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OFFSHORE PILOT QUARTERLY

Views and News on Matters Offshore

Chaos, Shrunken Heads and Harmful Comments

It is universally known today that there are two ways of reducing your taxes: by avoiding or evading them. A British politician once made the comparison succinctly: "The difference between tax avoidance and tax evasion is the thickness of a prison wall." And the esteemed American jurist, Learned Hand, reminded us that avoidance – unlike evasion – of taxes should keep you on the right side of that prison wall: "There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich and poor; and all do right for nobody owes any public duty to pay more than the law demands".

Before income taxes, the ancient Chinese paid their dues with pressed tea and Amazonian tribesman paid theirs with shrunken heads. Tolls, trade and customs duties were the early source of tax revenue. Income tax is a relatively recent innovation and probably developed in tandem with the creation of regular annual income. The Dutch are to blame. In 1797 the Dutch Batavian Republic introduced income tax and not long afterwards (1799) Britain followed suit – although there was a period (1815-1842) when the British did not impose income tax. Government tolerance toward wily advisers and their tax avoidance-prone clients has been stretched severely in recent years. Before the globalisation of so much financial activity, income was mainly confined within national boundaries and factories, for example, unlike

computer terminals, were easier for the taxman to inspect. He didn't need a passport and there were no privacy barriers in place. So, many offshore financial service centres are today viewed by national governments as co-conspirators of tax dodgers and vital aids to clever tax planners. They are seen as an economic threat which they compound by attracting money launderers, drug smugglers and other assorted undesirables. Abdus Sattar, Foreign Minister of Pakistan, blames offshore secrecy laws for stopping the search for funds from corruption in his country, describing these offshore centres as "tribal areas" and adding that there is "total chaos in the Caribbean." It would seem to me that tribalism and chaos more aptly describe Pakistan at the moment.

It would be false to only lay blame for tax losses and criminal financial manipulation at the shoreline of the offshore centres. The Organisation of Economic Cooperation and Development countries may comment on "harmful tax competition" but their own practices (more on this later) should raise an eyebrow or two. And some OECD officials have argued that it is difficult to describe any competition as "harmful" from an economist's viewpoint. As for financial shenanigans, you need only to follow the current Bank of New York money laundering case where billions of dollars were cleansed. America has seen nothing like it before.



Double Talk

As long ago as 1921 the defunct League of Nations commissioned a report which concluded that double taxation (arising from a tax payer having global income) hampered economic activity and the free flow of capital. From this original report arose a model treaty (altered and updated by the OECD) that resulted in today's many bilateral agreements. By astute application of the bilateral tax rules, multinational companies in particular have been able to avoid onerous taxation on their profits by setting up in business where the tax burden would be least felt. The mobility of capital has meant that tax competition between countries has inevitably arisen. One of the hubs of international commerce, Panama, became a tax-exempt offshore jurisdiction as long ago as 1916 – well before the offshore financial services centres came into vogue. Taxes were made territorial and individuals or companies using Panama were given exemption from taxes if the source of their activity was outside Panama. Within Panama its residents (corporate or individual) can be taxed up to 50% of their income – a scale more in keeping with OECD countries unlike many of the latter-day offshore centres in the region which impose no income taxes whatsoever. Another example is Jersey in the Channel Islands, with a basic fiscal structure that was put in place in 1940, so it can also argue that its tax system (which does include income tax) was not created to accommodate the start of the rush offshore in the 1960s when, before it became a generic term, the word offshore was more often than not hyphenated. The Bahamas (which doesn't have any income taxes) is on less solid ground. It has not reacted kindly to OECD criticism. In fact, things heated up last year at the Paris meeting of the OECD at which the Bahamian Minister of Finance, Sir William Allen, was present. Amongst other barbed comments, the Bahamian delegation accused the OECD of hypocrisy and discrimination and whilst it is hard to support the Bahamas in the context of income tax when it imposes none – and the Minister of Finance has said that introducing income taxes is out of the question –

one can sympathise when bully tactics are being employed against it. There is a perception that because the Bahamas is part of the British Commonwealth it does not stand alone as an independent sovereign state and the islanders are very prickly on the subject. Even so, its membership of the British Commonwealth will mean that fellow member states can add to the OECD pressure to encourage the Bahamas to become more amenable and although its fate is not sealed in the same way as those of Britain's 5 Caribbean territories is, there is no doubt that compromise becomes more likely. The Bahamas is already starting to succumb to international pressure. Significantly, Sir William Allen has said that legislation is in the pipeline which will make its international business companies (IBCs), of which there were 102,000 at the last count, less secretive. It is thought that bearer shares could be banned and details of directors might become available to the public. Regular readers of this newsletter will remember (Volume 2, Number 6) that it was apparent that IBCs were going to become a main OECD target.

