

# TAX HAVENS CREATING TURMOIL



Evidence submitted to the  
**Treasury Committee**  
of the House of Commons  
by the  
**Tax Justice Network UK**  
June 2008

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**Cover photo:** The motor yacht *Turmoil*, registered in the Cayman Islands, photographed in Dublin's Dockyard Financial Services Centre 9 June 2008 by John Christensen. Aptly named and symbolising all the issues that the offshore economy raises.

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## 1: Executive Summary

***“We feel that this (lack of provision of an effective regulatory system) might be a grave omission, since it is notorious that this particular territory, in common with Bermuda, attracts all sorts of financial wizards, some of whose activities we can well believe should be controlled in the public interest”***

Extract from a memorandum concerning the Bahamas dated 3<sup>rd</sup> November 1961 submitted by Mr W.G.Hulland of the Colonial Office to Mr B.E.Bennett at the Bank of England. Memorandum seen in 1997 by John Christensen in the Bank of England archive.

The Treasury Committee (TC) announced on 30 April 2008 that it had “decided to undertake an inquiry into Offshore Financial Centres, as part of its ongoing work into Financial Stability and Transparency” and asked for written evidence to be submitted<sup>1</sup>. This document is the submission of evidence prepared by the Tax Justice Network UK.

This paper argues that it is a mistake to confuse the term ‘Offshore Financial Centre’ (OFC) with ‘tax haven’. These two are quite separate and distinguishable if intimately related phenomena that jointly make up the offshore economy.

We argue that the power in this relationship lies with OFCs and the companies that work within them, not the tax havens, so the focus of regulation must shift onto limiting the powers and impact of OFC operators within the global economy.

Tax havens are places that create legislation designed to assist persons - real or legal - to avoid the regulatory obligations imposed upon them in the place where they undertake the substance of their economic transactions. This is not by accident or chance: we provide clear evidence that these places, some of them countries, some not, but all with the power to pass legislation, set out to undermine the impact of legislation passed in other jurisdictions. These are deliberate acts of economic aggression targeted at sovereign states.

Offshore financial centres are not the same as tax havens. OFCs are the commercial communities hosted by tax havens which exploit the structures that can be created using

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<sup>1</sup> [http://www.parliament.uk/parliamentary\\_committees/treasury\\_committee/tc0708pn42.cfm](http://www.parliament.uk/parliamentary_committees/treasury_committee/tc0708pn42.cfm) accessed 8-5-08

the tax haven's legislation for the benefit of those resident elsewhere. In other words, the offshore financial centre is made up of the accountants, lawyers, bankers, plus their associated trust companies and financial intermediaries who sell services to those who wish to exploit the mechanisms the tax haven has created.

Until now all attempts to regulate the offshore economy have been focussed on tax havens. We argue that this has been a mistake. Tax havens are geographically located and have fixed spheres of influence. OFC operators, many of them multinational companies or banks, and some like the Big 4 firms of accountants present in every major and most minor tax haven jurisdictions around the world, can move their operations to wherever they want at a moments notice. They have used this power to threaten to leave any jurisdiction that does not comply with their wish to secure the legislation they desire. This has recently been used as a tactic in the UK, itself a tax haven.

The result has been that in the last decade new and highly abusive forms of offshore company and trust have been developed. These evolutions have been little documented and much less understood, but have allowed both companies and trusts to float free of almost any regulatory control. Again, this did not happen by chance. As we show, it is the OFC operators who have demanded and secured this benefit on behalf of their clients.

The consequence is obvious: whilst tax haven regulation is important it is impossible to expect the tax haven states to regulate the OFCs that operate from within them. Those OFCs hold all the power in this relationship. In effect they have taken these states captive, showing in the process complete indifference to the local populations of these places and their elected representatives.<sup>2</sup> It is not by chance that the degree of compliance with tax haven regulation that OFC operators demonstrate in their behaviour is astonishingly low, since they appear to consider themselves beyond the law of these places.

