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The Definition and Treatment of Tax Havens in Brazilian Tax Law between 1995 and 2015*

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I. PROBLEM DEFINITION

Although "tax havens" and "tax havens lists" are terms often used by general and specialized media, it seems that little attention is paid to the fact that the definition of a tax haven and the purpose of a tax haven list may vary greatly from country to country.

For instance, the Organisation for Economic Cooperation and Development (OECD) has recently published its updated list of uncooperative tax havens. The *OECD Secretary-General Report to G20 Leaders* [1], dated July 2017, states that:

Because of the perspective of the G20's call to identify non-cooperative jurisdictions on the tax transparency standards, jurisdictions have moved fast to meet the objective criteria: 31 have signed (or asked to sign) the multilateral Convention on Mutual Administrative Assistance in Tax Matters, 101 have committed to commencing automatic exchanges of financial account information in 2017 and 2018 (all requested jurisdictions have now committed), and 17 jurisdictions have improved their Global Forum rating on the EOIR standard, so that only one (Trinidad and Tobago) remains "Non Compliant".

The OECD's list featured only one country and had its usefulness criticized[2] [3]. On the one hand, the organization focused on willingness of jurisdictions to cooperate to the exchange of tax information. On the other hand, there has been a general feeling that it has not properly addressed the most relevant issues of tax. Or has it?

The answer depends on the definition of tax havens itself and on the purpose of the list. Although there is no universally accepted definition of tax havens, taking a look at two different approaches by international governmental organizations gives a good start.

The Organization of American States (OAS) defines a tax haven as a territory or a state with a legal or tax system that protects capital ownership by granting anonymous, confidential and safe instruments of property[4]. Usually a small territory has adopted an attractive tax policy for foreign investments in order to compensate for the lack of natural resources.

This is a very general definition intended at describing a wide variety of practices. It focuses on territories lacking

Abstract

Over the years, a number of 'tax haven lists' have been created at the national and international level, with varying definitions and criteria used to identify jurisdictions falling under their scope. This policy brief presents the experience of Brazil in compiling their national list of tax havens, the roadmap they followed for its implementation, and the impact that it has had on their foreign investment flows. It also provides the lessons learnt from this experience, which can be positively utilized by other developing countries.

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Ces dernières années, plusieurs listes nationales et internationales de paradis fiscaux ont été établies, dans lesquelles les définitions et les critères utilisés pour déterminer les juridictions qui entrent dans leur champ d'application varient. Le présent rapport se penche sur l'expérience du Brésil en la matière et examine le processus que le pays a suivi pour élaborer sa liste nationale de paradis fiscaux et les conséquences qu'elle a eues sur les investissements étrangers. Le rapport présente également les enseignements tirés de l'expérience du Brésil, qui peuvent servir aux autres pays en développement.

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En los últimos años se han creado tanto en el ámbito nacional como internacional una serie de «listas de paraísos fiscales» que hacen uso de diferentes definiciones y criterios para determinar las jurisdicciones que entran en su ámbito de aplicación. Este informe sobre políticas se centra en la experiencia del Brasil al respecto y se examina el proceso seguido por el país para elaborar su lista de paraísos fiscales y las consecuencias de esta lista para la inversión extranjera. Asimismo, se exponen las lecciones de la experiencia del Brasil, que pueden ser útiles para otros países en desarrollo.

* The policy brief is written in the author's personal capacity and does not reflect any official opinion or position of the Brazilian Tax Authority.

natural resources and that would otherwise not receive foreign investments, considered necessary for their development. The problem is twofold: territories not lacking natural resources that still engage in harmful tax practices and the line between a legitimate tax planning and an abusive one.

The OECD went a step further, setting the milestone in making tax haven lists two years after publishing its 1998 study named *Harmful Tax Competition: An Emerging Global Issue*[5]. The first list, containing 35 tax havens, was challenged by most of the listed jurisdictions and was criticized for leaving out well-known international financial centers that offered low tax services, such as Singapore and Hong Kong.

Later on, the OECD launched the *Project on Harmful Tax Practices* and, after a few reports and updates, recognized that, besides tax havens, preferential tax regimes also represented a more subtle but harmful tax competition. The practical problem was that tax havens and preferential tax regimes were both relative concepts: countries with different levels of taxation might disagree on what exactly a low taxation is.

To overcome this practical difficulty, the OECD laid down four key factors to assess the harmfulness of a tax regime:

(a) the regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities;

(b) the regime is ring-fenced from the domestic economy;

(c) the regime lacks transparency (for example, the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure); and

(d) there is no effective exchange of information with respect to the regime.

