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The Ills of Blacklisting for International Taxation

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The idea for this article came to me after I read a piece published by the International Tax Review with the title "Mexico confirms that US may qualify as a preferential tax regime in light of the 2017 Tax Cuts and Jobs Act".[1] Instead of curating a proper blacklist, or a published list of tax havens and preferential tax regimes, Mexico opted in 2008 for an "effective tax rate standard" to be applied by the taxpayers in assessing whether a foreign regime is blacklisted or not. Since the standard is 75% of the corporate income tax rate in Mexico (30%), given that the TCJA reduced the U.S. corporate income tax rate to 21%, 21% is lower than 22.5%, and, therefore, the U.S. may have entered the Mexican blacklist.

In reading about the Mexican way of blacklisting, I can only imagine what Brazilian taxpayers – and tax practitioners – would feel about our "official list standard" being replaced by an "effective tax rate standard" in the near future. Brazilian Law does make reference to a minimal tax rate in its blacklisting rules (and, for simplicity in this article, I have merged the concepts of blacklisting and graylisting in Brazilian Law – the former for tax havens, the latter for preferential tax regimes), but that minimal tax rate is not based on a percentage of the applicable Brazilian corporate income tax rate (the minimal tax rate is currently set at 17% by Article 1st of Ordinance MF 488/2014). Also, even though Brazilian Law identifies the criteria for blacklisting entries, Normative Instruction RFB 1,037/2010 provides an official list of those jurisdictions for taxpayers to consult and consider in their cross-border operations. The relevance of that list has been evidenced by its many amendments, which have been carried out routinely (-ish) by the Federal Tax Revenue of Brazil. They include **(i)** the suppression of a second reference to St. Kitts and Nevis, which had been featured for six years in two items of Article 1st, until someone realized *Federação de São Cristóvão e Névis* and St. Kitts and Nevis were the same place, **(ii)** the inclusion of Austria as having a preferential tax regime, something that continues to baffle our colleagues in Vienna to this day, and **(iii)** the inclusion of Ireland as a tax haven, not a terrible surprise if you look at the Irish corporate tax rate for trading income and certain dividends (12.5%), but a bold move nonetheless.

A bold and aggressive move. That is what blacklisting essentially is, and that is what I wanted to write about in this article.

Many practitioners look at the BEPS Action Plan, nowadays more of a historical reference, and focus their attention on the new provisions recommended for domestic law and tax treaties, especially those that were labelled by the OECD as minimum standards. Of the top of my head, I can think of at least ten papers that have been written about Action 6 in the last two to three years. Action 14 was a subject of one of my articles for Tax Notes International, and, given its analysis of *mandatory arbitration* in the field of tax treaty disputes, it has been the subject of many other articles in the Bulletin for International Taxation, Intertax, as well as other reputable journals. Action 5, however, which deals with *harmful tax practices* and is a minimum standard, has received far less attention from commentators than perhaps it should. Even those articles that have addressed Action 5 have done so in its official terms, and not on the policy implications of its prescriptions. One of those, of course, is good ol' blacklisting, the International Public Legal way of saying "now *that* will teach them a lesson".

Blacklisting, of course, is tempting to any sovereign power. The idea of **(i)** creating a list of jurisdictions that you regard as either *non-cooperative* (because they refuse to exchange information) or *cooperative*, *but harmful* (because they impose little to no taxes on individual or corporate income), and then **(ii)** enacting domestic measures to counterbalance or disadvantage operations and structures involving those jurisdictions is *brilliant* in theory. A blacklist is easy to implement, and it sends a message to the affected jurisdictions and their authorities, sometimes forcing them to a negotiation table they would have otherwise ignored. But the attractiveness of blacklisting disappears when *your jurisdiction* is staring at the business end of that gun, and if you bring the attention of the public to that gun, people might start to wonder whether you should have been blacklisted at all.

Consider the experience of the EU with blacklisting (and graylisting) for tax purposes. Provided you agree with its terms, outsourcing your blacklist to a supranational power is a *masterful tactic*. If that supranational power feels less constrained by the diplomatic implications of labelling jurisdictions as non-cooperative or harmful, all the better. Just read what the Commissioner for Economic and Financial Affairs, Taxation and Customs had to say when the EU released its first ever list of non-cooperative jurisdictions in December 2017:[2]

The adoption of the first ever EU blacklist of tax havens marks a key victory for transparency and fairness. But the process does not stop here. We must intensify the pressure on listed countries to change their ways. Blacklisted jurisdictions must face consequences in the form of dissuasive sanctions, while those that have made commitments must follow up on them quickly and credibly. There must be no naivety: promises must be turned into actions. ***No one must get a free pass****.*

