Incongruities and other unfathomables: HMRC’s Category 3 listing of Barbados

By Françoise L.M Hendy

From April 1, 2011 Barbados will be classified as a Category 3 jurisdiction by the United Kingdom Revenue Authority properly referred to as Her Majesty’s Revenue and Customs (HMRC).

Exactly four days after Barbados’ legal regime supporting transparency and exchange of tax information was found insufficient to warrant Barbados’ passing of the OECD/Global Forum Phase I Assessment, the UK government has classified Barbados as a jurisdiction from whom they expect difficulties in obtaining information on UK tax dodgers and other tax misfeasors.

In a statement released today and captioned “Offshore Tax Dodgers Run out of Time” the HMRC stated that from 6 April 2011 penalties for offshore non-compliance - for income tax and capital gains tax - will be linked to the tax transparency of the country involved. There will be increased penalties in place for under-declared income and gains from territories which do not automatically share tax information with the UK.”

Moreover, David Gauke, Exchequer Secretary to the Treasury, was quoted as saying:

"The game is up for those going offshore to evade tax. With the risk of a penalty worth up to 200 per cent of the tax evaded, they have a great incentive to get their tax affairs in order.

We have given HMRC an extra £900m to tackle tax cheats because we are prepared to act against the minority who refuse to pay what they owe.”

The new penalty system for tax non-compliance is based on a three tier classification of countries based on their level of tax transparency. More particularly, the new UK listing seems to rely on a jurisdiction’s transparency credentials based as adjudged by OECD standards.

According to Dave Hartnett, the Permanent Secretary for Tax this builds on other HMRC activity, including signing tax information exchange agreements, requiring information about offshore bank accounts and disclosure opportunities, including the Liechtenstein Disclosure Facility.

In practice this means that the penalty for non-compliance with certain aspects of UK income tax law will be determined by the foreign country implicated in the tax payers undeclared or under reported income tax or capital gains.

For category 1 countries the penalty will remain the same; for category 2 countries the penalty will increased by 150% and for category 3 countries like Barbados the penalty has been increased to 200%.

A sensible argument against the higher imposition for tax dodgers could hardly be made against the backdrop of
the HMRC’s well documented losses as a result of UK residents use of equally well known non-European and European jurisdictions. Moreover, given the G-20 agenda for a new economic world order and the UK government’s Coalition manifesto such a move could hardly come as a surprise.

The detail of this new penalty scheme and others can be found in Schedule 10 to the UK Finance Act 2010 referenced under Part 2 (Anti-avoidance and Revenue Protection) Section 35 (Penalties in respect of Offshore Income etc.)

Interestingly, although the Finance Act was enacted on April 8, 2010 Section 35 also provides that the new penalty scheme would come into being “on such day as the Treasury may by Order appoint.”

It is therefore reasonably possible to posit that it cannot be without coincidence that the HMRC announcement, following as it does the second tranche of OECD/Global Forum Phase I Assessments on a country’s legal and regulatory framework for transparency and tax information exchange, has not been influenced by this work.

To date the Global Forum has released eighteen reports on Australia, Barbados, Bermuda, Botswana, Cayman Islands, Denmark, Guernsey, Ireland, Jamaica, Mauritius, Monaco, Norway, Panama, Qatar, San Marino, Seychelles and the republic of Trinidad and Tobago.

Of the afore-mentioned countries, Barbados finds itself in company with Jamaica, Mauritius, Monaco, Panama, Seychelles, and the Republic of Trinidad and Tobago as category 3 jurisdictions. Of these countries Jamaica, Mauritius and Monaco were given the stamp of approval by the OECD/Global Forum Phase I review on transparency but are still considered not to be transparent by the UK government. The other assessed countries appearing in this third class of country each failed to convince the Global Forum of their compliance with international norms on transparency and exchange of information.

Those assessed jurisdictions however who either passed the Phase I inquiry, namely Cayman Islands or those who were successful in their Combined Phase I and II assessments – Australia, Denmark, Guernsey, Ireland and Norway maintained their category 1 listing under the 2010 Finance Act. Bermuda and Qatar are included in category 2.

Why, in opinion, this latest pronouncement by the HMRC - particularly in relation to Barbados - defies comprehension is described in the following paragraphs.

