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OFFSHORE PILOT QUARTERLY

Views and News on Matters Offshore

The Tiger and the Mouse

We read and hear continuously about a New Economy and an Old Economy from investment pundits and stock market analysts but never about Old and New Offshore Financial Services Centres. Just like economies, however, the offshore centres are destined to pass through turbulent and tranquil times but the distinction between old and new is not, in this case, one of longevity, it is rather about a centre's ability to withstand (or at least mitigate) the effects of a phenomenon that will become more and more apparent during the next few years. I believe that offshore centres will either be OECD-compatible (New) or not (Old). By being OECD-compatible, an offshore centre will be fully compliant with the regulations and supervisory standards recognised by the members of the Organisation of Economic Cooperation and Development. These new offshore centres will no longer represent the traditional concept of the offshore centre of the last century but will be, instead, primarily offshore pools of specialist knowledge and expertise. These New Offshore Centres will compete with one another solely on the basis of quality, reliability and efficiency, without the added features of novel legislation and being tight-lipped. This offshore metamorphosis, in any event, will not threaten their *raison d'être* because they have been traditionally used by the industrialised countries to create and facilitate a market for capital. New Offshore Centres should remain

an integral part of the international financial market system, despite an OECD 1998 report listing 47 offshore centres which fall within one or more categories highlighting an absence of legal and administrative transparency on the one hand and reluctance or refusal to exchange tax-related information on the other.

In some offshore jurisdictions there is a belief that the growing OECD menace can somehow be avoided by a last moment miracle but that degree of optimism tempts comparison with Winston Churchill's second world war view of a beleaguered ally: "An unfortunate man in a cage with a tiger, hoping not to provoke him while steadily dinner time approaches". Ronald Sanders, Antigua's high commissioner to London, doesn't believe in miracles and has warned that the Caribbean jurisdictions need to speak to the OECD with one voice, otherwise he fears that the jurisdictions will be "picked off one by one". However, in the British Virgin Islands the mouse has replaced the tiger as a metaphor. The Director of Financial Services, Robert Mathavious, ponders whether life can imitate art if the offshore centres are courageous enough to confront the industrialised nations. He draws inspiration from the film "The Mouse that Roared" in which a diminutive duchy declares war on the United States and ends up in a position to claim victory. In regard to dependencies of European Union member states, my money is on the tiger.



Foreign Merchants and Evil Tolls

15th June, 2000, is the 785th anniversary of Magna Carta (the Great Charter) which was the touchstone for individual rights and freedoms in Britain and, subsequently, the United States. In fact, its concepts and some of its words were incorporated into the American Declaration of Independence; the Lincoln Cathedral copy of Magna Carta was kept for the duration of the second world war in the United States. A discredited King John of England had been forced by his barons into accepting the terse but comprehensive 61 clauses of Magna Carta, the historical ramifications of which could not be imagined at the time. Clause 41 of Magna Carta gave generous dispensations to international merchants, permitting them, in essence, to enter and leave England for the purposes of their trade without being subject to any “evil tolls” except in time of war. Deliberate, as well as unintended, benefits arose from this toll exemption, not unlike the position today in jurisdictions which, for example, only tax resident companies and afford non-resident companies privileges similar in spirit to those given by England to those medieval foreign merchants. Over many years United States companies have established corporations in offshore centres (many of them, ironically, in British possessions) that function as tax-avoidance vehicles and subsidise US exports to the tune of some \$3.5 billion a year. Over 6,000 American firms benefit from this U.S. government-sanctioned arrangement (put in place to compete with European Union exporters); in the case of Boeing, having a foreign sales corporation (FSC) meant a saving of \$130 million in tax in 1998. However, FSCs have now been classified as shell companies by the European Union, a status shared by other offshore companies owned by individuals who evade taxes and salt their profits away offshore. The World Trade Organisation has upheld Europe’s FSC complaint and an October deadline for compliance now looms; disputes with Europe over beef and bananas pale into insignificance, because ten times more trade could be affected

if a solution is not found. Several counter-proposals are now on the table and more are being formulated to avoid a showdown. It will be interesting to watch the politics of this unfold. Governments have proved to be as artful and adroit at negotiating as offshore governments and practitioners have been at devising laws and techniques in order to keep the foreign tax man at bay. That’s something that hasn’t changed since Magna Carta.

The Jugglers of Brussels

Besides the FSC conflict with the United States, Europe has dissension in its ranks over the exchange of banking information between member states. A quagmire has been created which was primarily caused by an alternative proposal which Britain has made (to protect the City of London’s investment business) in order to overturn a plan to impose a minimum 20% withholding tax on non-resident savings accounts in each member state. Although several member states warmed to the idea, Jean-Claude Juncker, Luxembourg’s finance minister and prime minister, doesn’t like the proposal one bit and has declared that the Grand Duchy will not allow its banking secrecy to end. Could this be the Mathavious mouse that roared? But both Germany and Austria are affected too because they have strict rules controlling the release of banking information to governments. Britain has muddied the waters further by wanting to have the information exchange extended to non-European Union financial centres such as the United States and Switzerland. To the British Overseas Territories, the British finance minister, Gordon Brown, has given a loud and clear message leaving little doubt in their minds that he intends to put an end to “designer taxation” and that he is not prepared to “defend the indefensible”. Although Austria and Germany might see their way to accepting Britain’s proposal – because their banks do not rely on non-resident savings deposits – Luxembourg would be severely affected. The bulk of its savings deposits come from non-residents, many of whom live in other member states. Austria has already agreed to eliminate



