



TECHNIUM
SOCIAL SCIENCES JOURNAL

Vol. 27, 2022

**A new decade
for social changes**

www.techniumscience.com

ISSN 2668-7798



9 772668 779000

Pandora Papers and the latest European efforts to combat money laundering, tax evasion and tax avoidance

Dragoş Mihail Mănescu

The Bucharest University of Economic Studies, Romania

dragos.manescu@drept.ase.ro

Abstract. Following the revelations of the Pandora Papers on offshore financial mechanisms which allow European citizens to avoid paying tax obligations and to commit tax evasion or money laundering offenses, the European Parliament adopted Resolution 2021/2922 (RSP) requiring Member States to take urgent and decisive action, both legislative and investigative, to combat this type of criminal behavior. As a response to the request formulated by the Parliament, the European Commission drafted a Proposal for a council Directive laying down rules to prevent the misuse of shell entities for tax purposes by introducing new monitoring and reporting regulations.

Keywords. 2021/2922 (RSP), Pandora Papers, fiscal group, fiscal consolidation, tax evasion, money laundering, substance test

1. General considerations

Combating money laundering, tax evasion, tax avoidance and aggressive tax planning are actions that are increasingly in the attention of the legislative and executive bodies of the national states but also of the European institutions. In turn, the public is more and more interested in such harmful actions and calls for firm measures against such practices.

In time, there have been actions to disclose information regarding such practices taken by independent players, mainly journalists, actions generically named: Lux Leaks in 2014, Swiss Leaks in 2015, Panama Papers in 2016, Paradise Papers in 2017, Mauritius Leaks in 2019, Luanda Leaks and FinCEN files in 2020 and Lux Letters in 2021. The latest action to bring such illegal practices to public attention is the publication by the International Consortium of Investigative Journalists (ICIJ) of the so-called Pandora Papers package in October 3, 2021.

The information presented hardly surprises anyone, especially since it does nothing but show, once again, the weaknesses and legal obstacles that are found in the way the legislative systems¹, property laws and fair and equitable taxation are designed.

Such revelations have put additional pressure on lawmakers around the world calling for new measures. As a result, there has been a need in the United States, for example, to

¹<https://www.project-syndicate.org/commentary/pandora-papers-how-law-shields-wealth-by-katharina-pistor-2021-10?barrier=accesspaylog>

accelerate the enactment of the Transparency Law, which was passed by the US Congress in early 2021 and aims to combat the use of shell corporations in corrupt activities².

For its part, the European Parliament felt the need to take a stand and highlight, once again, the progress and obstacles identified in this area and to call on all relevant actors to take immediate action, given that this type of incriminating behavior leads to unfair tax competition and unfair tax burden distribution and distorts business decisions in the internal market³.

2. European Parliament Resolution on the Pandora Papers

(i) Thus, by virtue of its supervisory role over all European institutions, and in particular the European Commission⁴ and in accordance with art. 132 para. 2 and 4 of the Rules of Procedure of the European Parliament⁵, on 21 October 2021, Parliament adopted the Resolution on Pandora Papers: implications for the efforts to combat money laundering, tax evasion and tax avoidance (2021/2922 (RSP))⁶. As stated in the very text of the resolution referred to, in point D of the Preamble, the Pandora Papers represent the most recent major data leak that reveals the internal mechanisms of the offshore financial world⁷.

(ii) The preamble to that resolution makes a preface to the so-called indictment of the fight against money laundering and tax evasion, identifying the positive and negative factors and calling for immediate action.

(iii) Investigative journalism is also identified as having an “invaluable” contribution both in terms of obtaining information and disclosing it to the general public and the competent authorities, being practically an important element in combating the phenomenon, but also in terms of raising awareness of on this scourge, the resolution giving journalism a key role in maintaining democracy and the rule of law⁸. These are the reasons why journalists, their sources and whistleblowers are subjected to multiple pressures despite specific regulations designed to protect them⁹.

