Tax
Issue H64/2015 – 22 July 2015

Tax Analysis

Authors:

Hong Kong

Claus Schuermann
Partner, AP ICE
International Tax
Tel: + 852 22387884
Email: clschuermann@deloitte.com.hk

Olderigo Fantacci
Partner, AP ICE
Tel: + 852 28521260
Email: ofantacci@deloitte.com

A Hong Kong perspective on the EU efforts to prevent harmful tax competition

Europe's financial world has been in the global spotlight for some time—with Greece at the epicenter—but the European Commission's[1] recently issued action plan to reform corporate taxation in the EU and the accompanying list of jurisdictions (including Hong Kong) regarded as noncooperative by a number of EU member states, has put tax news on the front page, at least from a Hong Kong perspective.

The "Action Plan for Fair and Efficient Corporate Taxation in the EU" sets out a series of initiatives in the effort to tackle tax avoidance and achieve other objectives to improve the corporate tax environment for businesses throughout the EU. It also states that the EU needs to consider how best to integrate the result of the OECD base erosion and profit shifting (BEPS) project.

With this release, the European Commission joined the list of bodies and governments that have shared their views about necessary changes in international taxation. The action plan was accompanied by a list of 30 (non-EU member state) countries that are regarded as noncooperative (i.e. "blacklisted") by a certain number of EU member states, but not necessarily by the EU itself. Hong Kong was one of the jurisdictions listed. The consequences of inclusion on the black list currently are unclear.

This article takes a closer look at the European Commission's action plan from a Hong Kong perspective.

Background

The EU has developed its own ambitious initiative to combat aggressive tax planning (which is, in general, coordinated with the OECD's BEPS project). In March 2012, the European Council requested the European Commission to develop measures to strengthen the efforts to stop tax fraud and tax evasion; this was followed by a similar request by the European parliament in April 2012. The Commission issued a communication in June outlining how tax compliance could be improved, how tax avoidance and evasion reduced and how "fair tax competition" could be achieved among countries, in line with the EU Code of Conduct[2]. While the initiative originally was aimed at EU member states, it has been expanded to include third countries, and particularly to target noncooperative jurisdictions.

[1] The European Commission is the executive organ of the EU in charge of proposing legislation, implementing decisions and managing the day-to-day operations of the EU.
[2] Conclusion of the ECOFIN Council meeting concerning taxation policy, 1 December 1997 (98/C 2/01)

In December 2012, the Commission published a concrete action plan to enhance the efforts to combat tax fraud and evasion. The plan included an EU stance against tax havens and EU member states were encouraged to identify tax havens using common criteria and place them on national blacklists. The plan also included a request to member states to reinforce their tax treaties to prevent treaties from resulting in no taxation and recommended the adoption of anti tax avoidance regulations common to all member states. Footnote 2 of this report contains a list of 10 EU member states that have been requested to strengthen their tax collection; seven of these member states have blacklisted Hong Kong (see Appendix 2).

Action plan

The action plan of the European Commission includes five main elements:

1. ***Relaunching the common consolidated corporate tax base (CCCTB) initiative**:* Efforts to establish a CCCTB started in 2011, but did not make much progress. The Commission intends to relaunch this effort, since the CCCTB is regarded as a strong tool for harmonizing taxation and preventing loopholes. The Commission will issue a new legislative proposal in 2016 that would make the CCCTB mandatory for EU multinational enterprises (unlike the previous version that would have allowed EU multinationals to opt out of the regime), and all EU member states would be required to apply the same rules for calculating taxable profits of multinationals. A step-by-step approach would be taken for the introduction of the CCCTB, with the first step being a common corporate tax base, and postponing consolidation, which, according to the Commission, has been the most difficult element in negotiations thus far.

2. ***Ensuring fair taxation where profits are generated**:* Measures will be introduced to ensure that there is a connection between taxation and the place where activities are carried out. Relevant measures in this regard include changes to the definition of "permanent establishment," amendments to the EU interest and royalties and parent-subsidiary directives, improvements to transfer pricing and controlled foreign company regimes of EU member states and the implementation of the OECD's "modified nexus approach" to patent box regimes. These measures should be aligned with the OECD's action plan on BEPS, to ensure consistent implementation across the EU member states.

