EU-MERCOSUR FTA

Strategic GUE/NGL initiative

on alternatives to Free trade Agreements

EUROPEAN PARLIAMENT, Brussels, 2-3 May 2018

Background notes for the WORKSHOP ON DEMOCRACY AND TAX EVASION

1. General Comments

In the past, some studies have been conducted on the effects on money laundering, tax evasion and tax avoidance of free trade agreements; which have pointed out the following:

a. The power by authorities to apply controls on capital flows are being restricted while there are no particular instruments kept that could be used effectively to prevent illicit financial flows (Vander Stichele, 2012);
b. The EU has between 7 and 9 member states[1] (European Commission, 2017) that have been identified as having a high level of aggressive tax planning opportunities. FTAs does not fully exclude that foreign investors establish themselves with the purpose of tax dodging practices (Vander Stichele, 2012);
c. A wide range of speculative financial services are liberalized by the FTA without any particular mechanisms to ensure strong regulation or joint supervision (Vander Stichele, 2012);
d. The far-reaching commitments made by the EU and developing countries in the selected EU FTAs on access to the markets for goods and services, including in the financial services sector, translate into such agreements significantly increasing trade openness, and hence also the threat of money laundering facing developing countries (Ioannides, 2016);

Eskelinen and Ylönen (2017) have analysed the cases brought by Panama against Argentina and Colombia to the World Trade Organization (WTO), and how Panama has been able to invoke WTO rules to defend its tax regime. These cases should be seen as precedents of what can happen in the context of a FTA, given the success of professional advisors (enablers) in arbitrating between the different legislations in this case, and finding in non-discrimination rules, the loophole to be used against anti-tax avoidance rules used by, e.g. Argentina.

Ioannides (2016) has made a series of recommendations on strengthening the ability of EU FTAs to combat money laundering, tax evasion and tax avoidance, some of which are listed underneath:

a. if one of the EU's trading partners fails to implement the international and European AML/CFT standards (e.g. EU-Colombia/Peru FTA), then the EU should consider limiting the definition and/or scope of financial services to be liberalised where compelling reasons exist;

[1] Belgium, Malta, Ireland, Luxembourg, The Netherlands, Cyprus, Hungary; and also the United Kingdom and Estonia.

b. the EU should strive for a greater degree of specification of the AML/CFT and tax-related requirements in its FTAs;
c. ensure that all FTAs contain provisions on tax cooperation and that such provisions guarantee cooperation at the bilateral level in addition to any regional or international instruments or arrangements;
d. include provisions aimed at combating the mispricing of internationally traded goods and services;
e. include provisions on country-by-country reporting of corporate tax and the establishment of public registers of beneficial owners.
f. insist on the establishment of well-functioning channels of information exchange between domestic AML/CFT and tax authorities;
g. pursue a strategy of imposing a measure of conditionality during trade negotiations, where structural weaknesses in rule of law enforcement – mainly due to corruption, organised crime and shadow economy – undermine the EU's trade goals and the trading partner's legislative and administrative endeavours in combating money laundering and tax evasion

So far, such recommendations do not seem to have been included in the FTA EU-Mercosur.

2. Estimations of IFF

Vander Stichele (2012) has included some measures of the problem of IFF in based on data on illicit financial flows (IFF) produced by Global Financial Integrity (GFI); and on transit profits generated by drug deals from the United Nations Office on Drugs and Crime (UNODC).

Gaggero, Rua and Gaggero (2013) have studied the different components of capital flight in Argentina between 2002 and 2012, arriving to estimations of total stock held offshore by the Argentinians that today would add up to approximately USD 500 thousand million.

Cobham and Jansky (2017) have estimated that tax loss is around US$500 billion, and the intensity of losses is substantially greater in low- and lower middle-income countries; and in sub-Saharan Africa, Latin America and the Caribbean, and in South Asia compared to other regions.

However, except for some brief mentions of the possibility of the EU-Mercosur FTA in Ioannides (2016), no studies have analysed so far the impact on IFF of the EU-Mercosur FTA.

