Advisory

Mr. Moscovici and his EU Lists of Many Colours

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For those with better things to do than follow the machinations of EU tax policy, we should state that Mr. Moscovici is French. He is also amongst other things an EU Commissioner for Taxation, that the OECD is based in Paris, and that these things are not coincidental. The position that we arrive at is that the EU now issue a black and a grey list of "tax havens", a term which in the light of the transparency initiatives including FATCA and the OECD's version, the Common Reporting Standard is, in relation to signatory jurisdictions, meaningless, save in the halls of Brussels and Paris. Simply, the Cayman Government has adopted the right approach; that is to say, no more appeasement to the EU or its agent, the OECD, because a fair and balanced outcome is not within their sphere of contemplation, and from the outset, it is probably true to say, never has been. It seems that for the purposes of EU tax policy, the Cayman Islands will therefore be now be grey.

Before we analyse the EU double think let's get to the why; the importance of the role of the Cayman Islands as an offshore financial centre. As matters stand, we have some 7,500 hedge funds regulated, anecdotally some 75% of the world's total, with assets under management of US$2.4 trillion. There are over 20,000 private equity vehicles in the form of exempted limited partnerships in respect of which we have no figures of assets under management but would estimate the number to be almost as large again. Bank deposits and inter-bank bookings are in the region of US$1.4 trillion and there is a highly developed professional infrastructure of some 700 lawyers and over 1,000 accountants. If we look at just one onshore jurisdiction, we see that US$52 billion or about one third of the direct outward investment from Brazil flows through Cayman Islands vehicles. Our total estimates of aggregate investment in and through the Cayman Islands would be in the range of US$4-5 trillion which makes the Cayman Islands the largest financial centre in all Latin America and according to data from the IMF, the fifth largest financial centre in terms of foreign portfolio investment, itself worth US$2.6 trillion. This means that currently the Cayman Islands attracts more foreign portfolio investment (but see further below) than any of Germany, the Netherlands or Japan. In 2016, foreign banks had consolidated claims on Cayman counterparties for over US$1.2 trillion of which Japanese banks accounted for 40% and American banks for approximately 305.

Now contrary to the deliberate mischaracterisations of a number of high profile left wing NGO's (no doubt funded by various Treasury departments, and indeed one or two Charities like Oxfam and Christian Aid), the unanswerable fact (unless you are an EU tax commissioner) is that the Cayman Islands adheres to the highest of international standards on transparency. Tax authorities and law enforcement had access to information under the 36 Tax Information Exchange Agreements before the application of FATCA and the Common Reporting Standard. Given these transparency initiatives, references to "secrecy" are ill considered.

It is correct to say that the Cayman Islands Register of Beneficial Interests is not available to the public as is the Register in the United Kingdom but the Cayman Islands position, paradoxically, is consistent with the legitimate right to privacy established under the European Convention on Human Rights which is incorporated both into the UK law under the Human Rights Act 1998 and into the Cayman Islands Constitution (so we can observe that post Brexit, the Cayman Islands conforms to EU law and not UK

law). The furor concerning the Register of Beneficial Interests ignores the fact that prior to its introduction in the UK and for nearly two decades, Cayman Islands service providers have been obliged to maintain details of all 10% direct and indirect beneficial owners of Cayman Islands entities and on directors which information has been available to tax authorities under the Tax Information Exchange Agreements and to law enforcement.

Then there is the rarely mentioned statistic which reveals the mischaracterisations of the left wing high tax campaigners to be no more than propaganda. Notwithstanding the transparency in both tax and criminal matters, the number of enquiries made annually by tax authorities and law enforcement is less than 30 and there have been no statistically significant taxes collected nor convictions obtained for any form of wrongdoing in relation to Cayman Islands entities from the inception of the transparency initiatives.

