EU tax haven blacklist--a misguided approach?

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Tax analysis: With the offshore finance sector facing wider scrutiny from media and government, senior analyst Markus Meinzer, and consultant Andres Knobel, both from the Tax Justice Network, talk about the misleading nature of the EU tax haven blacklist, and why blacklists might not be the right approach to tackle tax dodging.

What is the blacklist? What conditions apply if a jurisdiction is to be considered a non-cooperative tax jurisdiction?

There has been quite a lot of fuss regarding the EU blacklist of tax havens--not only because of the jurisdictions that were included (and the many obvious ones that weren't)--but also because of the Organisation for Economic Co-operation and Development (OECD) speaking out against the EU blacklist in defence of many traditional tax havens.

However, the question is not necessarily which list is right, but rather why is the approach of creating tax blacklists misguided?

Lists of tax havens (ie non-cooperative tax jurisdictions) are supposed to include jurisdictions whose legal framework and/or conduct in practice allow individuals and companies--either resident in the country that draws the list or, more generally, any non-resident--to avoid and evade taxes, or commit other crimes such as corruption or money laundering.

This would happen if any of the following conditions are met in any jurisdiction:

- no ownership and/or accounting information is registered on all legal entities (ie companies, foundations, partnerships) and legal arrangements (ie trusts), or whether bearer shares are allowed--the lack of registration information results in there being insufficient data to identify a person or verify accuracy of accounts respectively. Either case enables an individual to hide behind layers of entities and/or manipulate accounting records to commit a crime
- banks and other financial institutions allow anonymous accounts, or those not complying with know-your-client/anti-money laundering provisions to ensure that any fund or asset deposited, invested or stored, is not related to money laundering or corruption--this would include, for example, warehouses and safe deposits in freeports to store gold, art and valuables
- authorities have no access to information on the ownership of legal entities, legal arrangements and/or on accounts or valuables held in financial institutions (assuming that this information is registered)
- authorities have no legal framework to exchange the above information with any foreign country either because of legal or practical obstacles--eg the lack of international agreement, notifying the investigated taxpayer thus frustrating or jeopardising investigations, and/or the presence of undue appeal rights to postpone the exchange of information
- the legal framework is tailored to enable the circumvention of foreign tax and/or regulatory provisions through, for example, the Double Irish-Dutch Sandwich structure, and
- tax rate differentials being beyond a certain threshold as defined by the country drawing up the blacklist

A country could thus justifiably fall into the tax haven category by meeting any or many of the above conditions. This long list of potential criteria illustrates the pitfall of any blacklist. In today's world, with long value adding chains which are integrated across borders, and over two hundred tax jurisdictions worldwide, virtually any jurisdiction could be a tax haven in the eyes of another simply by accident. For example, the mismatching US and Irish rules on tax residency have resulted in Apple accumulating over $30bn profit in legal entities which were tax resident nowhere.

Usually, the country drawing up the blacklist would define some countermeasures for any individual or entity related to those blacklisted jurisdictions. These can include reducing certain tax benefits, taxing income as if dividends had been distributed, strengthening controlled foreign corporation rules, demanding more disclosure about the activities in those places, obliging financial institutions to restrict their services offered to entities in those places, or similar measures.

Given the potential for arbitrariness due to the long list of possible criteria, lists of tax havens should be fully transparent in their criteria so that jurisdictions may be included or removed only when there are changes to their legal framework. Tax Justice Network's Financial Secrecy Index does exactly this. While it focuses on financial secrecy rather than directly on tax, it offers objective criteria and verifiable data to rate jurisdictions according to their changing legal transparency framework--criteria such as banking secrecy, corporate transparency, and compliance with Financial Action Task Force recommendations.

Is the blacklist an effective way of identifying countries who engage in tax avoidance and tax evasion?

EU countries' national lists which feed the EU blacklist do not always explain their criteria. The OECD does a better job here--although problems lie with the criteria it uses.

For example, the US is rated as 'largely compliant' despite entities being incorporated in particular states (eg Delaware) without the provision of any ownership information. This therefore prevents even American law enforcement agencies (let alone any foreign authority) from identifying those who hide behind such entities. The same also applies to Switzerland. Interestingly, neither of these two--nor several other notorious countries used for tax avoidance by multinationals (eg Luxembourg, Ireland and the Netherlands)--are present in the EU blacklist.

This arguably bolsters the view that such lists are political and open to lobbying. This was shown when Bermuda succeeded in convincing Latvia that they should be removed from its national list, which will result in Bermuda's exclusion from the EU blacklist once it is updated before the year ends.

Are the EU and OECD doing enough to tackle tax evasion?

So far, the EU and OECD appear to be failing to learn from history. For over 30 years countries have been trying to rein in tax dodging by enacting blacklists but, so far, these efforts have largely failed. Embracing public transparency by introducing public country-by-country reporting for corporations, public registers of the beneficial owners of legal entities, and arrangements and detailed statistics on financial account information would be a more promising route to begin with. Only with such measures in place, could the confidence lost in the integrity of corporations and administrations alike through scandals such as SwissLeaks and LuxLeaks, be rebuilt. After this has happened, further reforms in tax law should be devised in the bright light of public, academic and media scrutiny--the very scrutiny that is currently lacking due to the persistent climate of financial secrecy.

Interviewed by Jo Edwards.

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