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Conundrums and Referendums

When I last met with my friend, Ben, (see the previous issue of the Offshore Pilot Quarterly) we discussed, among other things, the Organisation for Economic Co-operation and Development's tax harmonisation programme which has, so far, been floundering. Like Ben, some readers have asked what Panama's position is in all this. After all, it did sign a letter of commitment with the OECD, so isn't the situation clear? Not really, but what is very clear is that the gap between commitment and compliance remains huge. More later on.

The problems encountered by the European Union with its Savings Tax Directive gives a strong indication of the difficulties facing the OECD's larger project. After all, the EU has 25 members plus some participating third countries to deal with whereas the OECD has, perhaps, around 60 countries that must reach a consensus. Four leading OECD members, Australia, Canada, the United States of America and the United Kingdom have created a joint tax avoidance task force (note "avoidance" now seems to have the same connotation as the word "evasion" – how times have changed) which illustrates the wider problem. Criticism has come fast and furious from tax professionals. The complaints include a failure to provide adequate information about the project; a lack of consultation with the tax industry; being hypocritical in their approach and having an attitude which will surely alienate tax industry professionals and lead to the quarrelsome quartet being seen as the enemy. Those who have followed the OECD's own tax initiative will find those complaints to be all too familiar.

June was a busy month for both the OECD and the EU concerning tax policy. The EU Commissioner for Taxation (well known to readers of the OPQ), Frits Bolkestein, has declared that he was "delighted EU Member States have finally been able to agree after fifteen years of negotiations on the date of application of a Directive to ensure the effective taxation of savings income within the EU". He sees it as a "remarkable achievement" whereas I see his optimism as being the only thing that is remarkable at this point in time. I must ask myself: has defeat been snatched from the jaws of victory? At the end of June, behind closed doors, the EU representatives agreed to delay the implementation of the tax directive by six months, from 1st January, 2005, to 1st July, 2005, because the original deadline could not be met by all the countries involved. The fly in the ointment, however, is Switzerland, and even putting back the date is still no guarantee that the tax directive will come into force in July, 2005. In fairness to Switzerland, it had already warned the EU more than once that the original deadline was, from its standpoint, unrealistic. Now the Swiss are reminding the EU that the new deadline can only be met "in the absence of a referendum". Although the Swiss government does not expect the tax directive to be put to a mandatory referendum, under Swiss law voters have 100 days after a law is published to collect sufficient signatures in a petition to challenge the legislation. The country's anti-EU coalition has said that it will be able to get the 50,000 signatures needed to put the new law to the vote. Besides the Swiss situation, it is also necessary to get all 25 EU member states to agree that equivalent measures are in place in the other participating third countries, which include Liechtenstein, Andorra, Monaco, San Marino and the British and Dutch dependent territories. One can only guess the number of meetings that lie ahead, so beware of Hendricksen's Law: if you have enough meetings over a long enough period, the meetings become more important than the problem they are trying to solve. Austria and Luxembourg in particular are very sensitive to this issue of equivalent measures and problems may lie ahead that can't be resolved before July, 2005. July may still be on the cards, Mr. Bolkestein, but which year?

Funerals in Berlin

In Len Deighton's 1964 spy novel, Funeral in Berlin, the central theme is that things are not quite what they seem. The theme and location of the novel's plot have much in common with this June's meeting of the OECD Global Forum on Taxation because it was held in Berlin and, despite the report issued following the meeting, not everything was quite what it seemed to be. The objective of the meeting was to further the continuing process that will eventually lead to the application of satisfactory international standards of transparency and information exchange which will, in turn, create fair tax competition world-wide. There were 44 OECD and non-OECD governments represented (including the Bahamas, Mauritius, Panama and Samoa) and on the second and final day a way forward had been agreed. The whole initiative, however, hinges on the participation and co-operation of all financial services centres wherever they are located and those not represented at the meeting were conspicuous by their absence; much like Banquo at Macbeth's feast, the spirit of the absent guest pervaded the deliberations. Some of the 16 jurisdictions that the OECD considers are significant financial services centres, but which have not, so far, participated in the initiative include Andorra, Dubai, Liechtenstein, Monaco and Singapore.

There are countries that are already members of the Forum that will still have to change their practices and laws to meet the standards which the OECD wants in place. The ease with which this can be achieved, not to mention (in some cases) the political considerations involved, is far from certain. Then there's two more (considerable) hurdles: the participation of all financial services centres has to become a reality and, after that, Forum participants will have to reach unanimous agreement. As to unanimous agreement, Dean William R. Inge reminds us that "it is useless for the sheep to pass resolutions in favour of vegetarianism while the wolf remains of a different opinion". In this case, there's more than one wolf to deal with.

A date of 1st January, 2006, has been optimistically set by which time the existing Forum participants are encouraged to have in place effective exchange of information and transparency policies. The OECD report issued following the meeting was Clintonesque in its careful and qualified wording. In it the OECD makes reference to the possible need for "flexibility" and it understands that "a strict application of the date (2006) may be unworkable in some cases". There is a mechanism for when "factual disagreements regarding the practices of a particular country arise". A small group of Forum participants "would be designated", following an agreed process, to try to "resolve the factual disagreement". The mechanism will be fraught with problems. Besides having to reach agreement on the process, who will decide the make-up of this "small group"? Will the "particular country" be happy with the choice of members of, what is tantamount to, a review committee? According to a Harvard Business Review study in the late 1970s, the average committee comprises eight executives, each of whom wishes that at least three of the other seven weren't on the committee.