Besides the four key factors, the OECD also considers eight other factors in determining whether a tax regime is potentially harmful:

(a) an artificial definition of the tax base;

(b) failure to adhere to international transfer pricing principles;

(c) foreign source income exempt from residence country taxation;

(d) negotiable tax rate or tax base;

(e) existence of secrecy provisions;

(f) access to a wide network of tax treaties;

(g) the regime is promoted as a tax minimization vehicle; and

(h) the regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities.

Because of the project, the OECD developed an interesting model for analyzing tax regimes but opened the door for negotiations to remove countries from the list as long as they agreed to sign Tax Information Exchange Agreements (TIEA) with OECD members. Thirty-three listed countries joined the negotiations and left the list, which eventually became empty[6]. That is, until the latest update in 2017.

As for the purposes of a list, according to Jason Sharman and Gregory Rawlings, authors of a STEP study[7], there are four types of lists of tax havens:

a) blacklists – lists of jurisdictions considered to be tax havens according to national or domestic law. Transactions to or from such jurisdictions are subject to higher levels of taxation or denial of fiscal benefits;

b) informal blacklists – lists of jurisdictions considered to be potential tax havens according to national or domestic law, but with no automatic application of higher levels of taxation or denial of fiscal benefits;

c) greylists – lists of jurisdictions that are not considered tax havens in general, but that still have some transactions subject to higher levels of taxation or denial of fiscal benefits in case certain conditions are observed; and

d) whitelists – lists of jurisdictions that, according to national or domestic law, fulfill the criteria of having transactions from or to such jurisdictions receive a beneficial tax treatment, such as lower taxation or increased benefits.

According to these criteria, the OECD's is a blacklist, but is used to pressure for the signature of TIEAs with its members. The name of the list was changed to "non-cooperative jurisdictions" and the effects were extended from tax to commerce. So, considering the definition, the type of list and the purpose of the OECD, the one-country list might have satisfied its requirements. The fact that this list will be of little use to developing countries might be a good one, if these countries take the opportunity to deepen the discussion on harmful tax practices, implementing definitions and tax policies adjusted to their own needs.

Section II presents the evolution of the definition and tax treatment of tax havens in Brazilian tax law between 1995 and 2015. Section III discusses the main results of this 20-year experience.

II. DESCRIPTION OF THE BRAZILIAN EXPERIENCE

II.1. Legal roadmap

Although the Brazilian tax law does not use the term "tax havens", Article 24 of Law 9,430, dated 27 December 1996[8], defines "countries with favored taxation" as those where income tax rates of natural persons or entities are less than 20% (twenty per cent).

Article 24. The provisions regarding prices, costs and interest rates, contained in arts. 18 to 22, also apply to transactions carried out by a natural or legal person residing or domiciled in

Brazil, with any natural or juridical person, even if not related, resident or domiciled in a country that does not tax the income or that taxes it at a maximum rate lower than twenty percent.

Paragraph 1. For the purpose of the provisions in the final part of this article, the tax laws of that country, applicable to individuals or legal entities, shall be considered according to the nature of the entity with which the transaction was performed.

Paragraph 2. In the case of a natural person resident in Brazil:

I - the amount calculated according to the methods referred to in art. 18 will be considered as cost of acquisition for purposes of calculation of capital gain on the disposal of the good or right;

II - the price related to the good or right alienated, for purposes of calculation of capital gain, will be verified in accordance with the provisions of art. 19;

III - the price of services rendered, determined in accordance with the provisions of art. 19, will be considered as taxable income;

IV - the interest determined in accordance with art. 22 will be considered as taxable income.

Paragraph 3. For the purposes of the provisions of this article, the taxation of labor and the taxation of capital, as well as the dependencies of the country of residence or domicile, will be considered separately. (Redaction given by Law 10,451/2002)

Paragraph 4. <u>A country or dependency whose legislation does not allow access to information on the corporate composition of legal entities, their ownership or the identification of the beneficial owner of income attributed to non-residents are also considered to have a favored taxation</u>. (Included by Law 11,727/2008) (highlighted)

The law aimed at applying transfer pricing rules to such cases, regardless of the transactions being performed between related parties or not. A favored taxation could distort prices, shifting profit away from the national tax base, as shown in the example in box 1.

