TRUST SERVICES, S.A.

Fiduciary and Corporate Services to Professional Firms, Institutions and Individuals since 1981.

Small by Design. Built on Expertise.

OFFSHORE PILOT QUARTERLY

Commentary on Matters Offshore

June, 2009.

Volume 12
Number 2

Going to the Dogs

We all make mistakes. William Shakespeare in his King John play mentions a cannon 150 years too early; similarly he writes of clocks in Rome striking the hour in Julius Caesar and the seventh-century Hamlet studying at a university (Wittenberg) which was not founded until 1502. An April summit in London hosted the leaders of the Group of 20 world economies that account for 85% of global output and they had a lot of mistakes to address; far more than William Shakespeare ever did.

This G-20 meeting has been called a defining moment in the midst of a truly terrible global recession; the International Monetary Fund expects the world's advanced economies to record their sharpest declines in the post-Second World War era as a result of it. The World Trade Organisation thinks global trade could fall by nearly 10% in 2009, a phenomenon not seen since the last World War. Gordon Brown, the British prime minister, spoke of a grand bargain between countries, which does indeed sound grand and would stand a chance of success had he not asked countries to place international, rather than national, interests first. Good luck, Mr. Brown; as Adam Smith said in the "Wealth of Nations" about the human condition: "nobody ever saw a dog make a fair and deliberate exchange of one bone for another with another dog".

Just a week before the London gathering there was a smaller summit held in Viña del Mar, a seaside resort in Chile, that perhaps can be best described as a southern hemisphere overture ahead of the G-20 play in London where several leading actors put on fine performances. In Chile leaders from South America, Europe and the United States came together to cover a variety of economic issues, the main one being how to tackle global financial reforms to avoid a repeat of the current crisis. The Chilean experience for the United States of America's vice president and the prime ministers of Britain and Spain was less than comfortable, however, because they were all cast in the role of villains of the plot by the leaders of Chile, Brazil, Uruguay and (less credibly) Argentina. Brazil's president, Luiz Inácio Lula da Silva, told Britain's Gordon Brown, Spain's José Luis Rodríguez Zapatero and the US vice president, Joe Biden, that the ill wind of recession had blown in from the north and that they must "carry most responsibility for the débâcle".

It was particularly appropriate that Chile should have hosted the seaside summit because it is a shining example of fiscal prudence and stewardship, as I wrote in this month's Latin Letter ("Latin Lessons"), my regular column in the British journal, Offshore Investment.com. Predictably, Venezuela's president, Hugo Chávez, who attended, complained that Messrs. Biden and Brown were a threat to "South American unity"; despite this and the Brazilian president's words, however, it became clear that there was indeed both an understanding between north and south about the economic problems and a strong desire to find common ground in trying to solve them.

Although no Brown-style grand bargain was reached, the visitors got a clearer picture of the Latin American political landscape. What the president from Venezuela highlighted, in fact, was the lack of unity between, what has been called, the progressive left governments and those with a socialist temperament and agenda akin to Hugo Chávez. That said, despite any success at Viña del Mar (Vineyard of the Sea), I would think that no matter the quality of the Chilean wine served, it would have tasted a little sour for the European and American visitors when comparing their respective economies with the Chile model.

U(BS) Tube

Besides what I call the cappuccino collapse that governments are experiencing: the ill-founded faith in financial systems that has been blown away like froth from a cup of cappuccino, leaving behind just the coffee's bitter taste, the leading governments have looked not just at bankers and chief executive officers in their search for scalps.

A perennial source of irritation – bank secrecy – has been put high on the G-20 agenda of issues that must be resolved. Admittedly, the rash behaviour (not just in lending practices) of Switzerland's UBS bank, once crowned the world's biggest wealth manager, has given traction to the case for an all-out assault on financial services centres offering bank secrecy. And Switzerland's scalp would be a real prize: it is reckoned that perhaps one-third of the $11,000 billion in hidden wealth is managed there The stakes for Switzerland are high with about 13 per cent of gross domestic product in the alpine haven coming from financial services.