3. ***Creating a better business environment**:* Measures will be introduced to eliminate obstacles for businesses operating in the EU, including measures allowing group entities to offset profits and losses they make/incur in different EU member states until full CCCTB consolidation is introduced and proposals to improve existing mechanisms to resolve double taxation disputes in the EU.

4. ***Increasing transparency**:* The goal of this item is to increase tax transparency, both within the EU and toward countries outside the EU to ensure fairer taxation and prevent abuse. This includes developing a common approach toward noncooperative jurisdictions, starting with a pan-EU list of countries. Other plans include the introduction of country-by-country reporting requirements.

5. ***Improving EU coordination**:* The action plan states that cooperation between member states is essential to successfully address tax avoidance issues. The commission will launch a discussion within the "Platform on Tax Good Governance" to determine a strategic approach to controlling and auditing companies carrying out cross-border business, and will develop a proposal to reform the Code of Conduct on Business Taxation to enable it to react more efficiently to harmful tax competition and provide guidance on how to implement nonlegislative EU measures against corporate tax avoidance.

These measures indicate similarities with the OECD's BEPS initiative, and the European Commission states that the action plan is "very much aligned" with the BEPS initiative.

Blacklisting of jurisdictions

In June 2015, the European Commission published its decision to establish an expert group called the Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation. The action plan indicates that 15 EU member states currently have criteria for assessing foreign tax regimes in terms of tax cooperation[3]. One criterion for being noncooperative, in most cases, relates to the degree of compliance with transparency and exchange of information measures. Another criterion is the presence of harmful tax measures. Other specific criteria apply on a country-by-country basis.[4]

Along with its action plan, the Commission issued a list of 30 noncooperative jurisdictions (see Appendix 1) that include Hong Kong. The sole criterion for listing a jurisdiction was that at least 10 EU member states have considered the jurisdiction as noncooperative on their own black lists.

[3] France, Germany and the UK, among the largest economies of the EU, do not use blacklists.
[4] http://ec.europa.eu/taxation_customs/taxation/gen_info/good_governance_matters/lists of_countries/index_en.htm

Several of the blacklisted jurisdictions already have issued statements in response to their inclusion on the list and asked to be removed. The Hong Kong government issued its comments on 18 June 2015, calling the allegation that Hong Kong is a noncooperative jurisdiction "totally unfounded." [5]

The European Commission has since emphasized that the list is simply a summary of the approaches that countries currently are following, and that it should create a basis for harmonization of criteria for classification as a noncooperative jurisdiction.

Comments

Hong Kong's inclusion on the blacklist

Hong Kong's inclusion on the black list issued by the European Commission's does not seem coordinated with the efforts of the OECD Global Forum, which has not regarded Hong Kong as noncooperative. Certain other considerations regarding Hong Kong's inclusion on the black list are described below.

A comparison of Hong Kong with the EU member states that have blacklisted it results in certain noteworthy observations. Seven out of the 10 EU member states that have included Hong Kong on their own black lists appeared on the list of EU member states that were asked to strengthen their own tax collection practices in 2012.[6] Two of these EU member states (i.e. Bulgaria and Lithuania) have a lower corporate income tax rate than Hong Kong; however, no EU jurisdictions were included on the Commission's list.

Most of the EU member states that have blacklisted Hong Kong have a smaller national gross domestic product (GDP) than Hong Kong, whereas Hong Kong's GDP is even higher than that of larger EU member states such as Denmark or Finland. Hong Kong's GDP is higher than that of all other jurisdictions listed on the black list issued by the Commission (for which GDP data currently is available) *combined* (see Appendix 1). This indicates that considerable business activity *actually* is taking place in Hong Kong.

Certain EU member states that have included Hong Kong on their black lists may end up removing it from the lists due to subsequent developments. For example, Italy's tax law provides for two separate black lists for different purposes, both of which currently include Hong Kong. The lists are issued by the Minister of the Economy via ministerial decree, and they include all countries and territories whose tax system does not provide for an exchange of information with Italy and/or provides for a significantly lower taxation burden than Italy. Hong Kong originally was included on the lists because it had not concluded an agreement with Italy on the exchange of information in the form of a tax information exchange agreement or a tax treaty. Recent developments, however, likely will change Hong Kong's status from an Italian perspective: in June 2015, the Italian parliament ratified the double tax agreement between Italy and Hong Kong, which will become effective in Italy starting from 1 January 2016. The application of the Hong Kong-Italy treaty is expected to lead to the removal of Hong Kong from both Italian black lists, as recently was the case with Singapore.

