The Crown Dependencies: an analysis of what has happene...

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The FT has reported this morning that:

Britain's crown dependencies have been plunged into uncertainty after the government signalled, in a dramatic sign of the intensifying pressure on tax havens, that their corporate tax regimes were unacceptable to the European Union.

The news is set to force Jersey, Guernsey and the Isle of Man to overhaul their tax regimes, possibly requiring them to introduce corporation tax. In a further setback for the Isle of Man's finances, it was told that the "common purse" agreement under which it shares value added tax with Britain was under review.

The crown dependencies use the "zero-10" corporate tax regime, which means many businesses pay no corporation tax. Although these systems were recently introduced to address EU concerns about their previous tax regimes, some European member states view them as predatory.

As far as I can tell the report is accurate with regard to the Isle of Man's Common Purse Agreement: the UK has served notice that the absurd subsidy to the Isle of Man, which has a higher GDP per head than the UK, and about which I have written so often, must be at least partially withdrawn.

The report about the zero ten tax regimes of Jersey, Guernsey and maybe the Isle of Man is less accurate. I cannot see how the EU can object to a zero per cent tax rate: indeed there is, as far as I can see no room to do so in the EU Code. These was in the OECD's 1998 attack on tax havens — which has now been consigned to history — but that and the Code are quite different things.

The reality is that in 2003 the Crown Dependencies did get an agreement from the EU that they could offer 0% taxes — at least in principle — and they could at the same time charge 10% tax on resident financial institutions. So long as these represented a minority of tax payers and were subject to clearly defined criteria this was agreed, in principle by the EU as I understand it at the time. I think this is beyond dispute. Hence â€šÃ„Ã²zero ten’ was born — and it has been claimed — I stress wrongly - with EU approval.

The trouble was that subsequent to receiving agreement the arrangements proposed by all three of the Crown Dependencies did, in varying ways, seek to move the â€šÃ„Ã²ring fence’ to which the EU objected from within what was perceived to be in the business tax code into the personal tax code of these islands.

This needs explanation. The EU Code — which attacked abusive tax regimes in a great many EU countries, and has subsequently been applied to the tax regimes of accession states, and which was therefore not targeted at tax havens per se, said that an arrangement was harmful if it was apparent that it provided a benefit on an unequal basis. So, in the case of the Crown Dependencies it was considered abusive that non-resident companies not be subject to tax and yet companies registered under identical law be liable to tax at 20% (at the time) if owned by local resident people.

The Crown Dependencies deemed it essential to their future — rightly or wrongly — to have companies on offer to those wishing to avail themselves of their secrecy provisions that paid no tax at all — an arrangement that has, of course, facilitated considerable tax abuse, whether it be evasion or avoidance. As a result they said that, taking the lead from the Isle of Man, who announced their policy in (if I recall correctly) 2000, henceforth they would not charge any tax on corporate profits recorded in the island — bar financial services companies, as noted above.

It is this policy the EU approved in 2003. It was not abusive.

However, when details of the schemes were announced — after 2003 I stress, I think in every case — there was a twist — which was that whilst theoretically local companies did not pay tax, their shareholders were forced to do so. The details of the schemes have varied over time. At first the profits of the local owned companies were simply apportioned to the shareholders as is they belonged to them — and those shareholders then paid tax as if they owned that profit — even though they might have had no access to the profits in question. These arrangements were extraordinary — they required shareholders to submit company tax computations — to which they had no entitlement as part of their own tax returns and pay tax on profits they may well not have received. They abused human rights law. They also required the company to pay the tax as agent for the shareholder. The policy was very obviously abusive. It was also very obvious that the reality was that nothing had changed, at all. Local companies were still being required to pay tax — it was just being said (and even then in fashion extremely hard to justify) that although they were paying they were doing so as agent for the shareholders. It was this scheme I objected to in 2005. Even then Jersey claimed I was wrong — that the scheme had been approved by the EU. But this was wrong.

I proved that. I went to Brussels and asked the team who would determine the issue on behalf of ECOFIN - the body that has to deem whether a tax scheme is abusive, or not.

