

## Scoreboard of indicators: methodology

### Overview

In September 2016, the Commission completed the first step towards a new EU listing process: a scoreboard of all third countries and jurisdictions for tax purposes.

This scoreboard presents the results of a first analysis carried out by the Commission, under which third country jurisdictions were examined against objective economic, financial, stability and tax good governance indicators.

The Commission's scoreboard is intended as a first basis for Member States in the Code of Conduct Group to decide which third country jurisdictions may be relevant to screen in more detail.

It is important to stress that the findings of the scoreboard are not sufficient to draw conclusions on whether a jurisdiction should be selected for screening or put on the common EU list. **This scoreboard does not represent any judgement of third countries, nor is it a preliminary EU list. It is an objective and robust data source, produced by the Commission, to help Member States in the next steps of the common EU listing process.**

It is now for Member States in the Code of Conduct Group to decide if and how they use the scoreboard in deciding on the third country jurisdictions to be screened.

### Background

In the External Strategy for Effective Taxation, the Commission set out a new EU listing process to deal with jurisdictions that refuse to comply with tax good governance standards. This list should be established based on a three-step process:

**1: Scoreboard:** Commission pre-assessment of all third country jurisdictions based on neutral selection and risk indicators.

**2: Screening:** Member States decide which third countries should be formally screened by the EU. This screening will include a dialogue process with the third countries in question, to allow them to react to any concerns raised.

**3: Listing:** Once the screening process is complete, third countries that refused to cooperate or engage with the EU regarding tax good governance concerns should be put on the EU list.

Member States endorsed this process at the May 2016 ECOFIN and called for a first EU list to be ready in 2017.

### Scoreboard

The Commission conducted a thorough pre-analysis of all jurisdictions, examining them against objective economic, financial and stability and governance indicators (selection indicators). For countries which rank high in all these selection indicators, a first risk assessment based on tax indicators was conducted in addition.

The results of this pre-analysis have now been presented to Member States in the form of a scoreboard. The purpose of the scoreboard is to score all jurisdictions to establish a priority among third country jurisdictions for further screening. This process is objective and neutral as it based on three data sets which cover three

areas of interest: (1) the strength of economic ties with the EU, (2) the financial activity and (3) stability factors.

It is important to stress that the indicators alone are not sufficient to draw conclusions on whether a jurisdiction should be put on the final common EU list. The economic and stability data serves for the first analysis of available and objective information to allow for a discussion among Member States in the Code of Conduct group. An in-depth analysis of the tax systems of jurisdictions is still needed.

## Scope of the scoreboard

In order to conduct the pre-analysis and compile the scoreboard, the Commission has collected data for all countries and jurisdictions in the world as far as available, in total 241. However a differentiated approach was followed according to the status of the jurisdictions. First, the 28 member states and the territories considered to be part of a Member State such as those covered by Article 355(1) TFEU are not included in the tables drawn from the scoreboard. Second, third country jurisdictions that already have a transparency agreement with the EU feature separately in the scoreboard (Table 2, "Third Country Jurisdictions with EU Tax Transparency agreement"). Currently, this covers Switzerland, Liechtenstein, Andorra, Monaco and San Marino. And finally, the 48 least developed countries (LDC) identified by the United Nations are also featured separately, in recognition of the particular constraints they face (Table 5, "Third Country Jurisdictions that are listed by the UN as Least Developed Countries").

After excluding the 28 Member States and associated territories referred to in Article 355(1), the 48 LDCs, and the five third country jurisdictions with a transparency agreement, 160 third country jurisdictions were assessed for potential pre-selection on the basis of the selection indicators.

**Table 1: Indicators used for the three dimensions**

<b>Strength of economic ties with the EU (Source: Eurostat)</b>	<b>Financial Activity within jurisdiction (Source: UNCTAD, IMF, Eurostat)</b>	<b>Stability factors (Source: World Bank)</b>
Total Trade - Goods+Services – (Export+Import)	FDI - Stocks Inward	Control of Corruption
Trade in Services - (Export + Import)	FDI - Stocks Outward	Regulatory Quality
FDI - Investment Positions with respect to EU, (Outward)	Income Flows - Paid Dividends	
FDI - Investment Positions with respect to EU, (Inward)	Income Flows - Received Dividends	
Foreign Affiliates of EU Enterprises	Income Flows - Paid Interests	
	Income Flows - Received Interests	
	Income Flows - Paid Royalties	
	Income Flows - Received Royalties	
	Foreign Affiliates of EU Enterprises	

## Selection indicators

The selection indicators are obtained for all jurisdictions and grouped into three dimensions:

- **Strength of economic ties with the EU:** To see how strong the economic ties are between the third country and the EU, indicators such as trade data, affiliates controlled by EU residents and bilateral FDI flows were examined.
- **Financial activity:** To determine if a jurisdiction had a disproportionately high level of financial services exports, or a disconnection between their financial activity and the real economy, indicators such as total FDI, specific financial income flows and statistics on foreign affiliates were used.
- **Stability factors:** To see if the jurisdiction would be considered by tax avoiders as a safe place to place their money, general governance indicators such as corruption and regulatory quality were examined.

