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Dodos and Snowballs

The December, 2003, edition of the Offshore Pilot Quarterly ("Bedlam and Bureaucrats") mentioned the tussle between the Cayman Islands and the British government over the issue of the implementation of the European Union Savings Tax Directive. The obstinate stance of the Cayman Islands, whilst entertaining, amounts to nothing more than pure farce. In January it was the turn of the Turks & Caicos Islands, through the declarations of its Chief Minister, Michael Misick, to join in the political pantomime. The Chief Minister has stated that the TCI is committed to implementing the EU directive provided the (now famous) level playing field principle (this time, however, in relation to the EU rather than the Organisation for Economic Co-operation and Development) is applied.

The Chief Minister is misguided by the obstinance of the Cayman Islands and assumes that he represents a sovereign state and not a dependency of the United Kingdom. That said, Michael Misick says that he (apparently) recognises the relationship with the United Kingdom and his January statement goes on to say that "in the spirit of co-operation and partnership" it has been "decided to implement legislation" – but subject to the proviso already mentioned. It looks to me as if the TCI runs the risk of getting a dose of the same medicine given to the Cayman Islands by the British finance minister, Gordon Brown, who has seen off the implacable McKeeva Bush, Leader of Government Business in the Cayman Islands, (and who has now accepted defeat).

The TCI has a turbulent past which saw its constitution suspended in the 1980s with direct rule from Whitehall which was a step, of course, not likely taken but, nonetheless, possible. In order to get the TCI back on track following the political upheaval, updated offshore legislation and regulation was necessary. Previously, an insurance law had been written but never promulgated. The banking law required an overhaul (a moratorium on bank licences had been imposed) and modern trust and insurance legislation was needed. Eventually, in 1989, draft offshore legislation and regulations, which I had been commissioned to prepare were sent to the Attorney General's Chambers on Grand Turk for vetting. When I eventually took up my post as the TCI's first financial services regulator later that year, the process of introducing those pieces of legislation commenced in consultation with the Attorney General, leading to the involvement of the TCI's Executive Council and, eventually, Legislative Council.

But the point is, at the end of the day, before any of the legislation approved could become law, it had to be put in a diplomatic bag and sent off to Whitehall in order to receive the Royal Assent. The power to deny Royal Assent is one of the reserve powers of the British monarch. (The power of the President of the United States of America to veto legislation or sign bills into law has its roots in the royal assent principle). The practical effect of this in the TCI in 1989 was that if the United Kingdom government hadn't liked what it read, the proposed legislation would have needed to be rejected or amended. That's the reality.

The flightless Dodo of Mauritius, the Tasmanian tiger, New Zealand's laughing owl and stubborn dependent offshore financial services centres all have something in common – all thrived for a long time before meeting disaster due to the acts of human beings. The human beings in the case of those dependencies sit in Whitehall. Gordon Brown has told his country's dependencies that he intends to put an end to "designer taxation" and that he is not prepared to "defend the indefensible". I predict that the TCI's resistance to the UK government has as good a chance of not melting away as a snowball has in a microwave on a two-minute setting.

Plucking Feathers

Over the years, Gabriel Makhlouf, chairman of the OECD's fiscal affairs committee and a former tax inspector, who is still a senior official at the Inland Revenue in the UK, has featured in the OPQ. He is leaving the OECD committee after 4 years during which time the question of harmful tax competition has become a major international issue. He has been, inevitably, a target of criticism, especially from professional offshore practitioners, because he initiated a policy of "naming and shaming" recalcitrant jurisdictions by issuing blacklists. Two years before the blacklists started in 2000, the OECD had published a report calling for a crackdown on tax havens. The topic appeared in the June, 1998, OPQ issue ("Countdown for Tax Havens") when it was noted that Switzerland had described the OECD report as partial, unbalanced and too narrow. Switzerland's stance today is a reflection of that conviction.

In March, 2000, after Mr. Makhlouf's appointment, a second OECD report was published which, this time, contained demands, rather than suggestions, specifically on the related subject of banking information. It accused 35 jurisdictions of harming trade and investment because of bad tax policy. In September, 2003, as disagreement continued, Switzerland and Luxembourg (with support from Austria and Belgium) blocked agreement at the OECD for access to banking information from 2006 onwards. This obstruction by the dissidents and mentioned in the last OPQ issue ("The Good Ship OECD"), resulted in the failure of the OECD meeting in Ottawa, Canada, in October last year to reach a satisfactory agreement with jurisdictions, such as Panama, which had previously given written commitments but which were subject to equal treatment for all. Gabriel Makhlouf has conceded that failure of even-handed treatment could mean that it "may take more time for some countries to arrive at the destination [transparency] than others".

The action by the dissident 4 presents Mr. Makhlouf with an impossible situation because all decisions by the OECD's fiscal affairs committee are reached by consensus and the 4 member countries cannot be forced to comply. The 2006 deadline is no longer a certainty for the offshore jurisdictions and the Committee's chairman has accepted that the OECD, perhaps, should have taken a less aggressive position from the start. He agrees that more speaking softly and less stick-wielding will probably result in greater progress.

The European Union's Internal Market Commissioner, Frits Bolkestein, is in a similar pickle with the European Union's Savings Directive which is due to come into operation by 1st January, 2005. But speaking softly is not Mr. Bolkestein's way (see the next article). Four European jurisdictions, namely, Andorra, Monaco, Luxembourg (also at odds with the OECD banking initiative) and Liechtenstein, are reluctant to adopt the directive. Additionally, Switzerland, although not an EU member (but still a significant European offshore financial services centre) has agreed in principle to also adopt the directive but there is, at the time of writing, a last minute hitch because the Swiss want their agreement to be linked with other, unrelated, EU legislation as part of a package. The directive requires the European jurisdictions, in addition to the dependencies of the UK (much to the consternation of Mr. Misick of the TCI) and the Netherlands, to adopt rules by 30th June, 2004, that will enable the exchange of banking information or, as an alternative, apply a transitional withholding tax from the beginning of 2005. Despite everything, Frits Bolkestein remains optimistic as so does Gabriel Makhlouf who believes that the Organisation's tax aims will eventually be met. The former tax inspector points to the many successes of his fiscal affairs committee, the chairmanship of which he has enjoyed, though he has said that he won't miss the lengthy and energy-sapping deliberations.