3. On EU FTAs and their references to tax evasion, tax avoidance and/ or money laundering

According to Ioannides (2016, pág. 33) it seems to be a common practice to exclude taxation of the non-discrimination obligations and they quote as an example Chapter 28 of the CETA[2], which allows some exceptions for taxation in the service and investment sectors. Moreover, article 350 of the Eu-Central America FTA specifies that the parties maintain the right to issue measures to counter money laundering, in respect of any existing double taxation agreement (DTA). In this sense, 'mailbox companies' would apparently not benefit from the provisions in the Investment Chapter, as

[2] ARTÍCULO 28.7 of the CETA refers to Exceptions on Taxation. See http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter/index_es.htm

to be qualified as an investor, it is necessary to have real business operations in the territory of one of the parties to the agreement.

However, the study (Ioannides, 2016) also clarifies that taxation is not uniformly treated in all FTAs (no similar article to 28.7 of CETA has been so far included in the FTA EU-Mercosur according to the information leaked so far[3]).

Ioannides (2016) also notes that the respect of Double Tax Agreements (DTAs) allowed for in FTAs would not necessarily provide for anti-tax avoidance tools to be employed, as DTAs have been signed in order to eliminate double taxation.

The same report presents a series of recommendations to be included in other FTAs, particularly regarding cooperation and exchange of information, as this has been treated differently in different treaties[4]; and no treaty so far includes any mention to the need of implementing country-by-country reporting (Action 13 of BEPS Action Plan).

In this respect, it should also be noted that Mercosur members are not part of the OECD, and the governance of transparency based on OECD criteria imposes other affiliation on such countries. And the Code of Conduct on business taxation of the Council has been repeatedly been highlighted for its lack of transparency.[5]

Ioannides (2016) also comments that no articles in FTA refer to the problem of under-invoicing and over-invoicing in the trading of goods, something which is a problem for developing countries, as evidenced by Grondona and Burgos (2015), among others.

The same study also mentions that it is evident that if a FTA is agreed between economies that have different levels of shadow economies, this will inevitably generate some impact on the illicit financial flows moving between parties after the FTA is implemented.

Finally, one of the problems of the free movement of capitals within the European Union and in the context of FTAs is precisely the lack of control of the financial flows, which in the countries that are member of the Mercosur is still carried out by a combination of institutions: tax administration, FIUs, prosecutors, and Central Banks.

While, in the case of the EU, it has implemented several directives that aim at incentivising investment and capital flow, eliminating the possibility of applying withholding taxes at source on interests and services or on dividends. Multinational entities have taken advantage of this, and

[3] See last February 2018 leak here: https://www.bilaterals.org/?eu-mercosur-fta-27-draft-chapters

[4] Proposed article 11 of the CETA states (however, this article has not been included in all FTAs):

> *Cooperation on taxation*
> *With a view to strengthening and developing their economic cooperation, the Parties adhere to and apply the principles of good governance in the tax area, i.e., transparency, exchange of information and avoidance of harmful tax practices in the frameworks of the OECD Forum on harmful tax practices and the Union Code of Conduct on business taxation, as applicable. The Parties shall endeavour to work together to promote and improve the implementation of these principles internationally*

[5] See paragraph 52 of the PANA Recommendations of December 13, 2017. URL: http://www.europarl.europa.eu/cmsdata/135340/P8_TA-PROV(2017)0491_EN.pdf

combined it with DTAs in order not to pay taxes anywhere, as was revealed by the LuxLeaks, Panama Papers and the Paradise Papers.

Moreover, a study performed for the PANA Inquiry Committee (Scherrer, 2017), which was based on a mapping exercise analysing the functioning of EU FIUs, clearly noted that the role of the FIUs varies across the EU, and in many cases FIUs do not exchange information if they assume the other FIU will disseminate the information with the tax Administration.

None of these problems have been addressed in any way by the EU FTAs.

4. EU and Mercosur Tax Havens

Finally, it should be noted that several jurisdictions have been identified both in the EU and the Mercosur for their opaqueness or their preferential tax regimes.

