator is calculated by simple addition of these components. The secrecy scoring matrix is shown in Table 1, with full details of the assessment logic given in Table 3 below.

The **secrecy score is not reduced** where a jurisdiction does any of the following:

1. effectively **exempts** foreign income from domestic taxation, be it through
   - **a)** a pure territorial tax system;
   - **b)** or through exemptions for
     - **i.** specific payments (such as dividends) or
     - **ii.** specific legal entities (such as International Business Companies);
   - **c)** deferral rules which disable taxation unless income is remitted;
   - **d)** zero or near zero tax rates (e.g. on corporate income);[1]
2. only offers the option to **deduct** foreign payments from the tax base;
3. provides **no unilateral double taxation relief** whatsoever.

Table 1: Secrecy Scoring Matrix KFSI 13

Regulation	Secrecy Score Assessment [Secrecy Score: 100% = full secrecy; 0% = full transparency]
COMPONENT 1: DIVIDENDS (50%)	
No unilateral double taxation relief through a tax credit system	50%
Unilateral double taxation relief through a tax credit system for one payment scenario (if recipient is either an independent or related legal person, or natural person)	40%
Unilateral double taxation relief through a tax credit system for two payment scenarios (if recipient is either an independent and/or related legal person, and/or natural person)	30%
Unilateral double taxation relief through a tax credit system for all three payment scenarios (recipients always receive a unilateral tax credit, regardless of whether s/he is an independent or related legal person, or a natural person)	0%
COMPONENT 2: INTEREST (50%)	
No unilateral double taxation relief through a tax credit system	50%
Unilateral double taxation relief through a tax credit system for one payment scenario (if recipient is either an independent or related legal person, or natural person)	40%
Unilateral double taxation relief through a tax credit system for two payment scenarios (if recipient is either an independent and/or related legal person, and/or natural person)	30%
Unilateral double taxation relief through a tax credit system for all three payment scenarios (recipients always receive a unilateral tax credit, no matter if it is an independent or related legal person, or a natural person)	0%

The data has been collected primarily through the IBFD-database (country analyses and country surveys).[2] In some instances we have also consulted the Worldwide Tax Summaries from PricewaterhouseCoopers[3] and other websites.

All underlying data can be accessed freely in the FSI database.

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 has become increasingly complex. A conflict exists between the emphasis on taxing the income where it arises (i.e. at source), or taxing it where its recipient resides.[4] 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, evidence for real life occurrence is exceptionally rare[5] , especially since many countries have adopted unilateral relief provisions to avoid double taxation. In addition, countries also negotiate bilateral treaties to avoid double taxation, so-called double taxation avoidance agreements (DTA).

A potential third option to ensure single taxation would be a multilateral agreement on the definition of the formula for apportioning transnational corporations’ global income[6]. Even though the G20 declared that “Profits should be taxed where economic activities deriving the profits are performed and where value is created”[7], which could be interpreted as a mandate to treat the corporate group of MNE as a single firm and ensure that its tax base is attributed according to its activities in each country,[8] the OECD’s BEPS[9] project has continued to follow the independent entity principle and refused to consider unitary taxation and formulary apportionment to tax transnational corporations. Thus, this option is unlikely to come into effect in the foreseeable future.

Assuming that cross-border trade and investment 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.[10]

Home countries of investors or transnational companies usually offer unilateral relief from double taxation because they want to support outward investment.

They do this primarily through two different mechanisms:

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 graphs below 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]

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.

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 8 above).

In addition, with more than 3000 double tax treaties currently in operation, the system has become overly complex and permissive, encouraging corporations to engage in profit shifting, treaty shopping and other practices at the margins of tax evasion (see here[12] for ways to address these issues and the various reports of the various reports of the BEPS Monitoring Group[13]). This is the context in which we review 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, the residence country may be 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 may have an important collateral effect: countries not offering an exemption mechanism to their residents nonetheless may 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 puts pressure on source countries to reduce tax rates on investments by non-residents in a process of tax war (or competition).[15] 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 wars 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 host 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 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.

All underlying data can be accessed freely in the FSI database. To see the sources we are using for particular jurisdictions please consult the assessment logic in Table 3 at the end of this document and examine the **Tax Details section** of the database report of the respective jurisdiction.