Panama may have one active company for every 6 people in a population of just over 3 million, but Geneva, the traditional home of private banking in Switzerland, has at least 140 banks that employ perhaps one in five of the working population of this small city of 180,000 souls. Ever since Switzerland enacted its bank secrecy laws in 1934, depositors have been drawn to its banks like bees to pollen for one reason or the other. The strong reason for the law in the first place was humanitarian: to protect the assets of German Jews and trade unionists from the Nazis; it was terror, not taxes, which was the raison d'être – even although the benefits later appealed to a wider market.

It is perhaps, therefore, an irony that Switzerland's banking flagship, UBS, should be the root cause of the disdain offshore banking in general has attracted – and which, unfortunately, comes at a time when governments worldwide are searching for every penny of taxes they can lay their hands on. In my opinion, UBS fell victim (it is, in fairness, not alone) to both haughtiness and complacency. Professor Richard Tedlaw, as a business historian at Harvard Business School, in 2003, observed a similar phenomenon, only in his case it was an individual rather than an institution. Henry Ford of Model T fame, the professor argued, was able to tell the difference between what he knew and what he didn't know until he embarked on "a mad, passionate love affair with himself, lost his perspective completely and stopped listening to other people". It would seem that whether vehicles are driven or devised, pretension can take root.

As the stable door is shut and the horse disappears over the horizon, the once over-confident UBS is closing every private banking account held in Switzerland by US residents and its Swiss-based client advisers are not allowed to travel to the US for purposes of meeting with US clients. This is in line with my own policy which has been in place for the last several years: all our business with US residents must be conducted beyond that country's borders. The nature of the beast calls for such a cautionary approach, even to the extent of not accepting speaking engagements in the US. My US clientele understand why they, not Mohammed, must go to the mountain.

I constantly remind clients about ensuring that issues such as foreign taxes are cleared up before committing to offshore structures. UBS has been charged by the US authorities of helping some of its US clients to evade taxes and Bradley Birkenfeld, a former UBS bank officer, admitted to squeezing diamonds into a tube of toothpaste for one client who was eager to export assets surreptitiously. By sheer coincidence, I have in the past told prospective clients moving assets offshore that, in the case of domestic legal and tax issues, they should remember that once the tube is squeezed there's no way to put the toothpaste back in it; that, of course, might not apply to diamonds which may be a girl's best friend but not a bank's.

The Nature of Words

During my 3-year appointment with the British Foreign Office, providing technical assistance, I attended a session of the United Nations Conference on Trade and Development held at Palais des Nations in Geneva and because the speakers came from all over the world translators were needed. But it was not the language translations heard through the headsets that presented difficulties: it was getting unanimous approval of the wording – in any language – of the various resolutions to be passed that caused (seemingly) endless problems; not just words, even commas and semi-colons, came into play. Such exercises in semantics are, to the bureaucrat, what pen and paper are (still) to the conduct of business.

I agree, as a professional trustee and writer, that the right word is very important, but of course, it is also true what the poet, Alfred Lord Tennyson, said: "words, like Nature, half reveal and half conceal the soul within". This was brought to mind as I studied the Organisation for Economic Co-Operation and Development's Model Tax Convention which has been used as a guide in preparing many tax treaties. In this new dawn of discovery OECD countries have seen a sudden rush to sign tax agreements, with one offshore financial services jurisdiction after the other, like falling dominoes, scrambling to conform. The wording contained in these tax treaties will become important as the various conditions under which bank information can be released for tax purposes are tested. What, however, I suspect is that the bureaucrats will discover that more than one of the offshore jurisdictions will play them at their own word game; there could be parallels with my United Nations experience in Geneva – except that it will be too late to change a word or a comma.

Switzerland has already emphasized that regardless of any tax treaties signed, bank secrecy remains in force and the Swiss Federal Council has stated that any information that is given will be in respect of "individual cases where a specific and justified request has been made". A specific request narrows the scope considerably and removes the possibility of, what has been colloquially termed, fishing expeditions.

The OECD Tax Convention refers to an obligation to provide information that is "foreseeably relevant" and is quite clear concerning a ban on fishing expeditions. It further excludes any request for information that is unlikely to be relevant to the tax affairs of the taxpayer. In fact, the wording is such that the country seeking information should demonstrate the foreseeable relevance of the information requested. Luxembourg, as if to reinforce this, and despite its willingness to conclude OECD-convention double tax treaties with OECD member states, has said, through its Budget and Treasury Minister, Luc Frieden, that information will be given in specific cases and where concrete evidence of a tax crime exists. Article 26 of the Convention itself does emphasise, however, that information should not be supplied if it "would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy".