This is not only the case in the archetypal micro-state that populates the tax haven world in popular perception. As we are now seeing this behaviour is being replicated in the world's major tax havens, of which, the UK is without doubt the most important. It is no longer possible for any objective person to deny the obvious fact that the UK is a tax haven and that the City of London is an OFC seeking to exercise control over our state. The evidence also shows that the City of London is also intricately connected to a web of satellite tax havens spread across the globe, including Crown Dependencies, British Overseas Territories and various members of the Commonwealth, which have served as conduits for capital flows into London whilst also providing facilities for tax evasion on an industrial scale.

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<sup>2</sup> See Christensen, J. and Hampton, M.P. (1999) *A Legislature for Hire: The Capture of the State in Jersey's Offshore Finance Centre*

The consequences are easy to see. The developing world is denied the capital resources it needs to establish stable, self supporting democracies. The UK's tax base is eroded and in the process its own democracy is threatened as electors note that large corporations representing nothing but the power of money seem more important to those holding office than their constituents. Corruption is enabled. Crime can take place almost unimpeded. These are the realities of tax havens, even if, as we acknowledge, the race to the bottom in taxation has been averted (as yet) as a consequence of the sheer exuberance of the boom economy. But that boom has now passed and exuberance has given way to turmoil. Hard times are upon us, just at the very moment when the consequences of tax and regulatory avoidance are impacting most heavily on the UK economy.

As we show though, there are solutions to the turmoil that tax havens create. We recommend that:

1. The focus of regulation must shift onto limiting the impact of OFC operators within the global economy.
2. This can only happen by massively extending the transparency of the financial world, whether offshore or not. The UK must show its commitment to this task and call for broader based, more accessible and much better regulated and enforced registers of companies, trusts, charities and other entities created by statute law, and abolish the use of nominees within them.
3. In addition banking secrecy, whose only impacts are pernicious, must be outlawed. To this end the UK must seek that the EU extends the EU Savings Tax Directive to all privately owned entities (whether they be companies, trusts, foundations, partnerships with limited liability or their like).
4. Furthermore, the UK must seek that the EU extends the EU Savings Tax Directive to all forms of income derived from capital including all forms of interest, without exception, income from insurance policies and pension funds, dividends of all forms, trust distributions and the payment of royalties, licence income and similar payments derived from the ownership of intellectual property, and:
5. The UK must seek that the EU extends the EU Savings Tax Directive to additional territories to ensure that its effectiveness is not undermined by tax havens such as Hong Kong, Macau and Singapore.
6. Next the UK must seek to end the secrecy that has been exploited by multinational companies to hide the abuses that they have perpetrated in seeking, legally and illegally to deny states of the revenues due to them by the use of offshore structures. This requires that the secrecy that consolidated accounts permit on intra-group trading and the location of group transactions must be ended and the UK should actively require the adoption of country-by-country reporting by the International Accounting Standards Board and by individual countries.

7. Corruption is endemic within offshore financial centres. The UK must extend ratification of the UN Convention Against Corruption and the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions to all territories for which it is internationally responsible and require their active participation in its implementation.
8. As a pragmatic step the UK should recognise the role of OFCs in supplying the mechanisms used in many corrupt transactions, and actively promote research into methods of curtailing this supply that do not rely solely upon the actions of tax haven governments who have neither the power, resources or inclination to regulate that supply.
9. The role of the UK as a tax haven has to end if it is to have the necessary authority to tackle the issues identified in this report. This means that one of its most notable tax haven characteristics, the domicile rule, must be abolished.
10. As this report notes, because of its tax haven status the UK currently provides a taxation environment that favours large companies over small ones, quoted companies over unquoted companies and international entities over those operating solely in the UK. This is despite the fact that at least half of all the UK workforce work for companies whose activities are located solely in the UK. The UK should now commit to a tax strategy that ensures that all companies have equal access to markets, all can enjoy equivalent tax rates (there is serious risk that smaller companies are paying taxes at higher rates than large ones) and that undue regulatory burden is not placed on companies operating solely in the domestic market as a result of the action of those working on a multinational basis.
11. To reduce the impact of offshore tax competition the UK should work with the EU to promote adoption of a Common Consolidated Corporate Tax Base that limits the possibility for companies to arbitrage the taxation laws of one country against those used in another, and that allocates profit to country on the basis of a unitary apportionment formula taking into consideration solely where a company's employees, assets and sales are located, so limiting the possibility of profit being shifted to a tax haven.
12. This would represent a new development in the relationship between the UK and Europe on tax matters. The UK is believed to have been an obstacle to implementation of some aspects of the EU Code of Conduct on Business Taxation. The UK should commit to this Code, seek to extend it to personal taxation and require that the Conduct Group monitoring its implementation publish reports on its work.
13. The UK has a special responsibility for the considerable number of tax havens that exist under its international protection. In 1998 the UK published the Edwards Review of the Crown Dependencies, but failed to subsequently require the proper implementation of