Results Overview

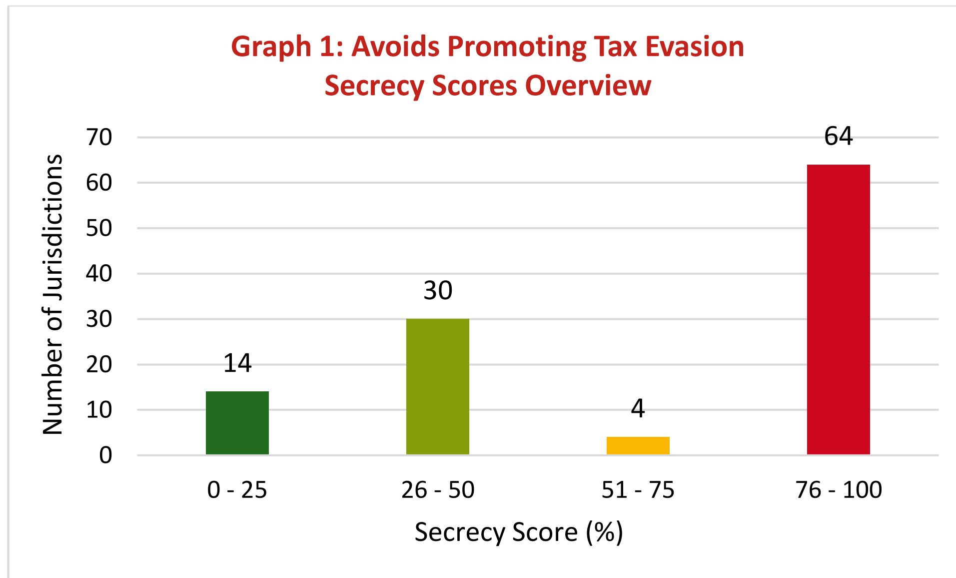

Table 2: Facilitation of Tax Evasion via Tax Relief – Secrecy Ratings

Country Name	Score	ISO	Country Name	Score	ISO
Andorra	0	AD	Lebanon	1	LB
Anguilla	1	AI	Liberia	1	LR
Antigua & Barbuda	1	AG	Liechtenstein	1	LI
Aruba	1	AW	Lithuania	0,3	LT
Australia	0,5	AU	Luxembourg	0,8	LU
Austria	0,4	AT	Macao	1	MO
Bahamas	1	BS	Macedonia	0	MK
Bahrain	1	BH	Malaysia (Labuan)	1	MY
Barbados	1	BB	Maldives	1	MV
Belgium	0,5	BE	Malta	0,8	MT
Belize	1	BZ	Marshall Islands	1	MH
Bermuda	1	BM	Mauritius	1	MU
Bolivia	1	BO	Mexico	0	MX
Botswana	0	BW	Monaco	0,7	MC
Brazil	0	BR	Montenegro	0	ME
British Virgin Islands	1	VG	Montserrat	1	MS
Brunei	1	BN	Nauru	1	NR
Bulgaria	0,3	BG	Netherlands	1	NL
Canada	0,6	CA	New Zealand	0,4	NZ
Cayman Islands	1	KY	Norway	0,3	NO
Chile	0,5	CL	Panama	1	PA
China	0,3	CN	Paraguay	1	PY
Cook Islands	0,8	CK	Philippines	0	PH
Costa Rica	1	CR	Poland	0,3	PL
Croatia	0,4	HR	Portugal (Madeira)	0,3	PT
Curacao	1	CW	Puerto Rico	0,8	PR
Cyprus	0,4	CY	Romania	1	RO
Czech Republic	1	CZ	Russia	0,8	RU
Denmark	0,3	DK	Samoa	0,8	WS
Dominica	0,8	DM	San Marino	0,8	SM
Dominican Republic	0	DO	Saudi Arabia	1	SA
Estonia	0,7	EE	Seychelles	1	SC
Finland	0,3	FI	Singapore	1	SG
France	1	FR	Slovakia	1	SK
Gambia	0	GM	Slovenia	0,4	SI
Germany	0,3	DE	South Africa	0,4	ZA
Ghana	0,8	GH	Spain	0,4	ES
Gibraltar	1	GI	St Kitts and Nevis	1	KN
Greece	0,3	GR	St Lucia	1	LC
Grenada	1	GD	St Vincent & Grenadines	1	VC
Guatemala	1	GT	Sweden	0,3	SE
Guernsey	0,8	GG	Switzerland	1	CH
Hong Kong	1	HK	Taiwan	0,6	TW
Hungary	0,4	HU	Tanzania	0,5	TZ
Iceland	0,4	IS	Thailand	1	TH
India	0	IN	Trinidad & Tobago	0	TT
Indonesia	0,4	ID	Turkey	0,3	TR
Ireland	0,9	IE	Turks & Caicos Islands	1	TC
Isle of Man	0,8	IM	Ukraine	1	UA
Israel	0	IL	United Arab Emirates (Dubai)	1	AE
Italy	0,5	IT	United Kingdom	0,8	GB
Japan	0,3	JP	Uruguay	1	UY
Jersey	1	JE	US Virgin Islands	0,8	VI
Kenya	1	KE	USA	0,4	US
Korea	0	KR	Vanuatu	1	VU
Latvia	0,4	LV	Venezuela	0	VE