They made it very clear in 2006 that:

1. No scheme was approved until it was law: Prior approvals were not given. They only ruled on laws in operation. So in their opinion zero ten had never been approved and would not be until it was in operation;

2. That the scheme of the sort noted above would not get approval — it was abusive.

Despite this Senator Walker claimed Jersey had approval —and it was to this claim that John Christensen addressed comments in 2006, which I have recently drawn attention to. What we knew was that the claims made, repeatedly, by Jersey politicians that zero ten had been approved were not true. We also knew that if we could determine this to be the case so too must they have been able to determine that.

The row had an impact — the proposed scheme was changed. Someone, somewhere obviously told the Crown Dependencies that the schemes would not be approved. Whether that was as a result of the Tax Justice Network visit to Brussels I do not know — but I do know the schemes were changed so that local shareholders were now only required to pay tax on 60% of profits, which was enforced by requiring that locally owned companies declared dividends of that amount of their profit. But powers were retained to ensure that if the companies failed to do this then it could be deemed that they had — and the company could still be required to pay the tax on behalf of the shareholders. So, some of the human rights abuses may have been removed — and companies were now allowed to retain some profit — but the ring fence that meant locally owned companies had to, in effect, pay dividends to ensure tax was paid whereas non-locally owned companies did not was retained. And since this was solely related to tax at the end of the day the abuse of the Code remained because locally owned companies were at a competitive disadvantage because of the application of deliberately constructed tax rules ensuring that this was the case — and the Code does not allow that.

This is why the Code has been violated.

Big questions remain. Did the UK mislead Jersey et al into thinking zero ten was acceptable? I genuinely don’t know, but candidly it does not matter. All the UK could do was to agree to present a scheme to the ECOFIN committee, or not. There was no way it could approve any scheme — that was the sole right of ECOFIN — so whatever the UK said there was no way any local politician could rely on that to say there had been approval under the Code. That was just not true — and the most cursory of examinations of the facts could have proven that.

And because the schemes have only been in operation now since 2009 (in the case of Jersey, slightly earlier for the IoM and Guernsey) it is only now that the ECOFIN committee can review them. I suspect that the review was planned for early next year based on past experience and advice I received a while back on the process involved. It was then they would get approval, or not as the case may be. And it was down to the UK to present the case — I stress, for the first time — for approval.

It seems the UK has decided it could not present that case, whether because it did not believe in it or because, as has been reported, others showed signs of raising material and justifiable objection. Again, it does not really matter which — either way approval, long predicted, but never secured was not going to happen.

What's the relevance of this analysis? I suggest three things. First, ministers in all these places have long said their tax schemes had been approved. On what basis is not clear — because in each and every case that very obviously could not be true. Until ECOFIN met and considered approved and operational legislation there was no way an approval could be given — so any such claims made were, by definition, wrong. Worse than that: they were untrue, and so seriously misleading to business and local people. I said so. So did others. We were right to do so, but were repeatedly told we were wrong. That has been proven beyond doubt not to be the case now. If those who claimed the schemes were approved were right then they could and indeed should produce that evidence now, table it for all to see, and challenge the UK and EU with it and say â€šÃ„Ã²be damned — we can do this as we have our approval to do so'. But I hear not a whisper that this will happen — because I am sure no such agreement exists. In which case, by definition all those who claimed the actual proposed zero ten schemes were approved must have made incorrect statements, and candidly, they must havce known that to be true. After all — you either have an approval or you don't. There's really no way round that. This is why there has been no fight back from the Islands — they all know they have no basis on which to fight — which is, again, clear indication they all knew they never had a scheme approved in the first place.

Second, ministers and others in the Isle of Man have repeatedly said I have been wrong to say the IoM has been subsidised under the Common Purse Agreement. And yet, once again, when change is announced they have simply roiled over and accepted the change. Why do that if they have any valid claim to the money on any reasonable and justifiable economic logic? Their trouble is, as I have repeatedly shown, that the logic for that claim does not exist — the IoM has been subsidised and that is the beginning and end of the story.

Which brings me to my third point. The tax policy of these islands has been built on the basis of not very sophisticated tax avoidance schemes and misrepresentations of the truth to the public for the last few years. That's no basis for the future. That future has to be built on a new basis of openness, transparency, compliance, and a willingness to cooperate which has been absent to date. Only then can these islands be integrated into the international financial community. I hope they are — but only on that basis. And this will require an enormous change of culture within the islands, their politicians, their representative organisations and a leap of faith from the rest of the world that has gown not to trust them. Is all this possible? I hope so. But time will tell.