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Views and News on Matters Offshore

Elephants, Blind Men and Blacklists

The bureaucrats of the world's industrialised nations have been busy on the offshore financial services front in recent times and this newsletter has been tracking significant developments for over 3 years. According to government research in the United States, offshore financial services centres hold around $5 trillion of which perhaps $500 billion is derived from questionable sources and The Offshore Forum, set up by the United Nations Office for Drug Control and Crime Prevention in Vienna, has been continually negotiating improvements in offshore regulatory standards, adopting a low-key approach. But coaxing has now been replaced by belligerence. In the United States the U.S. Treasury Secretary is promoting new draconian government powers concerning onshore and offshore financial institutions in the battle against money laundering under the auspices of the National Money Laundering Strategy for 2000. In Europe, whilst the European Union is contemplating its own significant tax changes, the United Kingdom has launched regulatory reviews of offshore financial services in both its Crown Dependencies (The Edwards Report) and its Overseas Territories (KPMG review).

Now we have a barrage of blacklists, so as I write this issue of the Offshore Pilot Quarterly, the story of the elephant and the six blind men comes to mind. Each of the blind men attempts to describe what the elephant looks like. One feels the animal's trunk and decides that it is like a snake. Another feels a leg and assumes it is similar to a tree. Although each blind man examines a different part of the elephant, drawing reasonable conclusions from his examination, not one of them can gain a complete and accurate image of the elephant. But we should remember that sometimes even those with vision, but handicapped by limited experience, can also reach reasonable, but inaccurate, conclusions. That is what is happening at the moment, following the publication of blacklists by the Organisation for Economic Co-operation and Development (OECD), the Financial Stability Forum (FSF) and the Financial Action Task Force (FATF), the latter two established by the Group of 7 industrialised countries. Some of those affected are having great difficulty in grasping the significance of these blacklists. Each list targets both traditional and non-traditional offshore financial services centres and has its own key concern. The OECD list deals with taxes, the FSF list with international economic stability and the FATF list with money laundering. It is only the OECD list that, in my opinion, is really contentious, with the other two lists rightly claiming the moral high ground.

The Group of 7 blacklists target the proceeds derived from corruption, drugs, kidnapping, fraud and such other abominations which should be an anathema in any jurisdiction. The FSF and FATF each named jurisdictions which they considered were unco-operative in the struggle with, respectively, international financial instability and money laundering. The FSF was created as a result of the 1997 Asian financial crisis and has directed its attention to the transparency of international transactions and the adoption of effective supervisory standards. 25 jurisdictions were found wanting and the FSF has threatened that those jurisdictions not willing to co-operate could eventually be faced with sanctions of some description. The FATF named 15 jurisdictions which it felt were hindering the fight against money laundering. Israel, Lebanon and Russia were included, reflecting the geographic diversity of the list. The FATF has also urged co-operation and has sent out clear warning signals that obstinacy will be met with counter-measures, as yet to be defined. A few of the jurisdictions singled out feel that their financial systems and money laundering efforts have not been fully examined and appreciated, thus claiming that they are the victims of prejudice and unfairness. But very often in the area of financial services a jurisdiction's legal and supervisory structure is akin to a curate's egg. Many English readers will be familiar with the metaphorical bad egg served at a curate's breakfast table which was described by the polite guest as "being good in parts". Many offshore financial services centres can, in fact, only claim that their supervision and legislation is good in parts. Panama, one of many examples, does not, for instance, permit brass plate banks, such as in the Bahamas, and requires disclosure of directors in the public records, unlike the British Virgin Islands; but Panama's money laundering legislation could be improved. Two new laws, prompted by these Group of 7 blacklists, intend to rectify matters and also speed up the process of investigations. Ideally, all of the jurisdictions dedicated to offshore financial services should have a common legal definition of money laundering that embraces every illicit transaction and they should be willing to pass on information to another jurisdiction within the ambit of this all-embracing money laundering definition.

Then again, there is also a clear distinction to be drawn between enactment and enforcement of legislation. Very often legislators put their pens away once a law has been promulgated, paying scant attention to the need for ancillary regulation. Even so, good laws and the existence also of good regulations still require effective supervision and this, in turn, calls for special skills and relevant experience. Several offshore jurisdictions clearly are lacking in this respect. There are jurisdictions that should give their regulators wider powers of investigation and other jurisdictions that should be far more diligent in seeing to it that banks watch more closely for suspicious transactions, as they do in Panama. These are all very real issues which must be addressed because legislative, regulatory and supervisory slackness can result in vagueness and inconsistency in those areas that are central to the concerns expressed by both the FSF and the FATF. As good as the intentions may be, however, the FATF and FSF agendas must not be allowed to become backdoors through which tax authorities, encouraged by the OECD list, can slip.