Transfer pricing rules would ensure that a fair amount of profit remained subject to tax in Brazil. According to the Explanatory Memorandum of Law 9,430/1996,

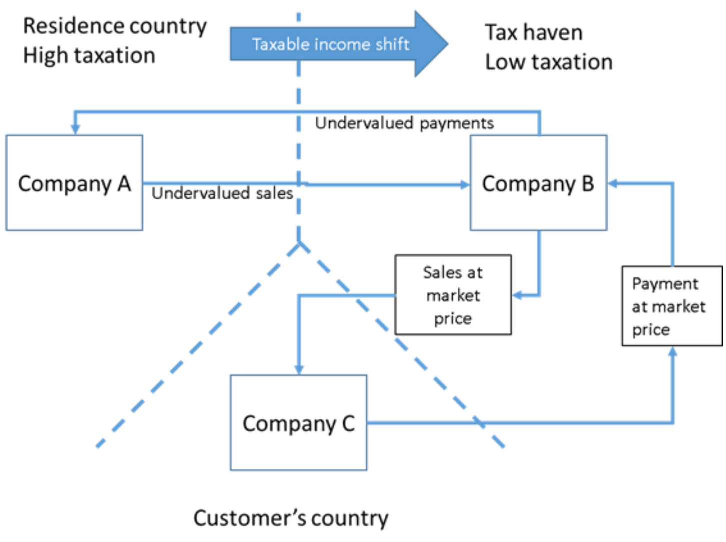
"5. Articles 18 to 24 lay down rules for companies that maintain import operations from or export operations to related foreign companies abroad, as well as for companies, related or not, located at countries known as 'tax havens', concerning the calculations of the results of such operations to be included in the tax base of corporate income tax.

The law lays down procedures to compare prices registered in import or export documentation to average prices of identical operations between unrelated parties, in order to determine the values to be added as import expenses or export revenues in the computation of taxable income.

The above mentioned comparison between average prices (or average expenses) and prices registered in import or export documentation may be carried out by the company itself and, based on such comparison, the company will eventually make the necessary adjustments in the Actual Profits Determination Book. In the omission of the company, the tax inspection will perform such comparison and, by the means provided for in this law, may require that the company pay the eventual difference between tax due and tax paid."

The rule was self-applicable and did not require any official list. Even the procedure of withholding taxes had been in place for more than 50 years. Indeed, according to articles 99 to 103 of Decree 5,844, dated 23 September 1943[9], banks and other financial institutions were responsible for withholding the due tax from applicable transactions and for transferring that due amount to the National Treasury in 30 days, even if they had not actually withheld the due tax from their clients' transactions.

Box 1 – How favored taxation distort prices



In this simple example, instead of direct sales to Customer Company C, Company A uses related Company B in a tax haven to break the operation in two phases: in the first phase, it sells for a price below market price to Company B. Then, Company B sells at market price to Company C. In doing so, most of the income will be assessed at the tax haven jurisdiction and, hence, will erode the tax base of Company A's residence country.

CHAPTER II – ON TAX WITHHOLDING

Article 99. The source is responsible for withholding the tax referred to in Articles 95 and 96 at the moment of the credit or payment of the income.

Art. 100. The source is responsible for withholding the tax referred to in Articles 97 and 98, when it pays, credits, employs, remits or delivers the income. (See Law 9,249/1995)

Sole paragraph. The provisions of the header of this Article do not apply to the following cases, when it is up to the proxy to withhold the due tax:

a) when the income derives from the rental of immovable property;

b) when the proxy fails to inform the source that the beneficiary of the income is resident or domiciled abroad.

CHAPTER III – ON TAX COLLECTION

Article 101. The persons responsible for withholding the tax are also responsible for collecting it to the tax offices.

Article 102. The tax collection shall be realized within 30 days from the due date of the withholding tax by the source or by the proxy of the resident or domiciled abroad.

Sole paragraph. In the case of real estate rents, the collection of the tax will be made every six months, during the months of January and July of each year, and will include the sum of the amounts withheld in the immediately previous semester. (Included by Law 154/1947)

Article 103. In case the due withholding tax has not been retained, the source or the proxy will be responsible for transferring the value of the due tax, as if it had been retained.

Although self-applicable, the rule still required a case-by-case analysis to identify whether a jurisdiction had a favored taxation or not. The financial sector considered that the cost of such an analysis should be supported by the Government and, for legal certainty, that its results should be made publicly available.

The private sector claims resulted in Normative Instruction (NI) SRF 33, dated 30 March 2001[10], which published the first list of jurisdictions with favored taxation. In the following year, NI SRF 188, dated 6 August 2002[11], added nine other jurisdictions to the list. For the complete evolution of listed jurisdictions in the Brazilian list from 2001 to 2016, please refer to the table in box 2.