No one can predict where the process might be when the OECD Global Forum meets again in October/November next year, but key to the project is the need, as the OECD puts it, to get those "significant financial centres that are not currently… in the process" involved. At least the OECD, when trying to lure those outsiders into the fold, has a clearer picture of what has offended so many jurisdictions in the past: its roughshod approach to the problem of tax harmonisation and transparency. This lack of understanding had scuppered the OECD Global Forum's previous meeting in Ottawa, Canada, last October (see Volume 6, Number 4, of the OPQ). The OECD, in recognising that fairness must be paramount in its approach now accepts that a level playing field should be its goal; it must try, however, not to score any more own goals. The OECD, rather than pursuing its aims with the tact and subtlety of a runaway train, should heed the observation Machiavelli makes in "The Prince": "It must be remembered that there is nothing more difficult to plan, more uncertain of success, nor more dangerous to manage than the creation of a new order of things, for the initiator has merely the lukewarm support of those who stand to gain from the institutions and the enmity of those who stand to lose". The Forum's funeral didn't take place in Berlin, but the patient is far from being off the danger list.

Feats, Calamities and High Winds

At conferences in Panama on offshore financial services two subjects come up frequently. One concerns China and the other the OECD. Two common questions are: "But don't the Chinese control commercial activity at one end of the canal?" And the other: "Surely, the OECD is the death knell for Panama's confidentiality laws?" Volume 6, Number 1, of this newsletter's sister publication, Letter from Panama, dealt with the perceived Chinese threat. Where China's influence can really be found is not in Panama's canal but in trade with Latin America. Its thirst for raw materials to meet its expanding economy is forging new alliances. It wants to join, for example, the Inter-American Development Bank. Membership of the region's multilateral bank would then allow Chinese companies to compete more favourably for infrastructure contracts in Latin America. Brazil's president visited China in May and has been encouraging the Chinese to invest in Brazilian railway, port and other developments. China is also purchasing products from countries such as Argentina, Paraguay, Peru and Bolivia. The economic ties with Latin America are set to grow over the long-term no matter how many bumps along the road the Chinese economy suffers.

As to the OECD question, it is appropriate to remember Samuel Clemens (who subsequently changed his name to Mark Twain). He was one of many sensationalist newspaper reporters on the American frontier who understood the importance of a good story. Whether it concerned imaginary gold mines or Indian massacres of settlors, those were "feats and calamities we never hesitated about devising when the public needed matters of thrilling interest for breakfast". Although objective criticism should be welcomed, rather than subjective bias, too many devised "feats and calamities" are reported (see Volume 5, Number 3, of the OPQ). Money laundering is about disguising the truth for which you can be imprisoned. Unfortunately, word laundering does not carry a similar penalty. These wayward wordsmiths who manipulate the facts and mislead are like the courtesans of Queen Catherine of Russia in the 1700s who gave her tours along the Volga river. She would see a happy and prosperous bourgeoisie living in idyllic villages, but these villages had been specially constructed for the Queen's benefit to hide the real squalor and, therefore, the reality of the situation. It is said that the mastermind behind these fake Crimean villages was Grigori Aleksandrovich Potemkin who (besides being the Queen's lover) was governor of Crimea. As such, he organized the Queen's grand 1787 Crimean tour with every intention of pleasing her but by doing so created (literally) a false image.

In much the same way, some people may have created a false impression about the OECD and Panama's confidentiality laws. Panama, along with other offshore jurisdictions, has agreed with the OECD that, in principle, it will work towards an even-handed international tax system. But Panama's government has made some important statements on the subject which are well worth remembering. It has been pointed out that the

Republic cannot be mixed in with the jurisdictions that are little more than manufactured offshore centres with designer tax advantages and whose economies – if not completely dependent upon the financial industry – are substantially so. Panama's economic development in the field of international services is, to quote the Panamanian government, "a consequence of history and not of initiatives to help evade taxes in other parts of the world". Panama has a tax system and Panamanian companies, for example, operating businesses locally pay income tax of 30%. The equivalent rate in Ireland is 12.5%.

The government's position is that the OECD did not enter into bilateral discussions with Panama but arbitrarily included Panama in a group of jurisdictions it described as tax havens; worse still, the OECD initiative started out, as Panama's government puts it, on the basis of "the threat of economic sanctions – disguised as defensive measures". Panama, as a founding member of the United Nations, respects the principles of self-determination, rejecting "the imposition of measures by coercive methods and force" and although Panama has continued in good faith as a participant of the OECD's Global Forum, this willingness "should not be interpreted as Panama's resignation to (sic) its sovereign right to conduct its international economic agenda". The government has made its position very clear: without equal treatment, the conditions will not exist "in order to develop effective commitments between the OECD and Panama". Panama sees the compromises reached (see previous OPQ newsletters) under the EU's Savings Tax Directive as discouraging and as a bad omen in its separate negotiations with the OECD.

I think that it would be fair to say that Panama's position is reflected admirably in the words of Mahatma Gandhi: "Let all the doors and windows of my house be open, and let all the winds come in. But I refuse to be blown away – that is all".

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