Who is to be Master?

The conditions upon which co-operation should be expected when a case is not straightforward will be open to interpretation, based on the very wording of the treaties; co-operation might not be as forthcoming as the bureaucrats had hoped. It will not be so much the compliance with, but the application of, the rules in future that will count. There will be no office of Grand Interpreter of Tax Co-operation deciding the meaning of such phrases as "justified request" and "foreseeable relevance" when applications are received.

But regardless of how such agreements might work in practice, and because fishing expeditions are not allowed (unless you're the US government, as you will see as you read on) let's not overlook the fact that before any fire is found, smoke has to be seen. This means that those confident with the privacy of their own positions can elect not to declare any earnings and take their chances. The stakes may have been raised but there will still be a lot of players left. Even the offshore centres on the OECD tax white list, being the very model of modern compliant financial services centres, are not 100% transparent due to the very nature of some of the structures based there. Trusts, for example, do not necessarily place material (or any) information on public record.

Panama, as with many other offshore financial services centres, is looking to Switzerland as the precedent for future policy on international tax co-operation. Hans-Rudolf Merz, the Swiss finance minister, has suggested that it could take years to renegotiate some 70 double taxation treaties because parliamentary approval and possible referendums could be needed. There may now be one more reason, however, to expect delays and for countries such as Panama to lose faith in the initiative's bona fides.

UBS agreed in February to pay $780 million to settle criminal charges brought by the US Justice Department and the Securities and Exchange

Commission over its banking activities involving wealthy US clients. But a related civil action by the US Internal Revenue Service is still pending which calls for the disclosure of information on some 50,000 account holders only suspected of possible tax evasion; no specific evidence, a tax treaty pre-requisite, has been submitted so it is tantamount to a fishing expedition. If UBS were to comply with this smoke-free demand it would be flouting the terms of the existing Swiss-American Double Taxation Convention; and, according to the Swiss government which has filed an amicus curiae brief with the US District Court in Miami, it would also have adverse consequences for Swiss law and sovereignty (see Article 26 of the OECD Tax Convention regarding public policy breaches). If this impasse is not solved, the repercussions could prejudice the success of current negotiations taking place between Switzerland and the US over revisions to the existing tax treaty. What explanation will the IRS provide for, in their view, this "justified request"? What do those words reveal and conceal? Switzerland will not be the only country asking those questions.

Alice in Wonderland was told by Humpty Dumpty that a word means what he chooses it to mean. "The question is", said Alice, "whether you can make words mean so many different things".

"The question is", said Humpty Dumpty, "which is to be master – that's all."

Panama is wise not to have joined the domino disclosure club of jurisdictions and, as the author, C.R.W. Spedding, says, it's the second mouse that gets the cheese. The isthmus government would be wise to remember this, because sometimes he who hesitates is not necessarily lost but saved.

Offshore Pilot Quarterly has been published since 1997 by Trust Services, S. A. which is a British-managed trust company licensed under the fiduciary laws of Panama. It is written by Derek Sambrook, our Managing Director, who is a former member of the Latin America and Caribbean Banking Commission as well as a former offshore banking, trust company and insurance regulator. He has over 40 years private and public sector experience in the financial services industry. Our website provides a broad range of related essays, including our other newsletter, Letter from Panama, which focuses on Latin America and is also written by Derek Sambrook. Additionally, his Latin Letter column appears in every issue of Offshore Investment.com, a British professional journal.

Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice before making offshore commitments.

Bankers
HSBC Bank (Panama), S.A
Banco Panameño de la Vivienda, S.A.
Multibank Inc.

Auditors
Deloitte.

Physical Address: Suite 522, Balboa Plaza, Avenida Balboa, Panama, Republic of Panama.
Mailing Address: Apartado 0832-1630, WTC, Panama, Republic of Panama.
Telephone: +507 263-5252 or +507 269-2438 – Telefax: +507 269-4922/9138
E-mail: fiduciary@trustserv.com Website: www.trustservices.net