Moderately Secretive 0 – 0,40	Secrecy Score 0,41 – 0,50	Secrecy Score 0,51 – 0,60	Secrecy Score 0,61 – 0,70	Secrecy Score 0,71 – 0,80	Secrecy Score 0,81 – 0,90	Extremely Secretive 0,91 – 1

 2018 © Tax Justice Network

Table 3: Assessment Logic

Info_ID	Text_Info_ID	Answers (Codes applicable for all questions: -2: Unknown; -3: Not Applicable)	Valuation % Secrecy
None	In the absence of a bilateral treaty, does the jurisdiction apply a tax credit system for receiving interest income payments?	3: yes, all three types of recipients [i) legal person – independent party; ii) legal person – related party; iii) natural person]; 2: for 2; 1: for 1; 0: for none.	(3): 0%; (2): 30%; (1): 40%; (0): 50%
None	In the absence of a bilateral treaty, does the jurisdiction apply a tax credit system for receiving dividend income payments?	3: yes, all three types of recipients [see above]; 2: for 2; 1: for 1; 0: for none.	(3): 0%; (2): 30%; (1): 40%; (0): 50%

[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] http://www.ibfd.org/IBFD-Tax-Portal/About-Tax-Research-Platform; 12.05.2015.

[3] http://www.pwc.com/taxsummaries; 12.05.2015.

[4] TJN-Briefing on source and residence-based taxation: http://www.taxjustice.net/cms/upload/pdf/Source_and_residence_taxation_-_SEP-2005.pdf; 12.05.2015.

[5] See pages 3 and 7 here: www.taxjustice.net/cms/upload/pdf/Unitary_Taxation_Responses-1.pdf; 12.05.2015.

[6] See page 297, in: Avi-Yonah, Reuven 2016: A Proposal for Unitary Taxation and Formulary Apportionment (UT+FA) to Tax Multinational Enterprises, in: Rixen, Thomas/Dietsch, Peter (Hrsg.): Global Tax Governance – What is Wrong with it, and How to Fix it, Colchester, 289-306.

[7] G20 Leaders' Declaration, September 6, 2013, St Petersburg, http://www.g20.utoronto.ca/2013/2013-0906-declaration.html#beps

[8] https://bepsmonitoringgroup.files.wordpress.com/2015/10/general-evaluation.pdf

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

[10] See, for instance, 1) Hearson, Martin 2016: Measuring Tax Treaty Negotiation Outcomes: The ActionAid Tax Treaties Dataset (ICTD Working Paper 47), Brighton, in http://www.ictd.ac/publication/2-working-papers/99-measuring-tax-treaty-negotiation-outcomes-the-actionaid-tax-treaties-dataset;12.01.2018; 2) a comprehensive analysis of the Netherlands double tax treaty network, here: McGauran, Katrin 2013: Should the Netherlands Sign Tax Treaties with

Developing Countries?, Amsterdam, in: https://www.somo.nl/wp-content/uploads/2013/06/Should-the-Netherlands-sign-tax-treaties-with-developing-countries.pdf; 18.12.2017; 3) the example of Switzerland renegotiating its DTAs with developing countries, pages 23-24, here: www.taxjustice.net/cms/upload/GlobalForum2012-TJN-Briefing.pdf; 12.05.2015, or for more details on this case (in German): http://www.alliancesud.ch/de/publikationen/downloads/dokument-24-2013.pdf ; 12.05.2015; 4) Neumayer, Eric 2007: Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?, in: Journal of Development Studies 43: 8, 1501–1519; and 5) 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 FDI can be found (in German) here: www.suz.uzh.ch/herkenrath/publikationen/workingpapers/FDI_EL-Forschungsnotiz-01-10.pdf; 12.05.2015.

[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; 12.05.2015). This "modestly higher overall effective tax rate" could be higher than the corporate tax rate of one particular country, but it may still be lower than another country's corporate tax rate. If one called this situation double taxation, then this implies speaking about double taxation also in situations in which two unrelated companies operate in two different countries, with one country levying twice as high a corporate tax rate as the other country. This, of course, is non-sense and reveals the dubious and theoretically flawed nature of the concept of double taxation.

[12] www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf; 12.05.2015.

[13] https://bepsmonitoringgroup.wordpress.com/tag/bmg/; 12.05.2015.

[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 (see endnote 11 above for details). 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; 12.05.2015.

[15] For a background on the terminology around tax competition and tax wars, see: http://foolsgold.international/fools-gold-rethinking-competition/; 12.5.2015.