its anonymous savings passbooks (there are, surprisingly, some 20 million accounts) but whilst the abolition of account anonymity is palatable, Austria's bank secrecy laws are expected to remain intact. Mr. Karl-Heinz Grasser, the Austrian finance minister, has speculated that Luxembourg, Austria and Switzerland could perhaps form a coalition, becoming a force in defence of banking secrecy.

Three days after Gordon Brown's proposal to substitute information exchanges for a withholding tax, the OECD published a report (backed by all 29 members) suggesting that banks should cooperate with the tax authorities of other countries but only when specific tax-evasion cases are being investigated: "information fishing" has been ruled out, perhaps suggesting that restricted rather than routine exchanges of information will be the norm. Clearly, the European Union and the OECD are not aligned and whatever Gordon Brown might advocate, banking secrecy appears far from dead. It is little wonder that the Brussels information circus has been running for 3 years, but at least the various performers (especially the jugglers) will, I am sure, prove to be thoroughly entertaining. Michael Oalshoff, the late British political philosopher, was right: "Life is a predicament, not a journey".

Fraud.com

I wonder if Steven Spielberg has considered making a film about financial chicanery? I'm sure the central characters, if based on reality, would prove as fascinating as large underwater predators and extra-terrestrials. In advance of preparing an article on offshore scams for a journal, I was reviewing one which I had written several years ago and I soon realised that the text of my original article was as applicable today as it had been when first written. Nothing had changed except that the specific cases which I had mentioned in it were now dated. The fact is that people have been falling into the same traps and swallowing the same improbable stories forever. An anonymous pamphleteer's thoughts when he

wrote about the collapse of the South Sea Bubble (the 1720 plan to take over Britain's national debt in return for interests and sole trading rights in South America) still ring true today: "There must be a vast Fund of Stupidity in Human Nature, else Men would not be caught as they are, a thousand times over, by the same Snare; and while they yet remember their past misfortunes, go on to court and encourage the Causes to which they were owing, and which will again produce them". No wonder Sir Isaac Newton observed that he could "calculate the motion of heavenly bodies, but not the madness of people" and Charles Mackay for his 1841 book on the 1630s tulipmania in the Netherlands chose the title "Extraordinary Popular Delusions and the Madness of Crowds".

The two most common fraud ploys practised and written about are known as pyramid and Ponzi schemes. Each ruse relies on an ever increasing number of new participants who, by supplying fresh contributions, provide funding for withdrawals with generous enticing interest to earlier investors. The pyramid scheme has its origins in the sale of detergent by a group of companies back in the 1970s whose sales people spread the message that direct distribution of detergent would erode the excessive profits of soap powder manufacturers. It was the group which made most of the money whilst the hapless victims filled their garages with unwanted detergent. And Charles Ponzi was an Italian-American banker who, in the 1920s, claimed that international arbitrage in postal reply coupons was the road to riches. It was for him.

Going offshore seems to add extra panache to the pitch but it is where, unfortunately, wise counsel from a grey beard is too often replaced by double talk from a Blue Beard. A mix of common sense and analysis is the best defence against the fraudsters and Dr. Benjamin Spock's controversial childcare book written over 50 years ago gave advice to mothers which the childless should also bear in mind: "Trust yourself. You know more than you think you do". Try and find out the history of the people and the business that is being



promoted and get advice. Explanations that absolute secrecy must be observed, avoiding access to information and the possibility of independent verification, should set off alarm bells. Remember also that a veneer of respectability is the finest weapon in the trickster's arsenal (the infamous Bank of Credit and Commerce International had Jimmy Carter's name on its letterhead) and lawyers, for instance, are targeted by them (as well as money launderers) because they provide a layer of legitimacy and probity to a transaction. But it is the internet that has become the deceiver's best friend and which poses the greatest threat today. Meetings, the telephone and letters – once essential tools for deception – can now be circumvented. Virtual deception has eclipsed actual deception. Henry Morton Stanley, the explorer, (he was eventually

knighted by Queen Victoria) became an agent for King Leopold II of Belgium who controlled the Congo during his reign which ended in 1908. In order to convince local chiefs to sign over their land to Leopold, Stanley told them that whites had the magical power to not only resist bullets but to control the power of the sun. Stanley would have someone shoot at him with a blank cartridge and miraculously retrieve a planted bullet from his shoe. Then, using a magnifying glass to light his cigar, he would tell the natives that he could also have the sun burn down a nearby village if he desired it. These days, the need for cigars, bullets and magnifying glasses is not so great. If ever Mr. Spielberg is interested in a film about great cons of the past I can, at least, suggest a possible title for it: "Swindler's List".

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