In March 2018, the European Commission highlighted the problem of aggressive tax planning opportunities given by 7 EU Member States[6]:

- Belgium: its tax system remains complex, with tax bases eroded by numerous exemptions, deductions and reduced rates.
- Cyprus: Cyprus' CIT rules are used by companies engaged in aggressive tax planning[7] because of the absence of withholding taxes on dividend, interest and royalty payments by Cyprus-based companies. This, together with the corporate tax residency rules and notional interest deduction regimes, may lead to those payments escaping tax if they are also not subject to tax in the recipient jurisdiction.
- Hungary: Hungary's tax rules may be used by multinationals in aggressive tax planning structures, as shown by the large capital flows entering and leaving the country as a share of GDP through 'special purpose entities'[8], combined with the absence of withholding taxes. The absence of withholding taxes on dividend, interest and royalty payments made by companies based in Hungary may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction.
- Ireland: Ireland's high inward and outward FDI stock can only partly be explained by real economic activities taking place in Ireland. The high level of dividend payments and charges for using intellectual property, suggest that the country's tax rules are used by companies that engage in aggressive tax planning. The absence of withholding taxes on dividend payments made by companies based in Ireland suggest that Ireland's corporate tax rules may still be used in tax avoidance structures. The existence of some provisions in bilateral tax treaties between Ireland and some other countries may be used by companies to overrule for tax avoidance as well.

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[6] See https://ec.europa.eu/info/publications/2018-european-semester-country-reports_en

[7] The author considers aggressive tax planning equivalent to tax avoidance. However, the wording of the European Commission is respected in this section.

[8] A special purpose entity is a legal entity that has little or no employment, operations or physical presence in the jurisdiction where it is located, and is related to another corporation, often as its subsidiary, which is typically located in another jurisdiction.

- Luxembourg: its corporate tax reform sought to boost competitiveness by lowering tax rates. In addition to lack of withholding tax on interest and royalty payments, there may be an exemption from withholding tax on dividends paid to a company resident in a country that has a bilateral tax treaty with Luxembourg and is fully subject to an income tax comparable to the Luxembourg corporate income tax.
- Malta: Malta's high inward and outward FDI stock is only partly explained by real economic activities taking place in the country. The high level of dividend, interest and royalty payments as a percentage of GDP suggests that the country's tax rules are used by companies to engage in aggressive tax planning. Companies might choose to invest in Malta to benefit from these corporate tax rules. The large majority of FDI is held by 'Special Purpose Entities'. The absence of withholding taxes on dividends, interest and royalty payments made by Malta based companies may lead to those payments escaping tax altogether.[9]
- The Netherlands: A large share of FDI stocks is held by so-called 'special purpose entities'. The absence of broad withholding taxes on dividend payments by co- operatives, the possibility for hybrid mismatches by using the limited partnership (CV) and the absence of withholding taxes on royalties and interest payments facilitate aggressive tax planning.

The EU and Mercosur member states have been identified in the following positions in TJN's 2018 Financial Secrecy Index[10]:

Rank	Jurisdiction
6	Luxembourg
7	Germany
14	Netherlands
20	Malta
23	United Kingdom
24	Cyprus
25	France
26	Ireland
35	Austria
41	Italy
47	Romania
51	Poland
52	Spain
53	Belgium
54	Sweden
55	Latvia
61	Denmark
62	Paraguay

[9] Malta has introduced a Notional Interest Deduction (NID) regime (available from 2018), which will allow companies and foreign companies with permanent establishments in Malta to claim a deduction on their equity against their tax base. The Commission does not consider this a risk. However, it is probable that it ends up being used for tax avoidance in the same way as interest deduction is.

[10] See https://www.financialsecrecyindex.com/introduction/fsi-2018-results

GUE/NGL
Gauche Unitaire Européenne/Gauche Verte Nordique
European United Left/Nordic Green Left
Groupe Parlementaire · Parliamentary Group
PARLEMENT EUROPEEN · EUROPEAN PARLIAMENT

64	Portugal (Madeira)
67	Uruguay
70	Czech Republic
71	Finland
73	Brazil
74	Hungary
76	Slovakia
79	Croatia
80	Greece
85	Venezuela
89	Bulgaria
93	Estonia
97	Lithuania
104	Slovenia

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