(iv) These pressures are statewide or from individual actors and are intended to affect the freedom of opinion or even the life, health and bodily integrity of those who disclose such incriminating actions. We believe that through these statements in the resolution, the European Parliament validate the journalistic activity and, at the same time, stand as its defender both against the interference of the Member States, which, through various authorities, may affect freedom of expression and also against those groups of criminals who aim to commit crimes such as those in the attention of the Resolution and target to eliminate the factors that would prevent or limit them in their criminal activity.

(v) Be that as it may, the resolution seeks to raise awareness of this criminal phenomenon among all actors involved, from citizens to companies, authorities and Member

² William E. Quick, James A. Kopfensteiner, The Corporate Transparency Act and Pandora’s Papers, *The National Law Review*, Volume XII, Number 4, January 4, 2022, <https://www.natlawreview.com/article/corporate-transparency-act-and-pandora-s-papers>

³ https://ec.europa.eu/taxation_customs/system/files/2021-12/COM_2021_565_1_EN_ACT_part1_v7.pdf

⁴ Ovidiu Ioan Dumitru, Andreea Stoican, *European Union Law, Lecture Notes*, Ed. ASE, București 2020, p. 67 și urm.

⁵ https://www.europarl.europa.eu/doceo/document/RULES-9-2019-07-02-RULE-132_EN.html

⁶ https://www.europarl.europa.eu/doceo/document/TA-9-2021-0438_EN.html

⁷ IDEM

⁸ pct. 1-4 in Resolution 2021/2922(RSP)

⁹ See also The DIRECTIVE (EU) 2019/1937 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 October 2019 on the protection of persons who report breaches of Union law, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1937&from=RO>

States as entities, and calls for immediate measures, both legislative and action, including the automatic exchange of information on transnational level.

(vi) These provisions must be corroborated with those of Directive (EU) 2018/843 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing¹⁰, known as the AML Directive 5 which requires, inter alia, the obligation for Member States to create registers with the real beneficiaries of all legal entities established in the EU, including trust funds, and to provide public access to information about the real beneficiaries in relation to most corporate structures.

(vii) At the same time, the proposal¹¹ for the 6th AML / CFL Directive, which is currently under analysis and debate, needs to be considered. As stated in the preamble, however, this proposal is not limited to transferring provisions from the current Directive to a future one but makes a number of substantive changes in order to achieve a higher level of convergence in the practices of supervisors and intelligence units. Also the proposal intends to strengthen the cooperation between competent authorities¹² and to make the introduction of an obligation for non-EU legal entities that enter into a business relationship with an entity required at EU level or that acquires real estate in the EU to register the actual beneficial owner in the EU registers with the real beneficiaries.

(viii) As can be seen from the text of the resolution, by virtue of its oversight role over all the European institutions mentioned above, the European Parliament addresses the role and work of all institutions responsible for money laundering and tax evasion, from the European Commission and the European Public Prosecutor's Office to the European Banking Authority, the European Court of Auditors, Europol and law enforcement agencies. At the same time, it addresses the need for global action to combat tax evasion, money laundering and aggressive tax planning.

In short, with this resolution, the European Parliament calls on the Member States of the European Union and on all the other countries:

- to investigate the economic crimes revealed by the Pandora Papers, an independent journalistic investigation that disclosed where and how the fortunes of some of the world's leaders are hidden.

- to take action to cover the shortcomings in national legislation which currently underline the avoidance of payment of tax obligations and the perpetration of offenses of tax evasion or money laundering.

- to tighten the legislation allowing the granting of citizenship or the right of residence / residence in one of the Member States on the basis of the payment of sums of money or the making of financial investments and establish clear and transparent rules in this area.

- to eliminate the tax havens at European level. It should be noted that the resolution nominates the British Virgin Islands as a favorite place for the registration of mailbox companies, as evidenced by the revelations of the Pandora Papers¹³.