the recommendations of the resulting report. The world has changed substantially since 1998 and another review is required, with Royal Commission status, to determine the UK's future policy for all the tax havens for which it has responsibility.

14. It is classic tax haven practice to allow 'offshore activity' to be regulated more lightly than that supposedly 'onshore'. The UK should require that its tax havens operate systems of accountability and transparency with regard to corporate and other disclosure equivalent to those of the UK, and as recommended in this report.
15. The need for improvement in regulation in the UK's tax havens has been graphically described by the National Audit Office in a report published in November 2007. It is vital that the weaknesses identified by the NAO are tackled, meaning that the UK must:
  - Improve the quality of its training for all staff seconded to Overseas Territories and the Crown Dependencies;
  - Second such staff as are needed to ensure that the financial services regulation of all territories for which the UK is responsible is operational and effective;
  - Ensure that deficiencies in current legislation for regulatory regimes are remedied with immediate effect, if necessary by way of Orders made in Council;
  - Require that contingency plans be put in place for the demise of the financial services industry in each of these locations;
  - Create plans to diversify the economies of these territories so that they might have alternative sources of income available to them;
  - Make clear that funds to ensure that this development is possible are dependent upon adopting recommendations on transparency included in this report.
16. The Crown Dependencies are particularly associated with the UK and are especially vulnerable to political capture by the financial services industry. The Isle of Man can only operate because of subsidies amounting to more than £200 million a year provided to it by the UK; Jersey and Guernsey are likely to run substantial government deficits as a result of tax changes adopted to comply with the EU Code of Conduct on Business Taxation. Neither gives indication of having contingency plans available to manage those budgets given the current likely down turn in their trade as the world financial crisis develops. The UK government should:
  - Make explicit the terms of its support for the Isle of Man government and make explicit its requirement that the Isle of Man comply with both the spirit as well as the letter of the EU Code of Conduct on Business Taxation in exchange for that support;
  - Require that each of the Crown Dependencies prepare contingency plans based on the premise that there will be no growth in their financial services sectors for the next five years;
  - Make explicit that support will only be forthcoming for these territories in future if they are willing to comply with recommendations on transparency included in this report;

- Require that each Crown Dependency develop a plan to break its dependency upon financial services as the main source of its income and demonstrate the viability of doing so.
17. No one suffers more from the existence of tax havens and OFC abuse than the developing countries of the world. For them this is not a question of ensuring the effectiveness of financial regulation or the efficiency of the tax system (although both have significance in developing countries): it is also a matter of life and death. The UK needs a policy on tax havens that is coherent with, and integrated into, its work on development. This must include commitments to:
- Provide technical support and training to developing countries to ensure they can engage effectively with tax haven abuses, whether relating to corruption, crime or taxation abuse;
  - Provide technical support to developing countries to ensure that they can negotiate effective contracts with significant commercial trading partners that provide them with access to adequate information to ensure that appropriate taxes are paid within their domain as required by their law;
  - Develop models for development that break the dependence on fiscal degradation that has been the pattern of incentive used to date, so undermining the credibility of developing country tax systems and their prospect of becoming effective, self governing democracies that are not dependent upon aid;
  - Support developing countries in creating effective information exchange agreements with other nations and with tax havens to ensure they have access to the information they need to ensure they can collect the taxes due to them;
  - Assist developing countries in recovering stolen assets that are their rightful property, including those that have arisen as a result of tax evasion, and to create effective mechanisms for the repatriation of these assets from locations over which the UK has control (including the City of London) to those places that need these assets to fulfil their development objectives.
  - Ensuring that international and domestic civil society is represented in the processes recommended here to ensure that governments are held accountable for the actions they take in the name of the people they govern and that where appropriate training is provided to ensure that those groups are empowered to undertake these tasks.
18. The first recommendation of this report was that the focus of offshore regulation should now shift from the tax haven as such to OFCs. All the recommendations since then have had that goal in mind, and yet none, as such, tackles the OFC operators; all instead seek to curtail their access to the abusive products that they sell. We believe that in the absence of a world tax authority this is the most pragmatic approach to this issue. Two actions would assist this task, however. The first would be to support the creation of a Code of Conduct for Taxation to be adhered to by governments. Progress is being made on this issue at the United Nations, and we recommend that that the UK support the development of that Code.

