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Muslims, Policemen and Silent Dogs

This quarter's newsletter contains extracts from a speech the main theme being blacklists and politics which I gave in March at the Fifth Annual Offshore Investment conference held here in Panama at the Hilton.

Blacklists, whatever their purpose, which are based on bias are dangerous. Their construction needs to be carefully thought out because they also create prejudice and excessive caution which, in turn, where financial services are involved, can increase compliance requirements and obstruct the flow of business. Let's first look at prejudice, which feeds on perception, often fuelled by blacklists that target countries providing financial services, the subject most readers are interested in.

Just as a section of society will quickly associate Muslims with mayhem, so a larger sector in my view associates offshore business practices with misdeeds. It follows that for offshore centres themselves, being on a blacklist comes as no surprise – whether it's justified or not – and, of course, as a consequence of this, excessive caution shadows the banks and other financial institutions dealing with offshore centres. The fear of swingeing regulatory fines, or worse, has compounded their apprehension. Already the Financial Action Task Force, an inspiration of the Organisation for Economic Co-operation and Development, has admonished some banks' de-risking policy, cautioning institutions against placing a virtual ban on politically exposed persons as customers, reminding them that acceptance should be based on exercising judgement. The FATF has defined de-risking as the phenomenon of financial institutions terminating or restricting business relationships with

clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach.

Another problem is that the United States of America's combative justice system does not help to make either US banks or foreign ones operating there feel comfortable. We have the case of 45-year old Caledonian Bank in the Cayman Islands which was ruined and is now in liquidation following a US Securities and Exchange Commission investigation. Based on the specifics of the case, the US judge asked the SEC lawyer how the commission could think that it was "entitled" to freeze money that belongs to the bank's depositors, rather than the bank, and was told that the issue was not discussed during the preliminary proceedings.

"The bank collapsed because of your actions, didn't it? Judge Pauley asked.

"Yes, your Honor," came the reply.

"It's stunning. It's incredible government overreach." The judge concluded.

A spokesperson for Caledonian's former management said: "We are pleased to see that some of the truth is starting to be revealed. Unfortunately, it does not look like justice will ever truly be served in this case. Our business has been destroyed and the careers and lives of the people that made Caledonian great have been forever changed". I am especially aware of the bank's plight for the deleterious effect it had on a client's business, despite being an innocent party.

Last April an American court dismissed charges against two Ukrainians in a case in which the only American link was the tangential involvement of a federal agency. The flimsiness of the link led the judge to throw it out and said it had been a deeply

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misguided attempt to turn America into the world's policeman. In the West only one country's leader is frequently referred to as Commander-in-Chief; well, with the brand of justice just mentioned, its Attorney General could be referred to as Demander-in-Chief. When one considers the many instances of legal high handedness it is perhaps unfortunate that the present incumbent bears the surname Lynch.

Whatever issues or criticisms one may have concerning FATCA, the OECD's Common Reporting Standard presents a much greater challenge and as with FATCA, the onus of collecting, collating and reporting information will fall upon the shoulders of financial institutions. Unlike FATCA, however, there are no minimum monetary thresholds and one cannot avoid the obligations. Reporting volumes will increase considerably and will result in stricter account opening requirements.

CRS is fertile ground for blacklists and it will be a game changer. A very careful analysis by service providers will be needed, the key to which will be entitlement and control of the income-bearing assets being reported. The US has no plans to participate but you will not find it on a future blacklist, I am sure of that. If ever an illustration of blacklists and politics was needed, you could not find a better example. The US argues that its FATCA legislation is sufficient. Critics argue otherwise and say that it leaves gaps in the transparency fence that allow a horse and carriage to be driven through; Tax Justice Network reckons that the US is now the third most secretive jurisdiction when it comes to corporate camouflage. Its absence from CRS reporting is unexpected, just like the dog that didn't bark in the night.

Non-US tax payers can place funds in US entities that use US local banks and circumvent CRS. Oh, and yes, if corporate cover is needed, any corporation should also be formed in one of three or four US states which require no details of ownership. Roderick Balfour, co-founder of Virtus Trust in the Channel Islands, speaks of people moving trusts to the US to get away from CRS. He says: "it's a huge hole in the bath for the water to go out of." It doesn't get

better than this and the US deserves an Oscar in tax evasion facilitation; this suggests that CRS has a double meaning: Can Remain Secret. In this instance the US, once again, not only rules the waves, but waives the rules. It should be at the forefront of CRS and in this instance the "indispensable nation" is the "indefensible nation".

CRS requires the collection and exchange of international financial accounts of taxpayers, but goes far beyond bank or custodial accounts and life insurance policies. It will include:

1. Shares in international companies – and loans to them, owned directly or indirectly by the taxpayer.
2. Trusts where the taxpayer is the settlor or beneficiary or to which he has made loans. This will apply to foundations in some instances.
3. The financial accounts of certain trusts, foundations or companies where the taxpayer is a controlling person, including as a settlor or founder, beneficiary or protector.

This is accompanied by full details of the taxpayer (tax residence, tax ID number and place of birth), of the financial institution filing the report, and the account details, including the account balance or value at the end of the year, movement on the account and when an account is closed. The impact on offshore centres, in relation to both cost and time, is immeasurable at this point, but as one commentator has observed "CRS will clog and may harm this essential mechanism" which is central to so many international business transactions.