- to take steps, on their own initiative, to protect their tax bases until the European Commission's intention to propose a directive on a common EU-wide system for withholding

¹⁰ <https://eur-lex.europa.eu/legal-content/RO/TXT/?uri=CELEX%3A32018L0843>

¹¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52021PC0423>: Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU)2015/849

¹² https://eur-lex.europa.eu/resource.html?uri=cellar:05758242-ead6-11eb-93a8-01aa75ed71a1.0021.02/DOC_1&format=PDF

¹³ https://en.wikipedia.org/wiki/Pandora_Papers

tax on dividends and interests is legislated, namely the intention to reform the EU's fair taxation policy, aggressive tax planning and harmful tax practices that lead to the erosion of Member States' tax base.

- to criticize the finance ministers of the Member States who have not yet assumed their individual and joint responsibilities in the fight against tax havens, offshore companies and trust structures¹⁴.

- calls on the US Federal Government and its governments to take further steps to ensure greater transparency in companies and to adhere to the Common Reporting Standard (SCR) by exchanging information without restriction with other countries, provided that some US states, such as South Dakota, Alaska, Wyoming, Delaware and Nevada, known tax havens, have become centers of financial and corporate secrecy, as revealed by the Pandora Papers¹⁵. As a supplement, we need to mention that one of the reasons that happened is considered to be the fact that starting with 1995, the state created "dynasty trusts" which no longer limited the duration of trusts but allowed creating trusts that could be passed down for generations with little or nothing in tax obligations¹⁶.

- calls on the Commission and the Member States to initiate new negotiations with the United States in the OECD in order to achieve full reciprocity in a framework for a common and strengthened Common Reporting Standard (SCR). To this is added the initiative of amending the United States' current criminal financial legislation respectively the Bank Secrecy Act enacted by Congress in 1970¹⁷. Following the release of the Pandora Papers, a group of US lawmakers proposed the so-called "Enablers Act" meant to take severe measures against the financial "enablers" that helped wealthy foreign clients to invest their money into the United States¹⁸.

- calls for stricter criteria for fair taxation, according to which the jurisdiction in question should not facilitate offshore structures or mechanisms aimed at attracting profits that do not reflect a real economic activity in that jurisdiction. As a result, a minimum level of real economic activity should be introduced as a criterion for what constitutes a tax haven, appropriate sanctions and a minimum effective taxation in accordance with the internationally agreed minimum effective rate of taxation under Pillar II of the Inclusive Framework¹⁹.

3. Proposal for a COUNCIL DIRECTIVE laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU

As a response to the request formulated by the European Parliament in its Resolution mentioned above asking for a firm EU action to counter the misuse of shell entities for tax purposes and, more generally, to the demand of several Member States, businesses and civil society for a stronger and more coherent EU approach against tax avoidance and evasion²⁰ and with the intention to combat the misuse of fictitious tax entities (companies) that do not actually have economic activity but are only used to evade the payment of taxes, the European Commission presented on 22.12.2021 a draft directive²¹ to impose new monitoring and

¹⁴ https://www.europarl.europa.eu/doceo/document/TA-9-2021-0438_EN.html

¹⁵ Pct. 53 in Resolution 2021/2922(RSP)

¹⁶ <https://www.washingtonpost.com/business/interactive/2021/booming-us-tax-haven-industry/>

¹⁷ Cora Leeuwenburg, The Pandora Papers and the Bank Secrecy Act, Journal of Regulatory Compliance, Loyola University of Chicago School of Law, October 22, 2021

¹⁸ <https://thehill.com/regulation/business/575700-pandora-papers-prompt-lawmakers-to-push-for-crackdown-on-financial?rl=1>

¹⁹ pct. 85 in Resolution 2021/2922(RSP)

²⁰ https://ec.europa.eu/taxation_customs/system/files/2021-12/COM_2021_565_1_EN_ACT_part1_v7.pdf

²¹ IDEM

reporting regulations. The new Directive applies to any entity engaged in an economic activity, regardless of its legal form, that is considered a resident tax and is eligible to receive a tax residency certificate in a Member State and targets those with cross-border activity.

It would enter into force on 01.01.2024 and, as stated in the Explanatory Memorandum of the Proposal, takes into account circumstances brought to light by the Pandora Papers disclosures.