Although it was long, the list failed to include some

Box 2 – Evolution of the Brazilian list of tax havens – Listed Jurisdictions

In the table below, the terms have the following meaning:

x = the jurisdiction remains listed in that year

included = the jurisdiction was listed in that year

renamed = the jurisdiction was listed under a new name (or names)

regime = the jurisdiction was excluded from the list, but had a regime included in the list of preferential tax regimes

Total number of listed jurisdictions:	44	54	65	66	68
Jurisdiction	**2001**	**2002**	**2010**	**2014**	**2016**
American Samoa	included	x	x	x	x
American Virgin Islands	included	x	x	x	x
Andorra	included	x	x	x	x
Anguilla	included	x	x	x	x
Antigua and Barbuda	included	x	x	x	x
Aruba		included	x	x	x
Ascension Island			included	x	x
Bahamas, The	included	x	x	x	x
Bahrain	included	x	x	x	x
Barbados	included	x	x	x	x
Belize	included	x	x	x	x
Bermuda	included	x	x	x	x
British Virgin Islands	included	x	x	x	x
Brunei			included	x	x
Campione D'Italia		included	x	x	x
Cayman Islands	included	x	x	x	x
Channel Islands, The	included	x	x	x	x
Cook Islands	included	x	x	x	x
Costa Rica	included	x	x	x	x
Curacao	included	x	x	x	x
Cyprus	included	x	x	x	x
Djibouti	included	x	x	x	x
Dominica	included	x	x	x	x
French Polynesia			included	x	x

Gibraltar	included	x	x	x	x
Grenada	included	x	x	x	x
Hong Kong		included	x	x	x
Ireland					included
Isle of Man	included	x	x	x	x
Kiribati			included	x	x
Labuan	included	x	x	x	x
Lebanon		included	x	x	x
Liberia	included	x	x	x	x
Liechtenstein	included	x	x	x	x
Luxembourg		included	regime	x	x
Macau		included	x	x	x
Madeira Island	included	x	x	x	x
Maldives		included	x	x	x
Malta	included	x	regime	x	x
Marshall Islands	included	x	x	x	x
Mauritius	included	x	x	x	x
Monaco	included	x	x	x	x
Montserrat Island	included	x	x	x	x
Nauru	included	x	x	x	x
Niue Island	included	x	x	x	x
Norfolk Island			included	x	x
Oman		included	x	x	x
Panama	included	x	x	x	x
Pitcairn Islands			included	x	x
Qeshm Island			included	x	x
Saint Helena			included	x	x
Saint Kitts and Nevis	included	x	x	x	x
Saint Lucia	included	x	x	x	x
Saint Pierre and Miquelon			included	x	x
Saint Vincent and the Grenadines	included	x	x	x	x
Samoa	included	x	x	x	x
San Marino	included	x	x	x	x
Seychelles	included	x	x	x	x
Singapore			included	x	x
Sint Maarten	included	x	x	x	x
Solomon Islands			included	x	x
Swaziland			included	x	x
Switzerland			included	regime	x
Tonga	included	x	x	x	x
Tristan da Cunha			included	x	x
Turks and Caicos Islands	included	x	x	x	x
United Arab Emirates		included	x	x	x
Vanuatu	included	x	x	x	x

cases of tax planning that resulted in taxation much lower than the Brazilian standards. One example was the American state of Delaware, where certain legal structures allowed for tax-haven-like benefits (low taxation and secrecy). The same happened to the state of Nevada, especially in the casino sector. In both states, companies could elude federal taxation in the United States. However, the two states were not dependencies, nor countries on their own.

Realizing the lack of legal basis to include just part of a country in its list, Brazil enacted Law 11,727, dated 23 June 2008[12], which, as stated in its article 23, included articles 24-A and 24-B in Law 9,430/1996 to define preferential tax regimes and provide for the possibility of administratively adjusting tax rate thresholds.

Article 23. Law 9,430, dated 27 December 1996, is hence amended to include the following Articles 24-A and 24-B:

"Article 24-A. The provisions regarding prices, costs and interest rates, set forth in articles 18 to 22 of this Law shall also be applied in transactions carried out under a privileged tax regime between individuals or legal entities resident or domiciled in Brazil and individuals or legal entities resident or domiciled abroad, even if they are not related.

Sole paragraph. For the purposes of this article, it is considered preferential the tax regime that presents one or more of the following characteristics:

I – it does not tax income or taxes it at a maximum rate lower than 20% (twenty per cent);

II – it grants a tax benefit to a non-resident individual or legal entity:

a) with no requirement of realization of substantial economic activity in the country or dependency;

b) conditioned to the absence of substantial economic activity in the country or dependency;

III – it does not tax, or taxes at a maximum rate lower than 20% (twenty per cent) any inbound income;

IV – it does not grant access to information related to societary composition, ownership of assets or rights or to economic operations performed."

