Bat wings and BEPS

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Terry Dwyer's Commentary (Hackable Honey Pots – Issue 261) was, excuse the pun, a hive of (disturbing) information and, as always, admirable in its presentation. The invasion of privacy and its consequences concerns both of us and now Latins are being faced with the BEPS (Base Erosion and Profit Shifting) project devised by the Organisation for Economic Co-operation and Development (OECD), in addition to its Common Reporting Standard (CRS).

I am not sure if BEPSI (Base Erosion and Profit Shifting Initiative) would not be more appropriate, however, because like a famous soda drink, there will be lots of bubbles: some people will have theirs burst and others will be protected within them because, just like the soda drink, I foresee the compliance standard coming in many varieties. Already the United States of America has backed off from participation in CRS and as I wrote in my January business blog, Paul Ryan, Speaker of the US House of Representatives and former chairman of the House of Representatives Ways and Means Committee, has made it clear that he is not convinced "that Treasury has the authority to require country-by-country reporting by certain US companies (including sharing the information with foreign governments)". The OECD-inspired recommendations include a three-tier approach to transfer pricing documentation which requires a master file, a local file and a country-by-country report.

There is no doubt in my mind that reluctance in the US to join CRS and the lukewarm reception which BEPS has received from leading politicians stems, in large part, from concerns about how secure the information held will be. Nonetheless, Latin America's largest economy, Brazil, as well as its second-largest, Mexico, are active participants in BEPS; other Latin American countries are also engaged and new laws will complement and be consistent with the BEPS project; at least, that's the theory. The Brazilian Revenue Service is keenly aware of the impact BEPS will have, but I suggest that the government will be more concerned in 2016 with the impact the country's economic and political situation will have on Brazilians. When city budgets for this month's Carnival are curtailed you know that things are serious.

Throughout Latin America journalists are writing about the ebbing of the region's "pink tide", a reference to the weakening of leftist parties (not just in Brazil, but Argentina and Venezuela too) although Dilma Rousseff, Brazil's besieged president, is far more focused on the incoming tide of red ink flowing over the government accounts, as well as extricating herself from the corruption scandal she is embroiled in with Petrobras, the state oil company.

At the time of writing it is expected that Brazil's economy will have contracted by three per cent in 2015 and it is not certain that the president will still be in power in 2018 when the next presidential elections are held. Besides being deeply unpopular she appears to have completely lost control over congress. Some economists expect the economy to shrink a further 2% this year. Last September Standard and Poor's, followed by Fitch in December, reduced the country's credit rating to junk.

The positive thing about the Petrobras imbroglio, and which is part of a regional trend, is the fact that senior business and political leaders are being held to account, unlike in the past, particularly in the case of a state-owned company such as Petrobras. There is now a greater emphasis on the rule of law and in Guatemala a sitting president has been arrested whilst in Chile and Mexico members of the presidents' families have come under scrutiny over alleged conflict of interest abuses. Perhaps Latin America's younger citizens want a new order, as opposed to the embedded customs of the past, one which recognises the limits of power (as Nicolás Maduro in Venezuela found out last December when voters, old as well as young, delivered a crushing defeat to the ruling socialist party in congressional elections).

The region needs some positive news. This year its economy is expected to shrink for the first time – excepting a brief dip following the 2008 global financial crisis – for the first time in 33 years. But in true Dickensian fashion, there is a tale to tell of two countries: a burdened Brazil and a prosperous Panama. According to the United Nations Economic Commission for Latin America and the Caribbean, Panama's GDP is projected to have seen growth last year of 5.8%, the highest in the region, followed by the Dominican Republic (5.6%) and Bolivia (4.4%). Unlike Panama, however, the projection for the whole of Latin America this year is marginal growth of under 1%.

BEPS and CRS seem to present the perfect storm and although several countries in the region have agreed, in principle, to climb on board – including Panama, the region's banking centre – even the OECD itself has acknowledged that the current timetable is ambitious, particularly in developing countries, due to the fact that at present they simply do not have either the administrative or technical mechanisms in place – not to mention the resources.

The Panamanian government, through the medium of a published statement, confirmed how the country for more than 50 years has developed a corporate financial services platform for local and foreign users. Besides a territorial tax system, Panama is known for respecting the right to privacy and so a very careful analysis has been made of the Automatic Exchange of Information programme developed by the OECD; its scope, requirements and implications have been thoroughly reviewed (see my column Feather Dusters and Sledgehammers in Issue 261). The government agrees in principle with the aims of the programme but argues that it must not be a means by which the competitiveness of some countries will be undermined.

The published statement set out the criteria for Panama's participation (expected in 2018) in the OECD programme. Here are some key points:

1. The exchange will be based on bilateral agreements without accepting external pressures regarding which countries Panama should sign agreements with.
2. The other country must have a legal framework to protect the confidentiality of the information, particularly stored data.
3. The information in the other country has to be legally protected in that it will only be used appropriately and only for the purposes specified in the agreement. Panamanian services must not expose users to unreasonable risks of a political, economic or personal security nature.
4. Co-operation within the ambit of the programme must be in accord with the fundamental principles of international law and respect for the sovereignty of states.

The stipulations just set out include concerns equally shared by the US and point towards why it will not participate in the CRS programme and is likely to baulk at the idea of completely embracing the OECD'S BEPS initiative. US Treasury Secretary, Jack Lew, has spoken of the risks the project poses to economic growth if it is not implemented correctly. He wants to find a constructive way to have more inclusive discussions which will "incorporate the concerns and policy decisions of both developing and developed countries".

Noam Chomsky, the American philosopher, when challenged to come up with a sentence which was grammatically sound but entirely without meaning chose: "Colourless green ideas sleep furiously". Ambiguity through verbal dexterity is not just the preserve of diplomats and it could be several years before we have an effective global information exchange network as envisaged under CRS. To my mind, the dark cloud of Niccolò Machiavelli hangs over this endeavour: "It ought to be remembered that there is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things". What is certain at this point in time is that the leading OECD member, the US, has chosen its own path.

As the OECD starts to set deadlines for compliance with BEPS (which is as certain as night follows day) we will start to see corresponding blacklists created and protests about them will fall on deaf ears. In fairness, approximately 10% of the world's population is deaf to some degree and so the affliction is not exclusive to the OECD.

In 1550 BC one remedy in Ancient Egypt for hearing loss was to inject olive oil, red lead, ant eggs, bat wings and goat urine into the ears. It's going to take more than that in the case of the OECD.

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