Second, there is an action that could be taken to tackle the OFC operators, and it is within the UK's power alone to enact it. The UK should promote a Code of Conduct for Taxation<sup>3</sup> that would uphold the highest ethical standards of conduct, including a commitment to making full disclosure of all information noted in recommendation 2 above and to desisting from the promotion of all forms of tax avoidance on the part of all engaged in the taxation profession, whether in the UK or offshore. This should be enforced by refusing to extend UK government contracts for services to any company or firm that did not commit itself and all its group members and their affiliates trading under similar or associated names to that standard of conduct.

We are under no illusion about the size of the undertaking that implementation of these recommendations would require.

We also believe them wholly justified. The benefit of the actions proposed here, which would, for example, have reduced the impact of the current world financial crisis by substantially increasing the transparency of the world's financial systems, substantially exceeds any cost to the UK and its citizens of implementing these regulatory changes.

In addition, the UK, its international status, its tax revenues and its democracy would all be substantially enhanced by implementation of these recommendations. Tax havens are a pernicious cancer undermining all of these from deep within the heart of our society, the epicentre being in the City of London. Regulatory reform is essential if that cancer is to be prevented from both destroying our social order and replacing it with an undemocratic infrastructure intended solely to service the whims of an international elite drawn from the financial services sector.

Developing countries would benefit as much as developing countries from these recommendations. Tax havens and OFCs harm development processes by distorting capital accumulation and investment patterns, and facilitating grand corruption and embezzlement. Unless this cancer is tackled, there is no prospect for an end to aid dependency or for the creation of economically stable, democratic states able to feed, educate and provide health care for their populations.

Tax havens undermine effective democratic government and deny the supply of information that markets need if they are to operate properly. So significant is the challenge they pose to global economic and social stability that the risk cannot be assessed within the financial domain alone; it permeates the infrastructure of our society and this report reflects that perspective. As the author of the memorandum cited at the start of this chapter noted as far back as 1961, the offshore economy has attracted financial wizards whose activities should have been controlled at that time, and who urgently need to be controlled now. Since the 1960s the problem has become manifestly more urgent and

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<sup>3</sup> As an example, see [http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code\\_long.pdf](http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code_long.pdf) accessed 13-6-08

the risks to public interest have become that much greater as a result of half a century of inaction. The UK government can no longer turn a blind eye to problems that it has played a major role in creating.

## 2: Introduction

***“We feel that this (lack of provision of an effective regulatory system) might be a grave omission, since it is notorious that this particular territory, in common with Bermuda, attracts all sorts of financial wizards, some of whose activities we can well believe should be controlled in the public interest”***

Extract from a memorandum concerning the Bahamas dated 3<sup>rd</sup> November 1961 submitted by Mr W.G.Hulland of the Colonial Office to Mr B.E.Bennett at the Bank of England. Memorandum seen by John Christensen in the Bank of England archive.

The Treasury Committee (TC) announced that it had “decided to undertake an inquiry into Offshore Financial Centres, as part of its ongoing work into Financial Stability and Transparency” on 30 April 2008 and asked for written evidence to be submitted<sup>4</sup>. This document is the submission of evidence prepared by The Tax justice Network UK.

The Tax Justice Network (TJN) is a non-aligned coalition of people and organisations with a shared concern about the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. The international secretariat of TJN is located in the UK. It is stressed that this submission is not made by the International Secretariat but by UK based members of the organisation and they have sole responsibility for this submission. Some of those submitting this report are also closely associated with the work of that International Secretariat.