Perhaps his time as Gordon Brown's private secretary has imbued him with a dogged determination which echoes Gordon Brown's words, not to "defend the indefensible". But the chasm between the OECD and the offshore jurisdictions remains and, to add to the already complex situation, several other international bodies, including the United Nations, are now competing for influence on international tax policy. Mr. Makhlouf's offices may have once been the home of the Royal Academy of Arts, but his committee has not succeeded in the fine art of building bridges with its offshore opponents. Jean Baptiste Colbert observed that the collection of taxes was a skill and consisted of so plucking the goose as to get the largest number of feathers with the least hissing. To say that the feathers of the offshore jurisdictions have been, at the very least, ruffled, is to put it mildly. Expect a lot more hissing.

In Good Company

Adam Smith, the protagonist of free-market capitalism, held a dim view of joint-stock companies. He saw them as synonymous with greed and corruption. After all, in the 1720s, John Law's Mississippi Company ruined the economy of France, the world's most prosperous country at the time and in the United Kingdom the collapse of the South Sea Company caused nearly as much damage; the Chancellor of the Exchequer, along with several of the company's directors, found themselves temporarily imprisoned in the Tower of London. The British Companies Acts of the mid-19th century produced the joint-stock company of today and were the result of laws pushed through by a few English politicians that enabled people to create limited liability firms without first obtaining the sanction of parliament. Other countries began copying the United Kingdom as this daring and innovative way of doing business gathered pace. The 19th century English politician, Robert Lowe, described them as "little Republics".

Today, America has nearly 5.5 million companies and not much seems to have changed from the days when one corporate baron, John D. Rockefeller, was a symbol of "fraud, deceit, special privilege, gross illegality, bribery coercion, corruption, intimidation or outright terror" according to the author of that vituperative prose, the journalist, Ira Tarbell. Since the earliest business known to have multiple shareholders existed in the middle of the 13th century, companies have been at the centre of scandals often because the people managing them forgot the fiduciary relationship between themselves and the shareholders. As Adam Smith observed over two centuries ago, they are "managers rather of other people's money than of their own". The fact that business managers today use offshore financial services centres in their structuring does not transfer the root cause of criminal activities by some managers to those centres. Even so, those offshore centres have been seen as renegades much like Atlas, a rebel against the gods, who was punished by Zeus by having to bear the burden of carrying the heavens on his shoulders; the offshore centres seem destined to shoulder the blame of corrupt practices, regardless of where they originate.

Offshore jurisdictions have become the whipping boy of bureaucrats such as the EU's Internal Market Commissioner, Frits Bolkestein, who has said that the "role and regulatory control of offshore centres needs to be tightened" following the Parmalat scandal. It is this Parlamat prejudice, clearly, that will be clouding his negotiations with the four jurisdictions that are at the centre of the European Union's Savings Directive imbroglio (appropriately, an Italian word) already referred to. It is true that the Italian food company had a Cayman Islands subsidiary which is at the centre of a four billion euro bank account controversy, but observers have referred to the less-than-rigorous verification by the auditors of the account; the false documentation produced could have been used for an account anywhere. But what of the Citigroup entity registered in Delaware? It has the unbelievably ironic (or mocking) name of Buconero which is "black hole" in Italian. It is alleged that it was used by Parmalat to conceal borrowings and aid massive fraud. Mr. Bolkestein would do well to consider the buconeros operating within OECD jurisdictions.

Delaware is the incorporation capital of America where, it has been reported, more than 60% of all Fortune 500 companies are incorporated. Websites of service providers offer the incorporation of limited liability companies within 24 hours via telephone, e-mail and telefax. What would Adam Smith have said? The corporate laws of Delaware, home to just one-third of one per cent of all Americans, govern, in fact, more than half of all publicly-owned American companies. Its corporate case law is a treasure chest of precedents established over the last 100 years since Delaware's general corporate law was enacted in 1899. More than a quarter of state revenues come from corporate franchise tax which equals, roughly, $3,000 per year for every state household. I'm sure that this minute American state, described by the American Law Review over a hundred years ago as being a "little community of truck-farmers and clam-diggers", today appreciates the importance of its corporate laws in the same way as Panama, an offshore finance centre, does its own.

J. B. Priestley railed against "the shoddy, greedy, profit-grabbing, joint-stock company industrial system" and this century he has been joined by Frits Bolkestein who has said that real industry leadership is needed "to clear out the crooks" and to stop "unscrupulous practices and curb excessive greed". Ira Tarbell would have appreciated the EU commissioner's flamboyant style, especially when he goes on to say that scandals such as Parmalat are symptomatic of a corruption of financial markets likened to the "corrosive drip of a leaking fuel tank". His gaze from within his bureaucratic bubble is firmly fixed offshore where he sees the threat to transparency, especially, persisting. Maybe the EU bureaucrat is unaware of Delaware (stockholders are not revealed to the state) and nor, perhaps, of either Nevada where the law is silent on bearer shares or Wyoming where they are allowed. Panama, in fact, based its own corporate law on Delaware's, but Mr. Bolkestein might not appreciate that fact. Ah, the corrosive drip of bias.

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