The Cayman Islands and the EU Blacklist

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The Cayman Islands has been blacklisted by the European Union (EU) for failing to comply with good governance standards on tax, according to reports published in The Guardian newspaper. Anthony Travers, OBE, Senior Partner at Travers Thorp Alberga, comments on this decision.

"A Hug Is Always The Right Size." - Winnie The Pooh.

Notwithstanding the extraordinary efforts made by the Cayman Islands government to embrace tax transparency, and what many would describe as the ridiculous, novel and overreaching Economic Substance legislation, under threat of sanction by the EU, we can say now with certainty that the EU response is always the wrong size.

According to The Guardian[i] reporting on, what is almost certainly a deliberate and entirely predictable leak from the Economic and Financial Affairs Council (ECOFIN) ahead of any decision due to be made on 18 February 2020, we find the Cayman Islands is, once again, about to be blacklisted as a "tax haven" for "non-cooperation".

Put aside for the moment that, in this era of complete tax transparency, the use of the expression "tax haven" is fundamentally dishonest, the logical conclusion is that in introducing the preposterous Economic Substance Legislation; full exchange of tax information with relevant EU Member States pursuant to the Tax Information Exchange Agreements; beneficial ownership reporting to EU tax authorities and law enforcement; and automatic financial information exchange to those tax same authorities pursuant to the Common Reporting Standard (all of which, if it needs to be said, again, represent the world leading standards in transparency and cooperation) the Cayman Islands has, in fact, been wasting its time.

It is now clear that all along, the EU has been economical with the truth. All the EU ever really wanted was for the Cayman Islands to cease to exist as an offshore financial centre.

We can fleetingly make note of the irony: the EU, an organisation formed, in part, to prevent further Fascist hostilities in Europe, adopts the very same tactics of arbitrary and discriminatory coercion that it was intended to eradicate. And so, an organisation which was formed because France and Germany would never again trust each other formed the EU which it turns out nobody can trust. And why would it behave differently? What is there to stop it? If there is anyone out there remaining who doubts how an unelected and non-accountable bureaucracy may act in furtherance of its own objectives, then it should look no further than the EU behavior towards the Cayman Islands.

It seems Nigel Farage was right all along. No doubt leaked and suggested by ECOFIN, The Guardian trots out the same hackneyed clichés referring to the ludicrous narrative suggested by the Tax Justice Network, that the Cayman Islands "proliferates corporate tax avoidance" and is "non-cooperative". Anyone with a modicum of understanding of the fundamentals knows you need a Double Tax Treaty to conduct abusive tax avoidance and the Cayman Islands has none.

Worse than that, a further irony, the Double Tax Treaties that have (lawfully) enabled corporate tax avoidance on an industrial scale for the benefit of the US corporates, Google, Starbucks, Apple and the others, have all relied on EU jurisdictions, Ireland, the Netherlands, and Luxembourg. (It is for this reason that certain EU jurisdictions, notably France, have lost faith completely in the OECD Double Tax Treaty Network and seek now to impose a tax on gross profits without reference to deductions for research and development costs, royalties and interest payments.

Needless to say, there has been no admission by the EU or the OECD that their model Tax Treaty is hopelessly ineffective).

The Cayman Islands is not even remotely implicated, other than to the extent that US sub-part F income rules lawfully enable tax deferral[ii] for the benefit of the subsidiaries of major US corporates.

So, if it is the case that the European Union is no longer interested in transparency treaties, information exchange and cooperation, all of which the Cayman Islands have established beyond doubt, what exactly is the European Union interested in? The answer to that is not obvious at first sight. The answer is that the EU Commission and ECOFIN are panicked, as they should be given the extent of prospective and unavoidable EU welfare spending, at the prospect of lower and lower tax rates in the United States sucking in available global capital for investment at the expense of inward investment into the European Union. International mobile capital, when invested, creates jobs, pays pensions, generates tax revenues, and funds welfare programmes in the jurisdiction of investment; and the Cayman Islands, by facilitating international capital flows into jurisdictions like the United States, is regarded by the European Union as an integral part of the threat.

However, no doubt EU Tax Commissioner, Pierre Moscovici's instinct for self-preservation is greater than his inflated extraterritorial tax ambitions; nothing would induce him to enter into direct discussion with President Trump on the subject of raising US tax rates.

But he can certainly do his best to disrupt flows of investment capital in and through the Cayman Islands into the United States, and that, in a nutshell, is what the EU blacklist of offshore financial centres is actually about.