Hell and Good Intentions

The OECD has spent 2 years reviewing tax practices on a global basis, identifying those jurisdictions that could be considered threats to the fiscal well being of other countries; in effect, creating what has been labelled "harmful tax competition" due to their generous tax regimes. A blacklist of 35 world-wide jurisdictions was finally agreed after 47 had initially being scrutinised and again, not all of those named are traditional offshore financial services centres. The long-term aim of the OECD is to have exchange of information agreements put in place with all jurisdictions that have been blacklisted, so that other countries can fully investigate tax evasion by their nationals. The OECD has acknowledged that there is a legitimate role for bank secrecy in order to protect the confidentiality of financial affairs and it has attempted to further pacify some jurisdictions by saying that tax authorities are not to assume that "fishing" expeditions should be allowed: bank account holders should already be the subject of a specific tax investigation.

Total global tax transparency is the goal and the merits of tax competition have been relegated to the category of irrelevant. The OECD view is that foreigners should not be favoured over locals in a jurisdiction – at least not to the extent that is apparent in many instances. This view ignores the fact that favoured treatment has become the norm as an incentive in the world-wide economic scheme of things (see Foreign Merchants and Evil Tolls in our June issue). One needs only to look at the special economic zones of China and the attractive terms given to multinationals that set up their regional headquarters in Singapore to see the success of this healthy approach. And the fact that some of the targeted jurisdictions (including Liechtenstein and Panama) have had their present tax regimes in place long before the words "tax haven" were spoken in the same breath matters not one jot. But the OECD's blacklist is also a black sheep: it does not enjoy the consensus that concerns over money laundering and economic financial stability do.

The issue of global taxation systems and their conformity with one another will not be resolved any time soon, especially when the OECD has said that it will examine its own 29 members as critically as it has the non-member jurisdictions. This suggests a long road with no end in sight and many unexpected turns along the way. Even roads paved with good intentions can still lead to hell. One of many thorny issues within the OECD is the forging of a standard agreement for access to bank information in support of tax investigations. Progress on this point has been painfully slow, as illustrated by the problems experienced just within the European Union itself. It has taken the 15 European Union members three years of haggling just to agree the outline of a policy enabling access to bank records for tax purposes and because of strong opposition from Switzerland and Austria, it is possible that even this outline policy will collapse. At the same time, the European Union must address the many inconsistencies that the tax codes of its 15 members present and which have been highlighted in the report of its Code of Conduct Group on unfair business taxation. A total of 66 corporate tax breaks alone have been criticised. Maybe the European Union's present 100,000 pages of rules are about to be augmented by a hefty new set devoted just to taxation.

Strange Encounters of a Blurred Kind

International and influential opposition to the OECD harmful taxation initiative is growing. The initiative has been characterised as a plot by industrialised nations to secure their high-tax base by either stifling competition from competitive jurisdictions or forcing them to become surrogate tax collectors. It is telling that at the 1998 Group of 7 Summit (representing the core of the OECD membership) a statement was issued concerning the assault on tax evasion, and in the body of the text dealing specifically with money laundering, it was suggested that "authorities should be permitted, to the greatest extent possible, to pass information to their tax authorities to support the investigation of tax-related crimes". It is the OECD's ultimate aim to have tax offences added to the money laundering list alongside such crimes as kidnapping and drug trafficking. Already, the words "avoidance" and "evasion", when applied to taxes, are words that mean the same thing in the minds of some bureaucrats: both are tax offences. In the Channel Islands, the attorney general of Jersey has complained about the OECD's "deliberate blurring between tax evasion and tax avoidance". What he doesn't appreciate is the fact that bureaucracies invariably adopt the Humpty Dumpty approach, immortalised in "Through the Looking-Glass" when that rotund rascal declared: "When I use a word, it means just what I choose it to mean – neither more nor less". Beyond the third world there is, indeed, sometimes a blurred world.

But this blacklist blitz does not mean that the term "confidential offshore financial services" has the certainty of the fate of the dodo and the blacklists should not necessarily be seen to be the slippery slope down which financial privacy will slide. It is important to focus more on what has specifically been said rather than on the speculation the blacklists have engendered. Neither the FSF nor the FATF have mentioned deadlines or detailed coercive measures and although the OECD has set a deadline, it only requires those on its list to *express* a commitment to reform within the next year, without defining what future action may be taken against the defiant. In the words of the Vatican's Cardinal Joseph Ratzinger, when recently passing comment on the Fatima prophecy which is topical at the moment: "No great mystery is revealed; nor is the future unveiled. A careful reading of the text will probably prove disappointing or surprising after all the speculation it has stirred".

Perhaps the Norwegians have something. They are building a luxury ocean liner that will consist of apartments for purchase by the wealthy. The idea is to offer the first residential ship, called "The World", which will continuously navigate the globe. Now that could raise some interesting questions about one's residential status for tax purposes. It might be a world many people will increasingly want to live in.

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