

Tax Havens: The Red Herring of the Global Financial Crisis

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The alleged role of tax havens in the global economic crisis is stirring considerable debate. World governments are scrambling to enact massive spending programs, prop-up failing industries, nationalise companies and guarantee bank deposits—and additional tax revenues are desperately needed. By blaming offshore financial centres (OFCs) for everything from the banking crisis to taxation shortfalls, the G-20 and OECD member-nations now seek to eliminate OFCs and plunder protected offshore wealth under the guise of transparency and preventing “unfair tax competition.”

While addressing the US Congress, UK Prime Minister Gordon Brown expressed his desire to “outlaw shadow banking systems and offshore tax havens.” The US “Stop Tax Haven Abuse Act” creates certain “rebuttable presumptions” including that any person transferring assets to/from any “Offshore Secrecy Jurisdictions” does so for the purpose of evading taxes. The proposed Bill also authorizes the US Treasury to impose financial sanctions on jurisdictions found to be “impeding US tax enforcement.”

The Swiss government recently announced that it will relax its bank-secrecy rules and cooperate on tax evasion. Luxemburg, Liechtenstein, Austria and Monaco have followed suit and Cayman recently extended unilateral tax assistance to eleven G-20 countries enabling them to request tax information under the Tax Information Authority Law. Although these concessions kept Cayman off the OECD’s “blacklist,” Cayman still appeared on the “grey list.”

“The time of banking secrecy has passed,” French President Sarkozy said following the summit. “Everyone around the table wants an end to tax havens.”

Is there a need for offshore?

Banking secrecy is not a smokescreen for tax evasion. Confidentiality is a core principle for banks everywhere—not because people have something to hide, but because they wish to keep their financial affairs private.

Swiss bank secrecy legislation was enacted during the 1930s to prevent the Nazis from snooping on people. When Europe was embroiled in warfare and private property was frequently nationalised or stolen, Swiss banks remained an oasis of stability, where assets were secure.

OFCs are still important in protecting people victimized by crime, corruption, or persecution by shielding them from venal governments. The existence of OFCs is a reflection of the uncertainties and turmoil onshore. Even the OECD's Owens admitted that “tax havens are essential for individuals who live in unstable regimes.”

OFCs are an integral part of the global economy and provide a tax-neutral ground for onshore investments. Most money attracted by OFCs comes from institutional investment. Cayman is near the top most facets of financial services and draws substantial inter-bank deposits. American corporations make extensive and legitimate use of offshore regimes.

Individual investors also utilize OFCs, but little of this money has criminal origins. Instead, it represents legitimate investment by people seeking sound money management, asset protection or to legally reduce taxation.

Are all tax havens “offshore”?

The global outrage against OFCs is hypocritical. By OECD standards, the biggest tax haven is the US. Taxation expert Marshall Langer noted: “It does not surprise anyone when I tell them that the most important tax haven in the world is an island. They are surprised, however, when I tell them the name of the island is Manhattan. Moreover, the second most important tax haven in the world is located *on* an island. It is a city called London in the UK.”

In an exercise of gross hypocrisy, the OECD does not blacklist its own member nations.

The US levies no tax on dividends, interest or capital gains earnings of foreign investors in America, thereby encouraging foreigners to escape

such charges back home. In contrast to the reporting requirements it demands from foreign governments, the US imposes no requirements on its domestic financial institutions to report foreign investors' earnings. With the exception of Canada, the US exchanges no tax information with foreign governments. America's own “tax haven” policies have attracted over \$10 trillion in foreign investment—a major impetus for economic growth.

The tax evasion myth

The myth perpetuated by the OECD and G-20 nations is that OFCs encourage tax evasion. In reality, excessive tax burdens in welfare states encourage tax evasion, leading to capital flight to OFCs. Logic dictates that if politicians wish to eliminate capital flight, they should lower their country's oppressive taxes.

Unfortunately, world leaders may instead be heading, towards a global “tax truce” where all nations are taxed at the same high rate.

The “tax gap” myth

IRS tax gap estimates specify no number for “offshore.” Although some evasion doubtlessly occurs, it is probably incorporated in one or more other categories in IRS estimates. However, the supposed problem is relatively trivial. A former Democratic staffer named Jack Blum concocted an estimate of \$70 billion. When former House Majority Leader Arney asked for the methodology for the number, Blum confessed, for all intents and purposes, that he made it up.

The money laundering myth

According to the US State Department, CIA, IRS, and the FATF, OFCs are *less* likely to engage in money laundering because revelations of illicit activity would be damaging to the reputation of small economies, thus creating a greater incentive to weed out wrong-doing. In reality, it is difficult to transfer money to OFCs unless the funds are already in a financial institution. Yet if the criminal money is in a bank, there is no need to go ‘offshore’ since the laundering has already

occurred. The UN acknowledged that criminals avoid OFCs because cross-border transactions create paper trails and raise red flags for law enforcement.

While Cayman and many other OFCs require formidable due diligence on their clients, a 2005 money-laundering threat assessment conducted by the US Government found that Delaware, Nevada and Wyoming offered almost complete corporate anonymity. These states do not even ask for shareholders' names, nor do they routinely share information with the federal government. Instead of opening bank accounts in their own names, fraudsters simply form anonymous companies in states like Nevada with which they can then open bank accounts.

Although no country with a significant financial services sector is immune to fraudsters, it is clear that OFCs are neither the source of—nor the destination for—criminal proceeds.

Conclusion

The offensive against OFCs has been called a cheap populist measure designed to deflect voters' attention from the current financial crisis. Baroness Noakes, Tory Treasury spokesperson called the government's crackdown on tax havens "just a distraction" from the real problems facing the economy.

There is no evidence that OFCs played any role in the economic crisis and little evidence that fraud in conjunction with offshore accounts is any worse than fraud within onshore countries. After all, the \$60+ billion fraud perpetuated by Madoff occurred squarely on U.S soil. There is, therefore, no reason for G-20 and OECD member-nations to punish OFCs disproportionately—other than to plunder their protected wealth to pay for massive bailouts and stimulus packages.

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