The approach that this evidence takes is broad based. We note the Committee’s concern for financial stability and transparency. We share that concern, but believe that the role of the world’s offshore financial centres (or, as we would prefer to call them, for reasons explained in chapter 3, tax havens) is so important that they cannot be considered in that context alone. As such this submission considers the impact of tax havens and the offshore financial centres located within them (the distinction between the two will be explained in chapter 3) on the matters that the TC refers to in its brief, but in doing so makes clear that this does, in our opinion require consideration of the following issues:

1. Tax competition and its impact;

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<sup>4</sup> [http://www.parliament.uk/parliamentary\\_committees/treasury\\_committee/tc0708pn42.cfm](http://www.parliament.uk/parliamentary_committees/treasury_committee/tc0708pn42.cfm) accessed 8-5-08

2. Transparency and accountability both within tax havens, and the way that their opaque nature can be exploited as a result of weaknesses to be found in the accounting structures promoted by company law in the UK and elsewhere, and by the accounting profession;
3. The UK's own role as both a tax haven (which we will show that it is) and as a promoter of many tax havens (which is a widely acknowledged fact)<sup>5</sup> and the impact that this has on the UK's international relations;
4. The impact of tax havens on development and the developing countries of the world;
5. The domestic implications of tax haven policy, both with regard to the UK's own status as a tax haven, and as to the impact of other havens on its domestic regulation and tax haven;
6. The social implications of tax haven policies including the impact of increasing wealth disparities, the undermining of democracy and the alienation of the UK electorate from the process of government;
7. The undermining of corporate social responsibility and the failure of effective corporate governance.

In doing so this report takes a broad view of the issues that tax havens raise when their impact upon the UK is assessed. In this context issues relating to taxation, financial stability and transparency are themselves important, but this limited financial horizon does not reflect the full impact of tax havens on the UK, or the impact being a tax haven has upon the UK. This report will therefore consider the matters raised within this narrow domain but also within the broader perspectives of economics (as opposed to finance), ethics, political economy, development, corruption and criminal behaviour and politics. Along the way issues relating to sociology and anthropology might also be touched upon. It is our belief that the issue can only be properly considered in this way.

This reflects the authors' opinion that effective markets are essential to ensuring the supply of the resources that the people of the world need, and want. It also reflects our opinion that efficient markets are dependent upon two things: the first is the existence of an effective legislature that can provide the appropriate infrastructure in which markets can operate, and we know of no better way to ensure that this happens than by upholding the democratic process. The second requirement is symmetrical access to information.

Tax havens undermine effective democratic government and deny the supply of information that markets need if they are to operate properly. So significant is the

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<sup>5</sup> See, for example the report of the Public Accounts Committee of the House of Commons dated 1 May 2008 <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmpubacc/176/176.pdf> accessed 8-5-08

challenge they pose to global economic and social stability that the risk cannot be assessed within the financial domain alone; it permeates the infrastructure of our society and this report reflects that perspective. As the author of the memorandum cited at the start of this chapter noted as far back as 1961, the offshore economy has attracted financial wizards whose activities should have been controlled at that time, and who urgently need to be controlled now. Since 1961 the problem has become manifestly more urgent and the risks to public interest have become that much greater as a result of half a century of inaction. The UK government can no longer turn a blind eye to problems that it has played a major role in creating.

## Section 1

### 3: Understanding the issue

In offering evidence to the Treasury Committee (TC) on Offshore Financial Centres (OFCs) we are reminded of the proverbial response to the person asking directions that the respondent “would not start from here”. To explain, our concern is that in using the term “offshore financial centre” in its call for evidence the TC has already made an assumption about the issue into which they are making enquiry which we would wish to challenge. It would seem that the TC has decided to use the term OFC when referring to what are called in popular parlance ‘tax havens’. This, we submit, will cause confusion. The two are not the same.

#### What is a tax haven?

Tax havens are places that create legislation designed to assist persons - real or legal - to avoid the regulatory obligations imposed upon them in the place where they undertake the substance of their economic transactions. This is not by accident or chance: we provide clear evidence that these places, some of them countries, some not, but all with the power to pass legislation, set out to undermine the impact of legislation passed in other jurisdictions.