Consequently, this type of "mailbox" companies that are used, mainly for the purposes of aggressive tax planning or tax evasion, will be targeted by "measures that make it difficult for them to gain access to unfair tax advantages and will allow more possible abuse by national authorities of any abuse committed by such companies"²².

At the same time, transparency standards and objective indicators will be imposed in order to facilitate the identification by the national tax and administrative authorities of those companies that exist only on paper and are used for illicit purposes²³.

As a result, the Proposal is introducing the so called "substance test" in 7 steps that will help Member States to identify any form of legal persons that are purportedly used in an economic activity, but which are actually utilized for the purpose of obtaining tax advantages and lays down indicators of minimum substance for undertakings in Member States together with rules regarding the treatment for tax purposes of those undertakings that exceed the indicators²⁴.

The proposal regulates these 7 steps as follows:

1. undertakings that should report due to being found to be 'at risk' as they seemingly engage with cross-border activities (first condition) and, in addition, rely on other undertakings for their own administration. These third parties can be in particular professional service providers or equivalents.

2. reporting. The undertakings that are considered to be at risk are asked to report on their substance, that is to provide specific information that is to be assessed by the tax administrations in regards of premises available for the exclusive use of the undertaking; at least one own and active bank account in the Union; at least one director resident close to the undertaking and dedicated to its activities or, alternatively, a sufficient number of the undertaking's employees that are engaged with its core income generating activities being resident close to the undertaking. In these regards, we consider important to also see some of the international standard on substantial economic activity for tax purposes²⁵.

3. presumption of lack of minimal substance. This step refers to the undertaking that lacks at least one of the relevant elements on substance and should be presumed to be a 'shell', i.e. lacking substance and being misused for tax purposes.

4. possibility of rebuttal. The suspicious undertaking can counter-argument i.e. to prove that it has substance, relevant income or in any case it is not misused for tax purposes. We consider that it is only normal to give the possibility to the taxpayers to adduce specific data and concrete evidence regarding their individual case and contradict the general parameters set up by the indicators imposed by the Directive.

²² https://ec.europa.eu/commission/presscorner/detail/en/ip_21_7027, Executive Vice-President for an Economy that Works for People, Valdis Dombrovskis Press Release

²³ https://ec.europa.eu/commission/presscorner/detail/en/ip_21_7027, Commissioner for Economy, Paolo Gentiloni Press Release

²⁴ Art. 1 of the Proposal for a COUNCIL DIRECTIVE 2021/0434 (CNS)

²⁵ <https://www.oecd.org/tax/beps/substantial-activities-in-no-or-only-nominal-tax-jurisdictions-guidance.pdf>

5. possibility of gaining exemption from reporting for lack of tax motives. The Directive takes into consideration the possibility that an undertaking that does not fulfil the minimum substance indicators could still be a legitimate one and could be used for genuine business activities that does not involve creating a tax benefit for itself, the group of companies of which it is part or for the ultimate beneficial owner. In this case, the tax administration of the place of claimed tax residence of the undertaking is allowed to extend the validity of the exemption for another 5 years (i.e. for a total maximum of 6 years) in order not to have to verify/to submit to an audit the undertaking every tax year. We consider that this is a normal procedure that is meant to ease the activity of the tax administration, to confer the necessary credibility to its activity and also not to stress pointlessly the undertaking.

6. tax consequences. There are several important consequences that the tax administrations can call on. Art. 11 and 12 of the proposed Directive refer to these repercussions that can go from disregarding the agreements or conventions in force in the Member State on the elimination of double taxation of income or on the common system of taxation²⁶; to the not issuing of a tax residence certificate for tax purposes at all or the Member States will issue a certificate with a warning statement; tax the relevant income of the undertaking in accordance with its national law in Member States other than the Member State of the undertaking. Also, the Member States can apply penalties against the violation of the reporting obligations that can include an administrative pecuniary sanction of at least 5% of the undertaking's turnover.