"Article 24-B. The Executive Branch may reduce or reestablish the percentage values set forth in the header of Article 24 and in the indents I and III of the sole paragraph of Article 24-A, both of this Law.

Sole paragraph. The option provided for in the header of this Article may also be applied, in an exceptional and restrict way, to countries that form economic blocs of whom Brazil is a member."

Hence, according to the legal definition, a tax regime is deemed preferential if it has one or more of the following characteristics:

(a) No income tax or income tax lower than 20% (twenty per cent);

(b) Fiscal benefits to non-resident natural or legal persons with no substantial economic activity in the territory;

(c) No income tax or income tax lower than 20% (twenty per cent) on inbound income; or

(d) Does not grant access to information on legal ownership of companies, assets or rights or to the economic operations performed.

The definition of preferential tax regimes, reflecting the sophistication of worldwide tax practices, enabled the tax administration to better deal with harmful regimes inside jurisdictions that did not have a general favored taxation. In particular, the second characteristic, lack of economic substance, was justified because most entities that were created only to avoid tax do not have economic substance, that is, they may be just post-office companies.

As a federal prosecutor once stated[13], "*Brazil is so aware of the (in)correct (ab)use of tax havens that the Council for the Control of Financial Activities (COAF – Conselho de Controle de Atividades Financeiras), in one of its first booklets on money laundering, declared that both tax havens and offshore centers share a legitimate purpose and a certain commercial justification. However, the main cases of money laundering discovered in recent years involved criminal organizations that abused the facilities offered by them to accomplish illegal manoeuvers*".

When the law that defined preferential tax regimes came into force, the private sector once again claimed that it was up to the Government to state which tax regimes were preferential and, hence, subject to the specific tax treatment described in the next subsection.

Normative Instruction (NI) RFB 1,037, dated 4 June 2010[14], consolidated in a single list both types of tax havens defined in Law 9,430/1996: jurisdictions with favored taxation (article 24) and preferential tax regimes (article 24-A).

Soon after the publication of the new, comprehensive list, NI RFB 1,045, dated 23 June 2010[15], allowed for requirements for review of the list. Listed countries could then present relevant modifications in their tax law that enabled the review and, eventually, the exclusion from the list.

At that moment, there had already been an evolution in the international understanding that transparency could be an effective tool to tackle the problems related to the abuse of tax havens. The OECD, for example, changed its focus from the low or no taxation criteria to the fiscal transparency and exchange of information ones. Recognizing such evolution, Brazil implemented the possibility of reducing the tax haven threshold of income tax rate from 20% to 17%, in case the other jurisdiction complied with some international standards of transparency.

According to NI RFB 1,530, dated 19 December 2014[16], countries are deemed to comply with "international standards of fiscal transparency" if they have signed a convention or an agreement providing for exchange of information on tax matters with Brazil and if they have committed to take measures against tax evasion according to criteria set by international fora in which Brazil takes part, such as the Global Forum on Transparency and Exchange of Information for Tax Purposes. These are cumulative conditions, so the country should meet both conditions to be considered compliant with international standards of fiscal transparency.

NI RFB 1,530/2014 also establishes the procedure for listed jurisdictions to require review of the list, which basically involves an official requirement with proof of the entry into force of legislative changes that comply with both taxation and transparency criteria. NI RFB 1,560, dated 20 April 2015[17], which made some language improvements to NI RFB 1,530/2014, has updated this procedure.

NI RFB 1,658, dated 16 September 2016[18], implemented the latest reviews, updating the list of NI RFB 1,037/2010. It also stated the concept of "substantial economic activity" for the purpose of analyzing preferential tax regimes. According to this provision, economic substance requires appropriate operational capacity, which is evidenced by qualified staff and physical installations suitable (in quality and in quantity) for the management and effective decision making related to the activities aimed at generating income from own assets or from the participation in other companies, via dividends or capital gains. Finally, NI RFB 1,683, dated 29 December 2016[19], made language improvements to NI RFB 1,037/2010.