Barbados has had since 1970 a tax treaty with the United Kingdom that includes a provision on exchange of tax information. Of course the provision pre-dates the standard language in the 2008 OECD Model tax Agreement which is now
the litmus test for compliance in tax treaties. It is however the legal basis which has lead to the institutionalisation of tax co-operation between these two territories.

Like the exchange of information provision in the 1980 Barbados-Canada tax treaty the language can be interpreted as excluding those entities carved out of the entire agreement and so not covering the universe of potential tax payers the modern formulation explicitly includes.

However, although it may not yet be in the public domain it is certainly known by the members of the Global Forum and the OECD - both of which count the UK as an active member - that Barbados has concluded a protocol to its treaty with Canada which is to be signed and ratified following the completion of Canada’s internal processes (Barbados has already agreed to the initial text). Furthermore, Barbados has for over six months been pursuing the confirmation of dates with the UK to bring this agreement in line with its modern treaty policy.

Equally well known by the HMRC is the fact that Barbados and the UK have practised a form of international tax cooperation that though grounded in the legal instrument that gives the respective revenue authorities license to request and receive taxpayer information has in practice been applied to reflect the “spirit” of the agreement.

Put differently, Barbados has never to its certain knowledge allowed the ‘letter’ of the UK-Barbados tax treaty to be used as a means of shielding tax evaders from the full weight of both the Barbados and UK law. Indeed, the relationship between the two revenue authorities has always been characterised as mutually reinforcing of their shared goals and objectives in relation to revenue collection. Such is not the product of legal instruments evidencing a “promise to comply” but the translation of diplomatic expression into ‘on the ground’ practice.

With a new basis for enhanced capacity for exchanging tax information on the cards coupled with an existing infrastructure in both states to immediately implement the terms of the new standard for international tax cooperation one might rightly question what would give the HMRC reason to believe that it might have difficulty in obtaining information from the Barbados tax authorities after forty years of unimpeachable state practice.

Make no mistake, it is absolutely right to heavily penalise tax evaders especially given the universal need by countries the world over to increase revenue and cut expenditures.

It is absolutely right to impose stiffer penalties on UK tax payers whose “inaccuracies” are as a result of careless action, deliberate but concealed action or deliberate and concealed action as set out in Schedule 10 of the 2010 Finance Act.
It also makes good sense to relate the tax penalty to the level of transparency and access to tax information that the HMRC can expect where according to the Schedule “an inaccuracy” “involves an offshore matter” and if according to the new UK tax law “it results in a potential loss of revenue that is charged on or by reference to—(a) income arising from a source in a territory outside the UK, (b) assets situated or held in a territory outside the UK, (c) activities carried on wholly or mainly in a territory outside the UK, or (d) anything having effect as if it were income, assets or activities of a kind described above.”

What cannot be right and can justly be decried as grossly unfair is to characterise Barbados as “un-cooperative and lacking in transparency and from whom the request and exchange of tax information is expected to be fraught with difficulties.

This obviously erroneous inclusion of Barbados’ in category 3 listing is demonstrated by the fact that this nation has been an active and participatory member in the policy and practice of transparency and tax information exchange at the multilateral and the bilateral levels.

What makes today’s announcement so disquieting is that blame for Barbados’ failure to secure a passing grade by the OECD/Global Forum can be squarely placed ‘at the feet’ of those oftentimes un-wieldy government bureaucracies, who are known to both large and small states. This fact of ‘sovereign’ life has often been acknowledged by the OECD and Global Forum which has resulted in the often slow pace of ratification of bilateral instruments designed to apply the standards. It was also conceded that this malaise was most especially the lament of a country like Barbados legitimately able to apply the standards through appropriately worded tax treaties – once in force.

Close inspection beyond the “by-lines’ of the stories generated by the OECD press statement on Barbados’ Phase I Assessment verifies the truth of this statement.

Indeed, but for the slow pace of ratification by Barbados’ treaty partners an entirely different conclusion would have been reached by the OECD/Global Forum on Barbados’ transparency compliance.

That our longstanding trading ally and economic partner in transparency could not have cast a more discerning eye in its classification of territories according to their levels of compliance is of grave concern.

This is especially so in circumstances where although Barbados has no quarrel with the objectives of the UK 2010 Finance Act now finds itself having to undo the tarnish to our business brand this Category 3 listed has caused and the recovery the ground that will be lost to our competitors some of whom have lately come to accept what has from the outset defined Barbados approach to international tax cooperation.