Nevertheless, the use of the pejorative term “tax haven” finds favor in Paris. But if we analyse the popularly held mischaracterisations, none are tenable. It is inappropriate in the face of the transparency initiatives established to describe the Cayman Islands as a “tax haven” implying any form of secrecy that would facilitate criminal tax evasion. Furthermore, tax avoidance is by definition a function of onshore legislation. It requires a form of abuse of the double tax treaties, notably those between the European Union jurisdictions of Ireland, Luxembourg and the Netherlands (which the EU lists ignore), to shift profit from one jurisdiction to another, a practice assisted by use of the Double Irish and the Dutch Sandwich which those EU jurisdictions have actively promoted. But the Cayman Islands and other Overseas Territories without a double tax treaty network have had no role to play in tax avoidance techniques which shift profits around the EU tax treaty network, no doubt to the irritation of Mr. Moscovici.

We are therefore obliged to conclude that the EU initiative is in fact ideological, a conclusion that was readily apparent when the OECD published its “1998 Report on Harmful Tax Competition”. By way of reverse engineering and the starting assumption that tax completion was in fact “harmful”, small offshore jurisdictions with low or no direct taxation were “defined” instrumental in the “harmful practice”. They were defined as “tax havens” on the basis of: (a) no or nominal effective tax rate; (b) a lack of effective exchange of information; (c) a lack of administrative transparency; and (d) a novel and stunning requirement of the absence of “substantial activity”, which we now see resuscitated in the BEPS initiative and notwithstanding that no one else has suggested that international financial transactions, intangible by definition, have anything whatsoever to do with anything “substantial” save in dollar amount.

Labelling the offshore financial centre in pejorative terms as a “tax haven” stands no scrutiny. Investors invest where they want to invest. Those investments when made through a Cayman Islands entity are taxed in accordance with the laws of the place where the investment is made and secondly, and unquestionably, since the introduction of tax transparency, investors will also pay tax on the ultimate return of capital gains and dividends in the jurisdiction of receipt. It is in no way meaningful to designate the activities of the offshore jurisdiction as “harmful”.

This EU driven initiative on “harmful” tax competition is really concerned with two distinct issues. The first is the inevitable need, and for the reasons mentioned below, to increase tax rates within Europe, and the second, since there could be no guarantee that the rest of the world would follow suit (and indeed, it hasn’t), is the need to prevent capital flows away from the high tax EU jurisdictions to jurisdictions with lower tax rates. But if the capital flow is not being invested in the Cayman Islands then the investor is simply utilising the superior legal structuring available under Cayman Islands law to conduit the capital flow to the jurisdiction in which the investors want to invest. What is irritating Mr. Moscovici plain and simple is that that jurisdiction is not an EU jurisdiction.

And yet the EU persists in its suggestions that the Cayman Islands is “non-compliant” and should now be listed. Clearly, there is no rational basis for this suggestion. “Non-compliant with what?” anyone outside of Paris may well ask. Unlike the US, we appear somewhat carelessly to have signed every piece of paper the OECD have produced to date (but really need to look at the next piece of paper more carefully). But

what then drives the EU position? As with all EU doublespeak the answer is something quite different. There is wide spread panic within Europe on the subject of demographics.

Chancellor Angela Merkel is fond of quoting an alarming statistic. Europe accounts for just 7% of the world's population and 25% of its GDP and yet it accounts for a massive 50% of its welfare spending which is completely out of control and is on a scale which is lavish and unaffordable compared to the rest of the world. The problem with populist politicians in Europe who have bought their votes with unsustainable government spending and borrowing is neither Ms. Merkel nor any other of them has the will to do anything about it.

By comparison, the United States accounts for just over 18% of global welfare spending whilst Germany, around a third of size, spends 12.5% of the global total. China with 20 times the UK population, accounts for 2.4% of the total, Russia 2% and India 2.6%. As a result, total spending across the EU on infrastructure projects has dropped to 2.7% of GDP with the biggest countries in the Euro zone, Germany, France and Italy, having reduced infrastructure spending from between 15-20% over the past decade. But that is not the worst of the problem.