What we know it is not about is EU individuals, organisations and institutions using the Cayman Islands; the statistics reveal such usage to be statistically insignificant and therein lies an absurd truth. What is the actual effect of including the Cayman Islands on an EU blacklist? In technical terms, the answer to that is marginal to none. Reputationally, of course, since it seems that no one understands what a blacklist is or what it is supposed to do, the damage may be far greater and hence the use of leaks to the press, the smear tactics, and the unsound comments about non-cooperation and tax avoidance.

Here, the EU has already worked its black arts; the Cayman Islands brand is (and for no particularly good reason that anyone can discern) already regarded as toxic in the boardrooms of most EU institutions. But should we care? The European Union is in fact, and has been for some considerable time, a dead zone in so far as the Cayman Islands is concerned. Less than 8 per cent of the investment in Cayman fund structures is EU investor based and that we can predict will go to zero.

Reputational risk apart, let us drill down to the precise consequences of the blacklist. The EU is impotent on tax matters. It has no "federal" taxing capability (a structural flaw that, if not corrected, will ultimately ensure the EU's implosion) and so it is simply the case that recommendations may be made in respect of a blacklisted jurisdiction by ECOFIN to each Member State.

But the likely measures we see are infinitely less damaging than the toxic public relations that surrounds them.

In the non-tax area, defensive measures, if adopted, would preclude investment in Cayman Islands entities by:

1. The European Fund for Sustainable Developments;
2. The European Fund for Strategic Investments; and
3. With less certain effect, the "general framework for securitization", whatever that is supposed to mean.

In the tax area, the ECOFIN recommendations may amount to introducing the following administrative measures (all of which, as far as we can see, apply in any event). Namely:

1. Reinforcing transaction monitoring;
2. Increasing audit risks from taxpayers who benefit from the listed regimes; and
3. Increasing audit risks for taxpayers who use these specific jurisdictions.

The Council may also invite Member EU States to apply at least one of four specific legislative measures including:

1. Non-deductibility of costs (possibly a new point);
2. Controlled foreign company (CFC) rules;
3. Withholding tax measures; and
4. Limitation of the participation exemption on profit distribution

But the CFC rules and withholding tax rules are by no means new points and are of limited application, given that Cayman Islands entities will pay tax in the jurisdiction of investment in any event.

In effect then, at the technical level, the suggested "blacklist" sanctions are of limited to no concern to the Cayman Islands even assuming EU investment. Every Cayman Islands investment vehicle, of which I am aware, pays tax in the jurisdiction of its investment according to the laws of that jurisdiction. If that were not the case and if the comments of the Tax Justice Network were to have any integrity (which they do not) there would, by now, be a string of citable convictions for tax evasion by Cayman Island investment entities. There are not. Further, most EU countries laws will already have CFC legislation and withholding taxes (although, possibly not certain Eastern European jurisdictions which have the benefit of a flat tax, but they are not statistically relevant in terms of dollar flows to and from the Cayman Islands).

From as far back as 1984, with the first exchange of letters in relation to information on narcotic offences with the United States government, the Cayman Islands history of cooperation has been exemplary. For the EU to suggest anything to the contrary is unsupportable and outright dishonest. We should perhaps sound a note of sympathy for the Cayman Islands government which has negotiated in good faith for the past 20 years whilst the EU has not. Throughout the recent introduction of the Economic Substance legislation, the EU, as is customary, has sought to continually move the goal posts by wishing to bring investment funds into scope when there is no sound economic or tax reason in doing so. The fundamental point remains true. Cayman Islands structures pay tax on profits and gains in the jurisdiction of investment. What the EU and their Gallic colleagues in the OECD propose is that investments in and through the Cayman Islands should bear tax twice. In this way, and only this way, Luxembourg and Dublin, they suppose, may seem more favourable as jurisdictions through which to conduct investment than the Cayman Islands. And it is true to say that if Moscovici has his way with the Common Consolidated Corporate Tax Base, and if tax rates across Europe are therefore harmonised and at a very high rate, no doubt, Dublin and Luxembourg will need all the help they can get.

But in the immediate term the Cayman Islands' response to these new leaks and threats from ECOFIN should be clear.

The Cayman Islands financial services industry is not a post Brexit bargaining chip. And given that there does not exist one shred of truth or integrity in the ECOFIN position, the Cayman Islands government should indicate that unless our full tax and all crimes transparency is recognised and respected immediately, and the Cayman Islands is removed from all lists grey, black (or double black), it will suspend the implementation of the Economic Substance legislation and the operation of every Tax Information Exchange Agreement with, and reporting under, the Common Reporting Standard to each EU member State. As is the UK, and since we have derived no credit, we may as well start again.