## Selection Methodology

For each of the three dimensions referred to above, a selection score is developed on the basis of the indicators.

The first step of the process is to collect data for the indicators for all jurisdictions for which they are available. Next, to account for differences in jurisdictions size, we scale some economic indicators by GDP. In addition, we average the indicators over time (over 2 to 5 years depending on data availability) to avoid that time-specific events distort the data and to capture long-term patterns.

Within each of the three dimensions, each jurisdiction is scored according to its highest rank<sup>1</sup>. For example, if a jurisdiction is ranked 2 in FDI positions and ranked 4 in all other indicators of economic ties with the EU, it will receive the score of 2 for the heading "Strength of EU Economic ties". The same is done for the other two dimensions. This gives a unique ranking for each dimension.

In the next step, we make scores comparable across dimensions. As jurisdictions are scored based on these data and since we do not have the same data availability for all indicators, we use percentage scores. This means that once jurisdictions are ranked, we divide their score by the number of available observations. For example, if a jurisdiction scores 12th on a dimension X (with 200 jurisdictions for which we have the data), it would then have the percent score value 6, i.e. we divide its score 12 by the number of available data 200 (times 100 to obtain the "percentage value"). If this jurisdiction scores 15 on another dimension Y and that we have only, say, 150 jurisdictions for which it is available, its percentage score will be 10, that is its score 15 divided by the number of available data 150 (times 100).

The last step is to define a selection rule based on these final percent scores. Different thresholds are applied to each dimension in the selection process, whose aim is to allow distinguishing between jurisdictions that are prioritised for further scrutiny and others. The decision rule applied is the following: all jurisdictions that score high (in the top x%) for each three dimensions are prioritised, and those that rank low on at least one dimension are not.

The choice of the thresholds draws on a few principles. With the first dimension, (1) strength of economic ties with the EU, we want to distinguish jurisdictions that have economic ties with the EU from those that have very little ties. We have hence decided to apply a threshold of 60. This means that jurisdictions with a summary percentage score for this dimension below 60 (i.e. that are in the top 60% of jurisdictions with the strongest economic ties with the EU) are selected. Next, the dimension (2) on financial activity is considered a key parameter. We have therefore decided to be more selective and apply a threshold of 40. This means that jurisdictions with a summary percentage score for this dimension below 40 (i.e. that are in the top 40% of jurisdictions with the highest financial activity) are selected. Finally, dimension (3) on stability factors allows excluding those jurisdictions that are the most unlikely to play a role because of poor stability indicators. For this reason we apply a threshold of 70. This means that the 30% lowest ranked jurisdictions on this dimension are excluded (the bottom 30% with the worst indicators for that dimension). All jurisdictions that pass the threshold for all dimensions are assigned to Table 1 "Third Country Jurisdictions that rank high in all selection indicators" whereas those jurisdictions that do not pass the threshold for at least one dimension are assigned to Table 3 "Third Country Jurisdictions that do not rank high in at least one of the selection indicators".

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<sup>1</sup> For the dimension Financial Activity, we separate the highest rank within each subgroup number of FDI stocks, Income Flows and Foreign Affiliates.

One important issue is missing economic data. Data may not be available for specific indicators for a variety of reasons such as the irrelevance of an indicator for a specific jurisdiction, weak administrative capacity of small or least developed jurisdictions to deliver data, but also opacity in the jurisdiction that may be an indication of lack of transparency. Jurisdictions which display missing values for all economic indicators are therefore reported separately in the scoreboard under Table 4 "Third Country Jurisdictions with no economic data".

## Risk Indicators

Once the selection indicators identified the jurisdictions which are most economically relevant, the Commission did a basic assessment of the potential risk level of these jurisdictions facilitating tax avoidance.

The risk indicators used were:

- (1) **Transparency and exchange of information:** The jurisdictions' status with regard to the international transparency standards i.e. exchange of information on request and automatic exchange of information.
- (2) **The existence of preferential tax regimes:** The existence of potential preferential regimes, identified by the Commission on the basis of publicly available information (IBDF, national websites etc.).
- (3) **No corporate income tax or a zero corporate tax rate:** The existence of a tax system with no corporate income tax or a zero corporate tax rate.

These three risk indicators, which reflect the situation in July 2016, were then applied to the most relevant jurisdictions (Table I), identified by the selection indicators, as well as to the five jurisdictions with transparency agreements with the EU (Table II).

It is important to point out that the risk indicators do not pre-empt the in-depth analysis of jurisdictions' tax systems, which will take place in the screening stage (Step 2). The risk indicators are only intended to provide Member States with as much information as possible to decide on the jurisdictions that they wish to screen.