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Commentary on Matters Offshore

Letter from Panama

Normally, the title above is a direct reference to our other quarterly letter which covers regional issues in contrast to the Offshore Pilot Quarterly's broader coverage. But in this case it refers to the missive (or should that be missile?) delivered by the Panamanian government to the Organisation for Economic Co-operation and Development concerning the objectives of its Global Forum on transparency and tax information exchange. The letter dated 28th January, 2003, was sent by Panama's Minister of Economy and Finance, Norberto Delgado D., to Donald Johnston, Secretary General of the OECD which is headquartered in Paris. The letter referred to serious misgivings which had been previously expressed last December to the OECD by Panama's Vice Minister of Economy, Domingo Latorraca; it was feared that favouritism might be shown to some of the EU members which would put into question the Global Forum's future direction. In January of this year Panama's suspicions were confirmed.

When I had met with my friend, Ben, for coffee we had spoken at length about Panama's policy regarding its co-operation with the OECD initiative (Volume 5, Number 4, of the OPQ) and the government's emphasis that a level playing field approach would be the only way forward. Developments since then have resulted not in a levelled playing field, but, rather, a dishevelled playing field. Panama's willingness to co-operate hinges on all jurisdictions – whether members of the OECD or not – being dealt with on an equal footing, which cannot be advanced by Panama being wrong-footed. This January, after 13 years of bargaining, bullying and persuasion an agreement on the taxation of personal savings within the European Union was reached. The agreement, however, realised Panama's concerns which had been expressed previously by Domingo Latorraca, when he had said that if Belgium, Austria and Luxembourg, all members of the EU, were dealt with preferentially, this would be unacceptable. Thus, Norberto Delgado D. wrote in his January letter that the resulting agreement with Belgium, Austria and Luxembourg was utterly rejected "as it directly violates the principle of equality envisaged". But the salt on the wound for Panama was one of the EU's justifications for the deal. It was argued that the 3 EU members should be granted special treatment because their respective economies were closely tied to being providers of international financial services. Surely, in the case of developing countries that depend heavily on international financial services, such as Panama, the argument for special treatment would be even more compelling? Panama has stated, as a consequence, that the OECD's tax information exchange project must be considered stalled until it can be determined whether there are sufficient grounds and guarantees to continue with the initiative. Panama's reaction has been echoed by other offshore participants in the project and the momentum created means that Panama can afford, at this stage, to step back and watch as events unfold if it wants to. Walter Bagehot observed that "the greatest wisdom of a constitutional king would show itself in well-considered inaction". Panama should heed his advice as the offshore battle with the bureaucrats, which is bound to ensue, gets underway.

Luxembourg felt sufficiently ecstatic by the EU deal for its premier and finance minister, Jean-Claude Juncker, to blow a kiss (rather than a raspberry) at the European commissioner for taxation, Frits Bolkestein. In fact, those 3 favoured countries, making up 20% of the EU's present membership, can now rightly claim the appellation of the triumphant triumvirate. Under the deal struck, they will levy a withholding tax (starting at 15% in 2004 with gradual increases which will stop at 35% in 2010) instead of exchanging information, unlike the other 12 EU members which will start to exchange information on non-residents savings from January, 2004. This deadline is unlikely to be met due to the logistics involved. Significantly, any dependent territories of the 12 member states are automatically included in the agreement which will now hang over some of the offshore financial services centres nestled in the Caribbean like a dark menacing cloud. It should be remembered that Chancellor Gordon Brown's riposte to those Caribbean British territories which had threatened to challenge any Order of Court covering information exchange, was both succinct and blunt: "If necessary, we will legislate directly". At the beginning of last December, the Chancellor had already given his "unequivocal assurance" to the EU Council that there will be automatic information exchange introduced in the Caribbean British territories and so the dependencies must be, in British parlance, truly browned off, a polite euphemism for being, to put it politely, disgruntled. T.S. Elliot reminded us in his Four Quartets that "Human kind/Cannot bear very much reality", and this must be why senior ministers in some Caribbean territories still believe that they can hold sway over Whitehall.

When one reflects that the EU tax talks began in February, 1989, it would be fair to say that the EU had truly made a meal of it. That is closer to the truth than some might imagine. Many believe that the seven-hour lunch which preceded the agreement in Brussels made all the difference to the outcome. The clash of views was interspersed with the clash of crockery and the rattle of cutlery whilst the meal was served in the European Council's large dining room. Economic adversity has underlined the need for a common European tax policy. The stakes were high: German residents alone have secreted more than $322 billion of savings abroad and so, inevitably, deals were struck.

Belgium was given a concession by the EU concerning a controversial tax scheme: if it would co-operate on the savings tax issue, its tax scheme would be allowed to run for a further 5 years. Luxembourg and Austria, however, were not going to be a walkover in this bout of fiscal fisticuffs. Crucially, 40 per cent of Luxembourg's gross domestic product comes from financial services and despite its size, with a total population of 440,000, Luxembourg has the same veto power as the 14 other EU members. Sometimes Greece helps and, despite Virgil's admonition to beware of Greeks bearing gifts, it seems that Greece, which is the current holder of the EU's rotating Presidency, proposed that the triumphant triumvirate be given the right to decide when the agreed-to withholding tax regime would end and exchange of information would begin. Not surprisingly, Switzerland's roll in all this was key, even although it is not a member of the EU. The alpine bastion of banking would not permit its financial secrecy to be violated but it had agreed to also levy a graduated withholding tax identical to that of the 3 renegade EU members. Belgium and the other 2 countries will only switch to exchange of information after 2010 if, by a unanimous vote, the EU can agree that Switzerland and also the wild card in the pack, the United States, are in full compliance with the OECD rules set down for the exchange of information. A jubilant Juncker endorsed the compromise and Austria was finally persuaded when the EU agreed to restrict the passage of heavy trucks through the Alps, an issue which affected Austria directly and had been a bone of contention for some time.