The long term concern is that fertility rates in Europe are decreasing as life expectancies increase. As Europe ages, the cost of health care and pensions will increase dramatically whilst tax revenues from a working population decrease and this is at a time when millions of migrants have come knocking on the borders of Western Europe and are increasing the burdens on the welfare state.

The migrant issue is an example of EU social engineering gone wildly wrong. Free movement of labor was one of the four immutable principles of the European Union and the EU motivation was therefore not merely humanitarian but that the immigrants would revitalise the European economy by providing an increased and essential younger labor force.

But it turns out that if we ignore unpaid internships and minor employment, only two years after the major influx from 2013, only 21% of asylum seekers had found employment. Amongst those that arrived at the peak of the crisis in 2015, only 5% were employed a year later and the German Commissioner for Immigration recently told the Financial Times that he believed that up to 75% of immigrants would be unemployed in five years. The OECD itself reported that less than 40% of asylum seekers had completed an upper secondary school education. German government estimates of their own cost of dealing with the asylum seekers proved inadequate. In 2016, as against an estimated cost of US$19 billion, the actual costs reported were some US$26.3 billion. And so rather than boosting German tax collections as intended, it transpires that Germany alone expects to spend an estimated US$86 billion on refugees between 2016-2020 or US$48,000 per migrant. The net result of these demographic issues is that taxes in Europe must not only increase significantly but that the European Union must move to harmonise tax rates within Europe and at the highest levels. In this context, a thriving offshore financial centre applying no tax at all represents the European Union's worst philosophical nightmare and we are targeted for that reason alone.

We see now the long term intentions of the European Commission to harmonise taxes within Europe manifested with the introduction in 2015 of the first working papers for the Common Consolidated Corporate Tax Base across EU member states. In this respect, the Commission are doing no more than playing catch up with the approach of the European Court of Justice which in its judgments from Cadburys, Schweppes to Marks and Spencer has done its judicial best to apply harmonised tax rules across the European Union notwithstanding that individual member states still and, increasingly delusionally, believe they retain sovereignty over direct taxation.

We see also in the US$14 billion fine by the European Competition Commission of Apple and the US$294 million fine of Amazon, that the EU is waking up to the understanding that tax avoidance occurs within its borders and is intent on eradicating it. Unless the EU implodes, tax rates in the EU must be harmonised and can then only go up.

The simple fact is there is no further global initiative to which the Cayman Islands can accede. It is no secret that what the European Union are actually demanding is the introduction of direct taxation in the Cayman Islands and that that simply will not happen. As to an EU blacklist, if we use the IMF figures portfolio investments in the Cayman Islands, we can conclude that only 8% comes from EU jurisdictions. And by that, I do not include the two European power houses, Switzerland and the United Kingdom. The Cayman Islands position is that it will protect the 92%.

The EU list is devoid of credibility for another reason. It excludes the EU jurisdictions where tax avoidance occurs in the range of hundreds of billions of dollars a year, it excludes China and it excludes the delightfully opaque United States of America which has sensibly ignored the OECD and signed up to absolutely no international transparency initiatives. No doubt, a certain amount of negativity must arise with regard to any black list but on any technical analysis, the indisputable fact is that the Cayman Islands complies with every international standard on transparency anti money laundering, anti-terrorism and international sanctions and has been determined to be compliant as a matter of fact.

It seems therefore that we are at an impasse. There is nothing we can do to further appease the EU which has acted in exactly the arbitrary and unjustifiable manner that its founding Fathers sought to prevent or as we might say in the context of this debate; *Plus ca change*. For the longer term, we are optimistic because if it is the case that Mr. Moscovici has in mind that tax rates in the EU must rise, and that we may in time see the imposition of an EU Financial Transactions Tax, then there will occur a shift in financial structuring away from Europe, in respect of which the Cayman Islands will remain well placed. No doubt in the short term transactions from the EU may diminish but they represent less than 8% of the Cayman book of business. Cayman will continue to protect the remaining 92%. We have been here before.