What blacklisting means for Hong Kong

The inclusion of Hong Kong on the Commission's black list negatively impacts Hong Kong's reputation.

It is unclear precisely why some EU member states have included Hong Kong on their black lists, but the government is taking steps that may address some potential concerns. For example, an EU member state may have considered Hong Kong's territorial tax regime when assessing whether Hong Kong is a noncooperative tax jurisdiction or provides for harmful tax practices.

The Hong Kong Inland Revenue Department already has become very cautious in processing offshore claims and discouraging taxpayers from applying for advance rulings on the source of profits. The Hong Kong government also has committed to enhancing its regime to facilitate the exchange of information with other jurisdictions, and plans to introduce domestic legislation to adopt the OECD's Standard for Automatic Exchange of Financial Account Information in Tax Matters.

The government should do more to explain its position on taxation to avoid misunderstandings, and it already has taken certain actions in this regard. The statement issued on 18 June 2015 (in response to inclusion on the Commission's black list) is one example.

[5] http://www.info.gov.hk/gia/general/201506/18/P201506180929.htm

[6] A list of 10 such jurisdictions appeared in footnote 2 of the Commission's December 2012 action plan to strengthen the fight against tax fraud and tax evasion, COM (2012) 722 final.

Conclusion

The European Commission's list of 30 countries that are regarded as noncooperative by certain EU member states has been regarded as the Commission's own list by many commentators. Many of the EU member states that have blacklisted non EU member states previously were advised by the European Commission to strengthen their own tax collection. It certainly raises questions that just those countries have blacklisted Hong Kong, among other countries. The respective EU member states generally are not economically the strongest within the EU. They largely include new EU member states, and it is questionable whether the tax collection problems in some of these countries are related to aggressive tax planning by MNCs.

If the EU does not harmonize its efforts to combat tax fraud and harmful tax competition with the OECD, there ultimately may be different sets of requirements that could be very difficult to comply with for third countries. This could lead to the opposite of the goal of simpler and more harmonized tax compliance rules. Instead, non EU member states' companies—and their tax authorities as well—could have to deal with an even more complex world, thus increasing the risk of further tax noncompliance.

While there has been much more talk about the OECD developments relating to BEPS than the EU initiatives, the significance of the EC's action plan should not be underestimated. While OECD actions are merely suggestions that will be implemented only if countries ultimately are willing to introduce legislation, the EU has the power to introduce legislation in its own right and, therefore, to influence the tax systems of member states directly.

Appendix 1

Overview of countries blacklisted by at least 10 EU member states, according to the European Commission, and their respective 2014 GDP (where available), as per the World Bank

		GDP (million USD) 2014
1	Andorra	3,249
2	Anguilla	no info
3	Antigua and Barbuda	1,269
4	Bahamas	8,511
5	Barbados	4,348
6	Belize	1,624
7	Bermuda	5,574
8	British Virgin Islands	no info
9	Brunei	17,257
10	Cayman Islands	no info
11	Cook Islands	no info
12	Grenada	no info
13	Guernsey	no info
14	**Hong Kong** [7]	**290,896**
15	Liberia	2,027
16	Liechtenstein	5,488
17	Maldives	3,032
18	Marshall Islands	191
19	Mauritius	12,616
20	Monaco	no info
21	Montserrat	no info
22	Nauru	no info
23	Niue	no info
24	Panama	46,213
25	St Kitts and Nevis	833
26	St Vincent and the Grenadines	729
27	Seychelles	1,406
28	Turks and Caicos Islands	no info
29	US Virgin Islands	no info
30	Vanuatu	802
	Total	**406,065**

[7] Hong Kong is blacklisted by the following EU member states: Italy, Spain, Portugal, Greece, Bulgaria, Croatia, Poland, Lithuania, Latvia, Estonia

Appendix 2

The following EU member states have blacklisted Hong Kong. Some of these countries have a double tax arrangement (DTA) in place with Hong Kong. The average corporate income tax (CIT) rate is 20%, only slightly higher than Hong Kong's 16.5% tax rate. The EC asked most of these countries strengthen their tax collection in 2012, as indicated below.