That blacklist included names like Bahrain, Barbados, Mongolia and Namibia, but it failed to mention other names, like possibly the United States[3] (which has been less than cooperative with the EU and is arguably the *incognito* tax haven of our times).[4] That was pointed out by commentators as unfair, one of them being the Finance Minister of Namibia, which said that the country is "clearly not a tax haven", and that its inclusion in the EU blacklist was (and is) "discriminatory and biased".[5] The newer versions of the blacklist have been shorter,[6] even though the update of March 2018 added three jurisdictions to six of the original eighteen. However, with its blacklist, the EU has effectively *pushed* an "internationally accepted" version of domestic tax policy into the agenda of developing and underdeveloped jurisdictions, which cannot bear the risk of not doing business with individuals and companies in the EU. Consider this:

- In the memorandum[7] released by the EU to explain its blacklisting criteria, it says that jurisdictions must have committed to implement the OECD BEPS minimum standards and should not have harmful tax regimes "which go against the principles of the EU's Code of Conduct or OECD's Forum on Harmful Tax Practices". It also states that those jurisdictions that *choose* to have no or zero-rate corporate taxation should ensure that this does not encourage artificial offshore structures "without real economic activity".

- Apart from possiblytheir tax systems, however, the jurisdictions that are still featured in the EU blacklist have other things in common. As of 2017, none of them had a GDP of over USD 25 billion.[8] With the exception of Namibia, their economies are primarily geared towards tourism and they all have small, insular territories, most of them in the Pacific Ocean. These are jurisdictions that are often unable to attract foreign direct investment due to their limited infrastructure and workforce, but their governments are still required to fund social programs,[9] invest in educational reform,[10] and improve the lives of locals through public works. The challenge, evidently, is finding the money to achieve those objectives.
- One common approach is to entice FDI via tax benefits, which may take the form of a reduced corporate tax rate or an outright exemption on foreign income. To claim, as the EU memorandum has claimed, that those tax benefits should be tied to "real economic activity" poses two obvious problems. The first is that "real economic activity" is predicated on a business environment that those jurisdictions simply do not have, at least not to the extent of OECD or G20 members. The second is that tying tax benefits to anything approaching *local content requirements*(which would establish a modicum of economic activity as a prerequisite for paying less taxes) puts those jurisdictions in the line of fire of the WTO, with its GATT and TRIPS limitations on LCRs. Simply put, governments of Namibia, Palau, Samoa and Trinidad and Tobago must choose who they'd rather annoy: **(i)** the EU, the OECD, and individual "blacklisters", with their complaints requiring more local business activity, **(ii)** the WTO, with its complaint about unfair international trade practices, or **(iii)** their own electoral bases, who might complain that simply doing nothing has led the country to lose its appeal to FDI and give away the investment required to fund key public policies.

As I said before, blacklisting is a bold and aggressive move in the International Tax arena. When blacklisting is carried out by individual countries, it serves the purpose of preventing the outflow of capital to more favorable jurisdictions, an outflow that might not be stoppable or preventable otherwise. When it is carried out by supranational bodies or organizations, it is advertised as a *response to unfairness* (via tax evasion and tax avoidance), even though it may very well *cause unfairness* by pushing less affluent jurisdictions into a modification of their domestic tax systems to match the unattainable standards of EU members and of sophisticated G20 economies worldwide. Blacklisting has the power to *regiment* international tax policy in different countries, big and small, under the guise of "tax harmonization". That is a charming concept in theory, but if implemented in a coercive manner, not taking into account the intrinsic disparities between predominant capital exporters and predominant capital importers, or commoditized and non-commoditized economies, or producer and market jurisdictions, a less diverse, dynamic and culturally symbiotic set of tax policies may result. The continuous wave of blacklisting practices nowadays seems to be leading us to that path.

Finally, one of my first short papers on International Taxation was an article titled "Le Coup du Berger: A Critique of the Contribution of the Emerging Economies to the OECD BEPS Action Plan".[11] In that article, written nearly five years ago, I compared the participation of emerging economies in the BEPS Action Plan to a *chess match* (which is why I made the reference to the coup, known in English as the Scholar's Mate). At the end of my conclusion for that article, I wrote something admittedly dramatic (I have moved on since then), but that seems to fit the post-BEPS movements we have seen from different countries and organizations towards the loosely defined goal of "tax fairness", particularly in the International Tax space. An adaptation of my final words in that article seems suitable for this piece, so, here it goes:

In this scenario, [the renewed interest in blacklisting as a tool to further an agenda of "tax *fairness"] should leave emerging economies staring baffled at the chessboard, trying to figure out where they went wrong. Meanwhile, the seasoned players on the other side will let go of their Queen, thus bringing the game to an end with one last, predictable word: "Checkmate".*

Thank you very much for reading this (pretty lengthy) article. If you have any thoughts on blacklisting, or perhaps on the current wave of blacklisting, please share them in the Comments section below. All the best!

P.S.: I am well aware of the practice of *whitelisting*, which has not been covered in this article and is a feature of country legislations like those of Argentina[12] and Italy.[13] This indirect approach to blacklisting has the sole merit of validating the efforts of foreign governments towards compliance (as opposed to "censoring" their jurisdictions for non-compliance), but its effects are the same as those of blacklisting inasmuch as it fosters a set of tax policies and *restrictions to tax policies* that are incompatible with the capabilities and profiles of other jurisdictions. Either they adapt (to the detriment of their budgetary constraints and necessities), or they face consequences in the form of lower thin capitalization thresholds, higher withholding taxes, or automatic application of transfer pricing rules, among other retaliatory measures.