All this means that, at the very least, several more years will elapse before banking secrecy, as we know it today, will end. One thing is certain: the OECD tax harmonisation initiative, of which the EU is an integral part, is destined to travel a long and grinding, not just winding, road.

Keeping Secrets

The EU agreement reached on taxation of savings perhaps brings to mind, for some EU members, the Hindi word "mahurat" which translates into "an auspicious moment to start a new enterprise". A chapter has been closed and it's time to move on, even although there was only partial, rather than complete, victory for members such as the United Kingdom and Germany which had both been insistent on all 15 members agreeing to information exchange.

The compromise agreement is yet another example of the diversity within the EU. To many foreign observers the EU does seem to be disjointed in vital ways, but it must be remembered that in many cases it has made impressive advances towards unity of purpose during its relatively short existence. If one looks across the Atlantic to the United States, for example, history shows that for the first 100 years after it was founded unity was not one of its traits. Between 1776 and 1865 most Americans referred to their country in the plural: the words "United States" were followed by "are" and not "is. State loyalty usually overruled any alliance to the newly-created nation as illustrated by the 1786 armed insurrection, for example, by farmers in western Massachusetts resulting from perceived economic and legal oppression from the east; several years later the citizens of west Pennsylvania, in another example, mounted an armed revolt against a federal tax which became known as the Whiskey Rebellion of 1794. Some scholars note that had secession been specifically provided for in the constitution, the United States could have split asunder on more than a few occasions in those first 100 years. Remember, too, when considering the birth pains of the euro, that it was not until 1862 that the United States adopted a single currency. Only when the Federal Reserve was created in 1913 could it be said that there was a proper central bank in the United States.

Three issues make the task of EU unanimity difficult: language barriers, historical enmities and the cultural differences. It is this last issue which has come to the fore in the EU's relations with Switzerland over the question of bank secrecy and although Switzerland is not a member of the EU, the culture clash which has arisen points to a commonplace problem which can be found within the EU itself. Swiss bank secrecy has cast a long shadow over the EU's tax harmonisation plans and the Swiss, by their actions and deeds, have illustrated their absolute belief in the right to privacy. The chairman of the Swiss Bankers' Association, Georg Krayer, has gone as far as to say that this right is on a par with the right to life and freedom of speech. Switzerland views with disquiet the alarming growth in the past 10 years of data collection which has spawned not only a surge in the employment of data protection officers, but has resulted in the erosion of privacy. In the commercial sector, the United States retail chain, Walmart, for example, by use of customer cards, can now track a customer's purchasing habits which may be useful for inventory, but is also an intrusion of privacy. So-called smart tag technology is being developed and pilot projects are presently under way which allow firms to link products to purchasers and so ordinary objects can be traced to the customer. Apparently, a privacy policy is being devised that will allow customers to cancel the smart tag at the checkout, but it is expected that the customer will lose such benefits as better warranties and returned-goods services. Such developments are particularly unsettling for Switzerland's bankers in a country which is steeped in the philosophy of Jean-Jacques Rousseau and Thomas Jefferson (no irony intended) who both believed passionately that it was the people, and not the state, who were the only lawful source of power.

Swiss bankers believe that the system of customer checks and balances which they have in place are second to none in the world. The banks do not need their government to adopt the Walmart or smart tag approach; they are capable of monitoring the situation themselves and protecting the privacy of their customers. Keeping secret the business of innocent, ordinary account holders is of paramount concern to the bankers and Georg Krayer asks: "How much control do we want the state to have? How important is privacy to us?"

Since the September attacks in the United States, which need neither a specific date nor year to define them, Geneva's banks, especially, have attracted wealthy individuals from the Middle East and the United States. Financial institutions in Geneva manage some US$120 billion, which is more than half of all money in Swiss funds or private accounts. The assault on bank privacy by both the European Union and legislation either introduced or proposed in the United States has only added to the Swiss controversy over information exchange which goes beyond taxation or terrorism to the fundamental concerns over state control and personal privacy. Jacques Rossier, a partner at Geneva's Darier Hentsch, which is more than 200 years old, has expressed the view that the United States in its approach to investigating financial transactions in this war against terrorism "doesn't follow the traditional way of international judicial assistance but pursues the politics of power, which involves blocking and boycott threats". Ivan Pictet, a partner at Pictet, Switzerland's largest private bank, has said that the bank acquired new clients during 2000 who were foreigners living in the United States and who were worried about legislative moves there which might block accounts and cause other problems for them.

With this background it is easier perhaps to understand the Swiss reluctance to removing bank secrecy despite being bombarded by bureaucrats in the OECD on the issue and, because of it, Belgium, Austria and Luxembourg may well see many years pass by before they have to choose between withholding tax and information exchange. It is probably one reason why Luxembourg's premier and finance minister, Jean-Claude Juncker made his amorous (although not appreciated) gesture to the European commissioner for taxation. It really is a sweet deal for Luxembourg.

So Panama, along with other sovereign offshore financial services centres, can breathe easy for some time to come as the OECD's tax harmonisation initiative, which has taken on a life of its own, suffers from, in memorable words borrowed from Thomas Carlyle, "an ever-living, ever-working Chaos of Being".

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Physical Address: Suite 522, Balboa Plaza, Avenida Balboa, Panama, Republic of Panama.
Mailing Address: Apartado 0832-1630, World Trade Centre, Panama, Republic of Panama.
Telephone: (507) 269-2438 – Telefax: (507) 269-4922
E-mail: marketing@trustserv.com Website: www.trustserv.com