Country	DTA with HK	CIT rate in country (2015)	Recommendations by EU given to strengthen tax collection
Bulgaria	N/A	10.0%	yes
Croatia	N/A	20.0%	no
Estonia	N/A	20.0%	yes
Greece	N/A	26.0%	yes
Italy	signed	27.5%	yes
Latvia	under negotiation	15.0%	no
Lithuania	N/A	15.0%	yes
Poland	N/A	19.0%	yes
Portugal	in force	21.0%	yes
Spain	in force	28.0%	no
Average CIT rate		**20.2%**	

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

Beijing
Andrew Zhu
Partner
Tel: +86 10 8520 7508
Fax: +86 10 8518 1326
Email: andzhu@deloitte.com.cn

Hong Kong
Sarah Chin
Partner
Tel: +852 2852 6440
Fax: +852 2520 6205
Email: sachin@deloitte.com.hk

Shenzhen
Victor Li
Partner
Tel: +86 755 3353 8113
Fax: +86 755 8246 3222
Email: vicli@deloitte.com.cn

Chongqing
Frank Tang
Partner
Tel: +86 23 6310 6206
Fax: +86 23 6310 6170
Email: ftang@deloitte.com.cn

Jinan
Beth Jiang
Director
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068
Email: betjiang@deloitte.com.cn

Suzhou
Frank Xu / Maria Liang
Partner
Tel: +86 512 6289 1318 / 1328
Fax: +86 512 6762 3338
Email: frakxu@deloitte.com.cn
mliang@deloitte.com.cn

Dalian
Bill Bai
Partner
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297
Email: bilbai@deloitte.com.cn

Macau
Raymond Tang
Partner
Tel: +853 2871 2998
Fax: +853 2871 3033
Email: raytang@deloitte.com.hk

Tianjin
Jason Su
Partner
Tel: +86 22 2320 6680
Fax: +86 22 2320 6699
Email: jassu@deloitte.com.cn

Guangzhou
Victor Li
Partner
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121
Email: vicli@deloitte.com.cn

Nanjing
Frank Xu
Partner
Tel: +86 25 5791 5208
Fax: +86 25 8691 8776
Email: frakxu@deloitte.com.cn

Wuhan
Justin Zhu
Partner
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032
Email: juszhu@deloitte.com.cn

Hangzhou
Qiang Lu
Partner
Tel: +86 571 2811 1901
Fax: +86 571 2811 1904
Email: qilu@deloitte.com.cn

Shanghai
Eunice Kuo
Partner
Tel: +86 21 6141 1308
Fax: +86 21 6335 0003
Email: eunicekuo@deloitte.com.cn

Xiamen
Jim Chung
Partner
Tel: +86 592 2107 298
Fax: +86 592 2107 259
Email: jichung@deloitte.com.cn

About the Deloitte China National Tax Technical Centre

The Deloitte China National Tax Technical Centre ("NTC") was established in 2006 to continuously improve the quality of Deloitte China's tax services, to better serve the clients, and to help Deloitte China's tax team excel. The Deloitte China NTC prepares and publishes "Tax Analysis", "Tax News", etc. These publications include introduction and commentaries on newly issued tax legislations, regulations and circulars from technical perspectives. The Deloitte China NTC also conducts research studies and analysis and provides professional opinions on ambiguous and complex issues. For more information, please contact:

National Tax Technical Centre
Email: ntc@deloitte.com.cn

National Leader
Leonard Khaw
Partner
Tel: +86 21 6141 1498
Fax: +86 21 6335 0003
Email: lkhaw@deloitte.com.cn

Northern China
Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 8518 1326
Email: juliezhang@deloitte.com.cn

Southern China (Hong Kong)
Davy Yun
Partner
Tel: +852 2852 6538
Fax: +852 2520 6205
Email: dyun@deloitte.com.hk

Southern China (Mainland/Macau)
German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0121
Email: gercheung@deloitte.com.cn

Eastern China
Kevin Zhu
Director
Tel: +86 21 6141 1262
Fax: +86 21 6335 0003
Email: kzhu@deloitte.com.cn

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanluk@deloitte.com.hk or by fax to +852 2541 1911.