II.2. Tax treatment

As explained in the previous section, a single law (Law 9,430/1996) defines "jurisdictions with favored taxation" and "preferential tax regimes" and the Brazilian list of tax havens (NI RFB 1,037/2010) includes both types. The tax effects of being a tax haven, however, are found in a variety of legal acts. The main effects (and their legal bases) are:

(a) automatic application of transfer pricing rules (Law 9,430/1996, articles 18 to 22);

(b) automatic application of withholding tax rate at 25% (Law 9,779/1999, article 8);

(c) automatic application of thin capitalization rules and reduction of the debt-equity ratio from 200% to 30% of net worth value (Law 12,249/2010, articles 25 and 26);

(d) additional restrictions to deduct expenses related to payments made to the jurisdiction from the tax base of the corporate income tax due in Brazil (only necessary and ordinary expenses for the maintenance of the source of income are deductible); and

(e) application of controlled foreign company rules, which include the taxation of profits earned by the holding companies located in the jurisdiction on 31 December of each taxable period, regardless of its characterization as an affiliated company and of the deferred payment system; and prohibition of the use of the deemed tax credit of 9% (Law 12,973/2014, articles 78, 81, 83 and 91).

The effects of being a tax haven have also evolved during the two decades under consideration. The initial proposal of applying transfer-pricing rules aimed at avoiding price distortion in transactions between related companies, usually belonging to the same multinational group. This effect still applies today, but new treatments have been included to consider other aspects of a harmful tax competition.

For instance, applying withholding taxes at a higher rate does preserve tax collection, as tax payment and collection do not depend on the operations conducted abroad. For example, the normal withholding tax rate of 15% is increased to 25% in case the payee is located in a tax haven. In other words, it saves the same tax in advance.

Thin capitalization rules, on the other hand, deal with a different problem, that of choosing an unrealistic proportion between equity and debt financing in order to have a lower overall taxation. Paying interests on loans may not only shift profit to the payee jurisdiction, but is also usually deductible from the tax base of the payer, leaving a smaller taxable income in its country. Here, the normal allowance for a 200% debt/equity ratio is reduced to 30% in case the payee is located in a tax haven.

Limiting the deductibility of expenses to those that are necessary and ordinary to the company's main activity, its source of income, is another way to prevent abuse of national tax law and international tax treaties. For instance, it is common for local subsidiaries to make contractual payments to their overseas parent company for technical assistance. The contents of the contract may vary greatly, but sometimes they include activities that benefit only the parent company. For example, the subsidiary might be paying for expenses related to board meetings of the parent company, which is not essential for the subsidiary's main activity. In that case, the deductibility of such payment from the subsidiary's income will not be allowed.

III. ANALYSIS OF THE POLICY'S IMPACT

Two decades have elapsed since the enactment of Law 9,430/1996 and there have been changes in both the theory and the practice of tax havens. The publication of the latest OECD's blacklist in July 2017 and the criticisms it has received make it a good timing to step back and also take a critical look at the evolution of the Brazilian list of tax havens, its accomplishments and problems it did not solve.

There are many ways to analyze the impact of a tax policy. In this policy brief, we take a look at a single statistic often cited to criticize any change in government policy: foreign direct investment (FDI). No matter what policy, which sector is in discussion, there will always be claims that a change will ruin investments in that sector, especially, the ones from abroad.

So, we will check the impact of the changes in Brazilian tax law related to tax havens on FDI, during the 20 years from the enactment of Law 9,430/1996 until the latest NI RFB 1,683/2016.

III.1. Foreign Direct Investment (FDI)

In the present analysis, we classify FDI into three categories, according to its origin: FDI from listed jurisdictions, FDI from jurisdictions with a valid agreement to avoid double taxation (DTA – double taxation agreement) with Brazil, and FDI from other jurisdictions (not listed, no DTA with Brazil). The sum of FDI from all three categories will be referred to as Total FDI. We shall look at divergences between the evolution of Total FDI and that of each category. The data on the amount of FDI is publicly available at the Central Bank of Brazil's website. Table 1 shows the evolution of FDI between 1995 and 2015.

When the Brazilian Government published its first tax havens list, it was a blacklist aimed at avoiding the erosion of its tax base. A massive outflow of FDI would certainly be one way that such erosion occurs. However, as a general observation, Total FDI had increased 9 times from 1995 to 2015, with a peak in 2010. All categories seemed to have followed a similar pattern in the period, as shown in Graph 1, which represents the values on Table 1 in a visual manner.