Shell Shock

As if all these developments were not enough to absorb and confront, the OECD's project known as BEPS (Base Erosion and Profit Shifting) is rapidly taking shape. We first saw the issue of corporate inversion (moving operations offshore) come up on the US political agenda back in 2002. Since that time several high-profile businesses have transferred their domicile and management from the US to places such as Bermuda, Barbados and other international financial centres which has proven to be very



controversial at both the US Federal and State level as tax revenues are at stake.

The problem is that today the international nature of business can touch upon the tax system of any one or more of some 200 jurisdictions worldwide. Inevitably, any jurisdiction could be a tax haven in the eyes of another simply by accident rather than design. Through a mismatching of US and Irish rules on tax residency Apple accumulated over \$30 billion profit through legal entities which were, in fact, tax resident nowhere. To counter this, in 2013 the OECD produced an action plan to tackle the problem and last October it produced its final BEPS package. This came after extensive consultations with governments, regional tax organisations, NGOs and business associations. 60 countries were involved and businesses, including NGOs, contributed over 12,000 pages of comments on the 23 discussion drafts published and discussed at 11 public consultations.

The OECD Secretary-General said that the Action Plan “marks a turning point in the history of international tax co-operation”. That said, we have already suffered the Great Recession and now we are likely to experience the Great Regression as we see the potential for global conflicts concerning taxes; rather than improving co-operation, I can see barriers being erected and the opposite of international tax co-operation could prove to be the outcome, particularly in respect of corporations; both the UK and the EU could be on a collision course with the US over BEPS. BEPS could become a battlefield. New minimum standards on country-by-country reporting are to be put in place which will impact on treaty shopping and put an end to the use of shell companies which have no substance but through which investments are channelled. A century after the First World War term was coined, corporations, and not soldiers, are going to suffer from shell shock, albeit a different kind.

The OECD has said that it knows that jurisdictions are unlikely to move to implement the recommendations all at the same time. Unlikely? About as likely as President Obama holding a

birthday party at the White House for Bashar al-Assad. Nonetheless, the OECD says that it has put together a flexible package, which contains minimum standards, and the G-20’s finance ministers endorsed the final package at their meeting in Peru last October. They stressed that the OECD must prepare an inclusive monitoring framework as early as possible during this year.

So a BEPS blacklist is on the horizon and the criteria for blacklisting will be according to the OECD’s definition, of course. One commentator has said it will repaint the tax landscape globally. And just like CRS, there are those jurisdictions that are eager to be early supporters of the project. Australia, for example, has adopted some measures even before the final recommendations became known. On the other hand, just like CRS, there are those jurisdictions who welcome this move as enthusiastically as some Americans would want a President Donald Trump in charge of foreign policy.

Dancing with Bees

In the case of both BEPS and CRS the one non-participating country that sticks out like the pope at a rave party is the US. The comments of senior US government officials and members of Congress are interesting and hardly endorse the BEPS objective. The US government, unfortunately, will be reliant on Congress when the time comes – if it ever does – to implement BEPS. Forget a blacklist; the US represents a black hole and I suspect that Jack Lew, the US Secretary of Treasury, whose comments have been vague, has deliberately taken a leaf out of the book of Kingman Brewster, Jr. the late academic and diplomat who said: “If I can take refuge in ambiguity I can assure you that it is quite conscious”. Why not put the US on a BEPS rainbow list? There’s no clear defining colour to it and full compliance will be somewhere, sometime, over that rainbow of Dorothy’s.

Transfer – pricing documentation and country-by-country reporting for the purposes of BEPS produces a wide range of information. The OECD recommends a three-tiered approach to compilation



of data consisting of a master file, a local file, plus the country-by-country reports and just a single breach in only one country could expose the data (this has equal application in regards to CRS). OECD assurances are hollow as they don't control access to the information, whereas we have been confronted with a long history of leaks of tax payer files due to inadequate safeguards; officials have even released information to attack political opponents; the US is not immune from that. According to the US Treasury Inspector General for Tax Administration, 1.6 million Americans were victimised by identity theft in the first half of 2014, up from 271,000 in 2010.

And as disconcerting as the US situation is, many other nations are far more vulnerable. Governments, for the first time in many instances, will have greater oversight of the balance sheets of tax payers, and this extends to trusts, foundations and companies. The data mining opportunities are considerable as is the vulnerability of taxpayers; perhaps some governments will be able to develop new taxation strategies targeting new sources of tax. As I have said before, a mine of information for governments, but a minefield for the public. Wikileaks, for certain, could well prove to be the bellwether for future disclosures of confidential information, the consequences of which could vary according to the individual; it's possible that basic human rights or freedoms could be prejudiced.

Doubtless the momentum building against tax dodgers – particularly corporate ones – will continue. The good ship America, the West's economic leader, whose dominance rose from the ashes of Europe's wars in the first half of the last century, has now entered troubled financial waters; it will need more than Simon and Garfunkel to build a bridge over them. If Europe was strong, this would be a counterbalance, but it is not. And further afield there does not seem to be one big economy displaying the confidence and providing that strong economic alternative found in previous global downturns; China, for example, is concentrating on domestic development so this makes the malaise different this time, with perhaps India one beacon of hope.

In closing, let me return to the hydra-headed subject of regulation. Those of you visiting Panama will see on the Cinta Costera along the city's seafront the number of people jogging, running and cycling. Exercise is a very popular worldwide pastime; unfortunately, exercising judgement by bureaucrats, banks and their compliance departments is not. As regulations and controls mount, many offshore financial services providers might hear buzzing in their ears in line with a remark made by Australian comedian, Tim Ferguson: "Just remember, life is not a race, it's a dance, a dance in a room slowly filling with bees".

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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 in the appropriate jurisdiction before making offshore commitments.

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