What are the prospects of the European Union and OECD campaign against "harmful taxation" working? Heavy reliance is being placed on a blacklist of uncooperative jurisdictions which could be published by June of this year. Unfortunately, the list will not only include small islands dotted across the world's oceans but two wealthy countries – Switzerland and Luxembourg – which have gone on record as saying that they will not be bound by any OECD recommendations. Predictably, some OECD officials favour making deals with recalcitrant offshore jurisdictions in order to receive a larger proportion of revenue from those multinationals which have carefully structured themselves and reduced their taxable income significantly. It should be remembered that 85% of all multinationals are incorporated in OECD countries. But the multinationals are not just using palm-fringed offshore centres, they are also taking advantage of the existing tax competition within the OECD and European Union countries. As with money launderers,



drug smugglers and assorted undesirables, the offshore centres are not the only havens of refuge. A report out of the European Union's Helsinki summit last December highlighted 66 different varieties of preference that were found within the European Union and with the exception of Sweden, all member countries engaged in some form or other of what could be described as "harmful" tax practices. Britain blocks a European Union savings tax directive because of fears of what might happen to the City of London: from Threadneedle to Threadbare Street? Switzerland and Luxembourg refuse to share tax information when its bankers must offer discretion to clients if it wants to maintain its perceived competitive advantage. There's not just double taxation, there's double standards as well.

Net Results

Recently, a Carnival Cruise Lines ship was adrift near the Turks & Caicos Islands in the Caribbean. Its name was "Destiny". Many offshore centres see their own destinies adrift, especially those who sense capitulation because their fate is held hostage to decisions that will be made by a controlling sovereign power in Europe. Some offshore centres (especially Bermuda and the Isle of Man) see the internet as a panacea and are promising to cooperate on international tax investigations while concentrating their efforts on establishing the necessary environment to host internet business - shifting more from electronic banking to electronic trading. If they think that this will be a solution to their problems, they should think again. The internet has every likelihood of increasing so-called harmful tax competition by making it a lot easier, for example, for multinationals to move their activities to the no-tax or low-tax offshore centres which may be geographically on the other side of the world, but, for all practical purposes, are as close as the plastic mouse at your finger tips. It hasn't taken businessmen long to – literally – click on to this and OECD governments could find secret bank account concerns being eclipsed by worries over undeclared profits from such commodities as

clothing, coffee and cement. Tax collection has been based on the right of every country to decide what taxes it will collect from within its borders and it is a right that is zealously defended within the OECD. Countries might give up elements of sovereignty by becoming members of international bodies, such as the United Nations and the International Monetary Fund, but the line is drawn at direct taxation. In the case of America, in particular, there is evidence that it cannot tolerate any infringement of its sovereign rights by any formal body over which it does not have direct control. The internet has no regard for either sovereignty or borders. Ironically, America could well seek a worldwide ban on any new proposed internet taxes because as a net exporter of e-commerce, it stands to be the biggest winner.

Could the internet become the international businessman's alternative to the bearer share, affording protection that is every bit as good? There are no simple solutions, but we should recall the comments of the Polish philosopher, Leszek Kolakowski: "We are condemned to subsist in a state of ignorance and uncertainty, in a discordant and contradictory world. But if we cannot make things much better, we can at least prevent things getting worse." I hope so.

Offshore Mischief

Recently, the British newspapers have been writing stories about Michael Ashcroft. The name might sound unassuming but the personality behind it most certainly isn't. Mr. Ashcroft is a larger-than-life individual with homes in Belize, Florida and London and who has a finger in several financial pies. He has a Belizean diplomatic passport and is the owner of that country's largest bank. For a spell he was the principal regulator of Belize's offshore financial services industry. Interesting enough, but what has caught the attention of the British press is the fact that he is also the Treasurer of the Conservative Party in the United Kingdom – not to mention one of its major financial benefactors. But my interest in this Belizean banker lies in the fact that in 1996 he apparently wanted – and expected to receive – a bank



licence in the Turks & Caicos Islands (TCI), a British Overseas Territory located between the Bahamas and Hispaniola. Twenty five years ago he would probably have been more successful, but in the wake of Sir Louis-Blom Cooper's two reports in the 1980s, a bank licence moratorium was imposed in TCI which was only lifted after my appointment as Regulator there by the British Foreign Secretary in 1989. Then followed the establishment of a regulatory body and my recommendations concerning changes and improvements to the financial services legislation.

Fortunately, I was no longer the Regulator in TCI in 1996 (Mr. Ashcroft is said to have threatened the British government with mischief if he didn't get that bank licence) but his case – if not the circumstances - is far from exceptional. Many individuals did want a licence during my tenure and although some of the applicants were not as rich as Mr. Ashcroft (he is supposed to be the 14th richest man in Britain) they certainly fell into the category of colourful characters. One wished to purchase an

island within the TCI group and issue special passports and currency. However, whether the motive of such individuals is ego or economics, it is bad public policy to grant bank licences to them. Offshore centres should not permit it and those that do (there are a few) add fuel to the fire of criticism stoked by the OECD. The Caribbean is littered with banking frauds devised and managed by one mastermind.

So when you are gauging the soundness of an offshore centre's regulatory regime, one quality yardstick which you can apply is to see if bank (as well as trust company) licences can be granted to individuals. Sir Blom-Cooper, the British lawyer, is still a frequent visitor to the Caribbean: last year he was conducting a commission of enquiry into alleged corruption in St. Kitts and Nevis and I suspect that it will not be his last trip to the Eastern Caribbean. It all reminds me of one of the characters in Bertolt Brecht's "Threepenny Opera" who asks: "What is robbing a bank compared to owning a bank?"

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