P.S. (2): It is not lost on me that this text started out with a comment on the Mexican view of the U.S. TCJA, and it ended with remarks on how the standardization of international tax policy (or even of an "internationally accepted" set of domestic tax policies) may be a threat to the economic health of smaller, less affluent economies. Oddly enough, those two comments show both sides of the same problem: given that my proposition is that blacklisting is capable of affecting the tax policy of non-cooperative or harmful jurisdictions, whether that capability is mitigated or enhanced by the strength of its target should be of little relevance. The fact remains that blacklisting can be a coercive tactic used by individual countries and organizations to disseminate their views on what an "acceptable" form of tax policy should be, either for the benefit of their domestic economies or in the pursuit of a noble goal such as "tax fairness" (which, in turn, is an expression that conceals the interests of those countries with higher levels of infrastructure, security and natural resources, which are poised to benefit from the eradication of aggressive tax incentives in other jurisdictions).

[1] See ARROYO, Daniela Iñigo; EGUIRAO, Juan José Paullada; e VELARDE, Oscar A. López. *Mexico confirms that US may qualify as a preferential tax regime in light of the 2017 Tax Cuts and Jobs Act*. International Tax Review, published on September 11, 2018. Available at: <http://www. internationaltaxreview.com/Article/3832008/Mexico-confirms-that-US-may-qualify-as-a-preferential-tax-regime-in-light-of-the-2017-Tax-Cuts-and.html>. Last access on September 14, 2018.

[2] See EUROPEAN COMMISSION. *Fair Taxation: EU publishes list of non-cooperative tax jurisdictions*. Brussels, published on December 05, 2017. Available at: <http://europa.eu/rapid/press-release_IP-17-5121_en.htm>. Last access on September 14, 2018.

[3] See FOWLER, Naomi. *Will the EU really blacklist the United States?* Tax Justice Network, published on June 11, 2018. Available at: <https://www.taxjustice.net/2018/06/11/will-the-eu-really-blacklist-the-united-states/>. Last access on September 14, 2018.

[4] See FORBES. *The U.S. Is Becoming the World's New Tax Haven*. Bloomberg, published

on December 28, 2017. Available at: <https://www.bloomberg.com/view/articles/2017-12-28/the-u-s-is-becoming-the-world-s-new-tax-haven>. Last access on September 14, 2018.

[5] See FIN24. *EU Blacklists Namibia as Tax Haven*. FIN24, published on December 12, 2017. Available at: <https://www.fin24.com/Markets/eu-blacklists-namibia-as-tax-haven-20171212>. Last access on September 14, 2018.

[6] See EUROPEAN COMMISSION. *Evolution of the EU list of tax havens*. Brussels, published on May 25, 2018. Available at: <https://ec.europa.eu/taxation_customs/sites/taxation/files/eu_list_update_25_05 _2018_en.pdf>. Last access on September 14, 2018.

[7] See EUROPEAN COMMISSION. *Questions and Answers on the EU list of non-cooperative tax jurisdictions*. Brussels, published on December 05, 2017. Available at: <http://europa.eu/rapid/press-release_MEMO-17-5122_en.htm>. Last access on September 14, 2018.

[8] See WORLD BANK. *GDP (Current US$)*. 2017. Available at: <https://data. worldbank.org/indicator/NY.GDP.MKTP.CD?view=map&year_high_desc=true>. Last access on September 14, 2018.

[9] See VOGELMANN, Connie. *Palau: Tiny Country, Big Problems*. F&ES Blog, published on January 29, 2014. Available at: <https://environment.yale.edu/blog/2014/01/palau-tiny-country-big-problems-2/>. Last access on September 14, 2018.

[10] See ALL AFRICA. *Namibia: Challenges Facing the Public Education System*. All Africa, published on January 05, 2018. Available at: <https://allafrica.com/stories/201801050484.html>. Last access on September 14, 2018.

[11] See CARVALHO, Lucas de Lima. *A Critique of the Contribution of the Emerging Economies to the OECD BEPS Action Plan*. Revista Tributária das Américas, Volume 10. São Paulo: RT, 2014.

[12] See KPMG. *Argentina: "White list" countries for 2016; transfer pricing implications*. Published on January 06, 2016. Available at: <https://home.kpmg.com/xx/en/home/insights/2016/01/tnf-argentina-white-list-countries-2016-transfer-pricing.html>. Last access on September 14, 2018.

[13] See KPMG. *Italy: Amendments to "white list" of countries, favorable tax treatment*. Published on January 06, 2016. Available at: <https://home.kpmg.com/xx/en/home/insights/2017/04/tnf-italy-amendments-to-white-list-of-countries-favorable-tax-treatment-for-foreign-investors.html>. Last access on September 14, 2018.

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