The absence of massive FDI outflows in the period is evidence that the tax policy, in general, did not have a net

Table 1 - Evolution of Foreign Direct Investment (1995-2015)

Foreign Direct Investment - FDI (US$ mi)	1995	2000	2005	2010	2015
Listed jurisdictions	4.219	14.683	14.158	28.843	12.606
Jurisdictions with DTA	18.135	52.902	102.908	408.295	246.864
Others	19.342	35.429	45.742	150.071	103.046
Total	41.696	103.015	162.807	587.209	362.516

FDI / Total FDI (%)	1995	2000	2005	2010	2015
Listed jurisdictions	10%	14%	9%	5%	3%
Jurisdictions with DTA	43%	51%	63%	70%	68%
Others	46%	34%	28%	26%	28%
Total	100%	100%	100%	100%	100%

Data source: Central Bank of Brazil

negative impact on investments. Focusing on the FDI from listed jurisdictions reveals some specific impacts of the policy.

The first list of tax havens, published in 2001, seems to have stopped new investments from listed jurisdictions until 2005, while total FDI kept increasing. In fact, while the absolute amount of FDI from listed jurisdictions remained at the US$ 14 billion level, its relative participation in total FDI declined from 14% to 9%. That is, the list made a change in the composition of FDI, shifting the flow from tax havens to other jurisdictions, especially those with a DTA.

From 2005 to 2010, the amount of FDI from listed jurisdictions doubled from the US$ 14 billion level to the US$ 28 billion level. However, in relative terms, its participation in total FDI decreased from 9% to 5%. Once again, there was a shift of investment flow from tax havens to other jurisdictions, especially those with a DTA.

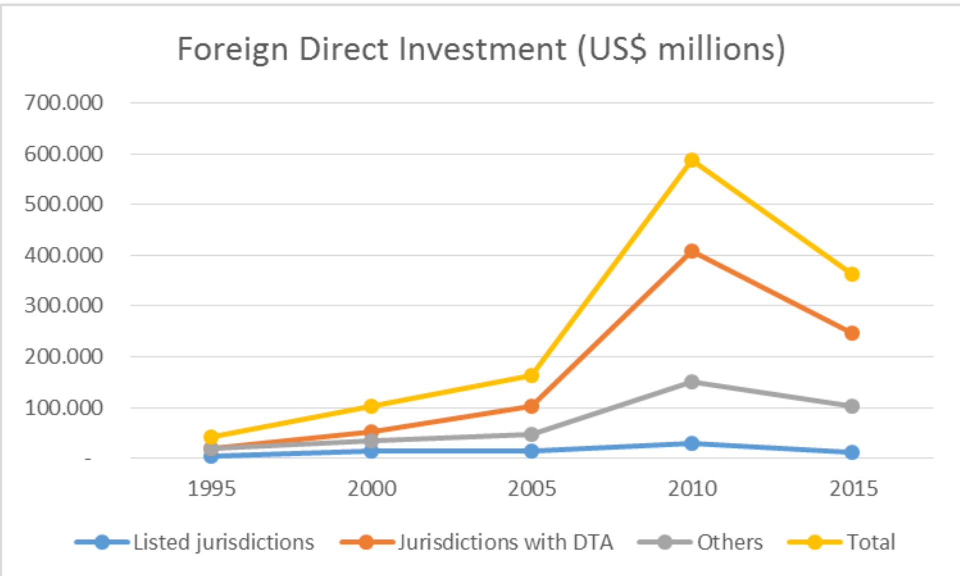
Finally, from 2010 to 2015, the amount of FDI from listed jurisdictions decreased from the US$ 28 billion level to the US$ 12 billion level. Total FDI and other FDI categories also decreased in the period, but none showed a decrease as steep as FDI from listed jurisdictions. In terms of participation, listed jurisdictions accounted for 3% of Total FDI. There was also a shift of investment flow from tax havens to other jurisdictions. This time, however, jurisdictions with no DTA seemed to have a higher increase. Further investigation would be needed to verify if this indicates the emergence and use of new tax regimes in countries with no DTA and which are not listed yet.

Graph 2 shows the participation of FDI per origin between 1995 and 2015.

