HOW CREDIBLE ARE TAX HAVEN BLACKLISTS?

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In IFC Review's Summer/Autumn Economic Report, Mark Pragnell, Director of Strategy and Consultancy at Capital Economics, London, questions the credibility of tax haven blacklists.

If a sovereign nation wishes to restrict trade, investment or any other relationship with another jurisdiction, it can and should do so. If a group of sovereign nations, such as the European Union or the membership of the OECD wish to do the same collectively, so be it. That's the nature of beauty and sovereignty.

But, when that exercise of sovereign power is in the form of arbitrary, inconsistent and incoherent threats of sanctions against competitor businesses in smaller nations, let's see it for what it is: protectionism.

The Council of the European Union's current process for blacklisting, what they call 'non-cooperative jurisdictions for tax purposes', is arbitrary. For example, at the time of writing, seven of the Crown Dependencies and United Kingdom Overseas Territories have been cited, under 'criterion 2.2', as having 'tax regimes that facilitate offshore structures which attract profits without real economic activity'. But, in practice, the 'tax neutrality' of the island IFCs proffers little or typically no opportunity to avoid payment of taxes in the EU28; the level of so-called 'substance' in the offshore centres is an irrelevance to their European tax liability.

It is inconsistent. Focusing blindly on 'offshore', Brussels bureaucrats are failing to identify where and how companies shelter profits from European taxes. Almost every significant example of profit shifting abuse in Europe has relied not on remote jurisdictions, but on the 'double tax' provisions of the bloc's own member states such as Ireland, Malta, Luxembourg and the Netherlands. But the practical politics of the European Union means members' indiscretions are ignored. It is realpolitik to pick on small islands – while the United States, for example, noted both for the likes of the Delaware regime that falls well short of international norms and its absence from the EU lists, is untouchable.

And, it is incoherent. The treatment being meted out by Brussels to tax neutral IFCs will cause harm to the tax receipts of the 28 member states themselves. Europe can expect less foreign investment, fewer jobs and slower economic growth, all to the detriment of its governments' coffers. Indeed, Brussels' desire to see 'substance' offshore will likely give greater opportunities for multinationals to book their profits outside the continent – the alleged problem that the blacklisting process is seeking to address.

But blacklists are effective at changing the behaviour of nations and territories that are too small to have the diplomatic, economic or military clout to resist.

Up to now, big countries have mostly named, shamed and then penalised IFCs to secure greater transparency for and adherence to measures to reduce financial crime and money laundering. We should rejoice at the end of Swiss-style banking secrecy laws and the demise of regulators who fail to show due diligence when the industry that are regulating isn't diligent. But Europe's current round of blacklisting steps well beyond precedent. It is the unjustifiable restriction of competitor nations' business activities. It is protectionism.

It is incredible that Brussels is pursuing a policy of protectionism under the arbitrary, inconsistent and incoherent guise of 'unfair tax'. But, for the island IFCs subject to the playground bullying of the gang of big kids that account for a fifth of the world's economy, the threat posed by blacklisting is more than credible.

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