7. potential request for the performance of a tax audit and exchange of information automatically via making data available on a Central Directory. An automatic exchange of data and free access to information on EU shells, at any time and without a need for recourse to the request for information is provided by the Directive. Also, one Member State can request from another Member State a tax audit on any undertaking that passes the gateway of this Directive²⁷.

To sum up, the Directive proposed by the Commission is meant to identify and neutralize a specific scheme used for tax avoidance or tax evasion purposes by giving the tax authorities the indicators and the tools necessary to disrupt the shell undertakings that use it and by strengthening the cooperation between Member States.

4. Conclusions

While the European Parliament's resolution is commendable, its role is rather declarative and without a concrete purpose. At the same time, the European Commission's initiative to regulate this thorny area is likely to make us aware that the economic and financial reality has shown us that the natural or legal persons addressed by these legislative measures have the necessary intellectual capacity and financial resources to be, almost every time, one step ahead of the legislative process. Moreover, many national or transnational interest groups are constantly striving to evolve and refine their evasive ways of taking action to elude huge sums of money from the attention of tax authorities.

On the other hand, the European legislative process has often been noted as being rather cumbersome. In addition, it involves long deadlines for transposition into national law, despite the immediate action needed in this area.

²⁶ COUNCIL DIRECTIVE 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States/ COUNCIL DIRECTIVE 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003L0049&from=EN>

²⁷ Article 13 of the Proposal for a COUNCIL DIRECTIVE 2021/0434 (CNS)

Moreover, at the present, as emphasized also by the European Commission²⁸, existing tax instruments at EU level do not contain explicit provisions targeting shell entities, i.e. entities that do not perform any actual economic activity, even if they are presumably engaged with one, and that can be misused for tax avoidance or evasion purposes.

As a result, of course, the obvious interest and the rapid start of this sinuous and cumbersome process are auspicious, but we are of the opinion that it is up to the nation-states to attack this problem immediately by clear, firm regulations and actions aimed at leading to limit the phenomenon of tax evasion, money laundering and avoidance of tax obligations, help to the recovery from the COVID-19 pandemic and lower the taxpayers' overall tax liability.

References

- [1] William E. Quick, James A. Kopfensteiner, *The Corporate Transparency Act and Pandora's Papers*, *The National Law Review*, Volume XII, Number 4, January 4, 2022, <https://www.natlawreview.com/article/corporate-transparency-act-and-pandora-s-papers>
- [2] Cora Leeuwenburg, *The Pandora Papers and the Bank Secrecy Act*, *Journal of Regulatory Compliance*, Loyola University of Chicago School of Law, October 22, 2021
- [3] Ovidiu Ioan Dumitru, Andreea Stoican, *European Union Law, Lecture Notes*, Ed. ASE, București 2020
- [4] <https://thehill.com/regulation/business/575700-pandora-papers-prompt-lawmakers-to-push-for-crackdown-on-financial?r=1>
- [5] <https://www.project-syndicate.org/commentary/pandora-papers-how-law-shields-wealth-by-katharina-pistor-2021-10?barrier=accesspaylog>
- [6] <https://www.washingtonpost.com/business/interactive/2021/booming-us-tax-haven-industry/>
- [7] https://www.europarl.europa.eu/doceo/document/RULES-9-2019-07-02-RULE-132_EN.html
- [8] <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52021PC0423>
- [9] https://eur-lex.europa.eu/resource.html?uri=cellar:05758242-ead6-11eb-93a8-01aa75ed71a1.0021.02/DOC_1&format=PDF
- [10] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1937&from=RO>
- [11] https://ec.europa.eu/taxation_customs/system/files/2021-12/COM_2021_565_1_EN_ACT_part1_v7.pdf
- [12] https://ec.europa.eu/commission/presscorner/detail/en/ip_21_7027, Executive Vice-President for an Economy that Works for People, Valdis Dombrovskis Press Release

²⁸ https://ec.europa.eu/taxation_customs/system/files/2021-12/COM_2021_565_1_EN_ACT_part1_v7.pdf