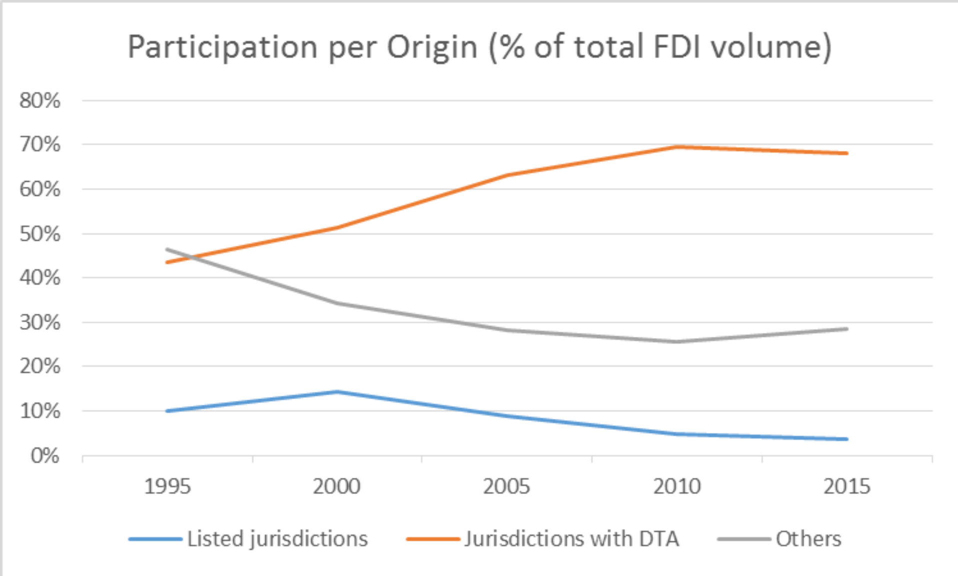
Here it is clear that investment flow has constantly shifted from tax havens to other jurisdictions. In this sense, the combined application of increased withholding tax, transfer pricing rules, limitation of benefits (deductibility of expenses from the tax base), thin capitalization rules etc. proved effective in reducing the participation of FDI from listed jurisdictions in Total FDI from 14% in 2000 to 3% in 2015. That reduction represents an efficiency rate of 78%.

This efficiency rate might have been somewhat higher, had the effects of a preferential tax regime been the same as those of a jurisdiction with favored taxation. The definition of preferential tax regime corresponds to a global trend to prevent and counter harmful tax practices. As implemented by Law 11,727/2008, the practical effect is

Graph 1 – Evolution of FDI in Brazil (1995-2015)



Graph 2 –FDI Participation (per origin) in Brazil (1995-2015)



the application of transfer pricing rules to compensate for the distortion in transactions between related parties or with residents of tax havens. The automatic application of an increased withholding tax was left out.

Obviously, there might be other factors that account for this efficiency rate, such as the celebration of DTAs with new jurisdictions, measures aimed at promoting the country as a destination for FDI and improvements in national infrastructure. All these initiatives could increase the volume of FDI from jurisdictions other than listed ones and, thus, reduce the participation of listed jurisdictions in total FDI. But it seems reasonable to affirm that the definition and the tax treatment of tax havens in the Brazilian legislation have had the double effect of reducing FDI from listed jurisdictions and strengthening FDI from non-listed jurisdictions, which is expected to broaden the country's tax base as well.

IV. LESSONS LEARNED

a) Having a tax havens list proved useful to shift foreign direct investment from tax havens to other jurisdictions, especially those with a double taxation agreement.

Tax incentives should not be the only reason for structuring a business in a country and fighting harmful tax practices should not be the only reason for refraining from structuring a business in a country. Real economic reasons, such as natural and human resources, location and infrastructure and maturity of the economic market should be taken into consideration when elaborating a business plan and when designing a tax policy. Accordingly, common arguments about losing FDI if a certain measure is implemented should be carefully verified. In the Brazilian experience, instead of a decrease in total FDI, there has rather been a shift in their origin, with preferable consequences to the national tax base.

b) Including both penalties and rewards seems to account for a more efficient implementation of a tax policy.

Punishing unwanted behavior is one way of enforcing economic policies, but it is not the only one. Rewarding good behavior is another one. In tax matters, applying increased taxation, limiting benefits or requiring extra obligations are examples of penalties for unwanted behaviors. Signing a double taxation agreement, granting economic benefits, requiring simplified obligations are examples of rewards for wanted behaviors. Combining penalties and rewards might increase the efficiency of tax policies, such as observed in the combination of a more rigorous tax treatment for tax havens with a policy of signing agreements with other jurisdictions to avoid double taxation.

c) The mere existence of a list, however, does not solve all problems related to tax havens. A tax havens list should be considered as part of a broader tax policy tailored to national interests.

Despite of the positive impacts of having a list of tax havens highlighted in this brief, there are also negative implications that should be considered, such as maintenance and political costs of the list. There should be a qualified and sufficient team to update the list and to provide technical arguments in political negotiations. It should also be noted that every development policy starts with a coherent tax reform and that there is no one-size-fits-all solution because the starting conditions, interests and difficulties are different for each nation.

d) Exhaustive lists do not always reflect the spirit of the law, and as such, the requirement of listing jurisdictions should be balanced against other principles, particularly considering the specific interests and needs of each State.

Endnotes:

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