Tax havens can be geographically identified. The characteristic that they have in common is that they have the right to create legislation. This does not mean that they are all, by any means, sovereign states. The Crown Dependencies<sup>6</sup> and the British Overseas Territories<sup>7</sup> are not sovereign states. The state of Delaware in the USA is not a sovereign state either, but it is generally considered a tax haven. Some tax havens are, of course, sovereign. Singapore, Panama and, of course, the UK are all sovereign states and are tax havens.

What tax havens have in common is that they create legislation designed to assist a person to avoid the regulatory obligations imposed upon them in the place where they undertake the substance of their economic transactions.

This needs explanation. First of all the difference between the substance and form of a transaction has to be understood. The form of a transaction is the legal identity given to it. So, for example, if a CD is sold by a UK limited company to a UK resident person the legal form of the transaction is that a UK company made the sale under UK law to a UK person.

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<sup>6</sup> Jersey, Guernsey and the Isle of Man.

<sup>7</sup> Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn Islands, St Helena and Dependencies, South Georgia and the South Sandwich Islands, the Sovereign Base Areas of Akrotiri and Dhekelia in Cyprus, and the Turks and Caicos Islands.

UK taxes will be paid on any profit arising from the sale, UK VAT will be paid, and a UK court could arbitrate on any resulting dispute that might have arisen. UK trading standards will apply.

Suppose now that the same CD was shipped from the same warehouse in the UK to the same person in the UK, but with the CD being routed through the Channel Islands on its way from the warehouse in the UK to the customer in the UK. The sale in this case is recorded as having taken place from the Channel Islands. The substance of the transaction has not altered. A CD that was in the UK has been sold to a person in the UK. However, in this second transaction the form of the transaction has been changed significantly. The sale is now recorded as having taken place in a Channel Islands company. The sale may be subject to the law of one of the Channel Islands. Tax on any profit arising on the transaction may either be paid solely (if at all) in the Channel Islands, or may be split between the UK and the Channel Islands (since presumably the warehouse operator still requires remuneration for their services in shipping the product from the UK). UK VAT may well not apply in this case, since a loophole is available that prevents this charge on this form of transaction. UK trading standards may not apply. UK courts may not be able to intervene in any dispute that arises on the transaction. And all this has happened because a wholly irrelevant step (as far as the customer is concerned) has been placed into the transaction requiring that it be shipped to the Channel Islands and back en route to them. As far as the customer is concerned nothing has changed. The substance of the transaction is unaltered and yet the legal form is entirely different. The transaction is now subject to the laws and regulations of a domain outside the UK even though the substance of the transaction took place wholly within the UK.

Tax havens create legislation to achieve this effect. They do not do it by accident. It is their deliberate intent that the structures created under their legislation should have impact either solely or mainly outside their territory to enable a person resident in another country to avoid regulatory obligations in the country or countries in which they undertake the substance of their economic transactions.

This same argument also succinctly shows the economic impact of such transactions. The consumer in the UK appears to benefit from this deal. They do not, of course. The lost tax has to be recovered from them in some other way. It may be, of course, be recovered from someone else, but there can be no doubt it will be paid. They don't really win at all as a result. The deal that has been done is clearly more costly, uses more resources, and has greater impact on the environment than that which should have been done more simply in the UK alone. The company that does this sort of tax avoiding deal beats its local competitors. The small shop on the High Street goes out of business. The community is blighted, young people who used to gather there are no longer encouraged to talk about and play music. The big international retailer gets bigger, extracts more monopoly profit. And the consumer loses again, whilst the richest who own such companies get richer and the poorest become poorer.

A perfect example of this pattern and the legislation used to create it might be found in the case of the Liechtenstein foundations that have been so much in the public eye in 2008<sup>8</sup>. The citizens of Liechtenstein are taxed, albeit at relatively modest rates, on their world wide income<sup>10</sup>. In that case they have no use for the Foundation that is one of the major export products of their jurisdiction, or of the zero per cent tax rate that it enjoys, but that is not available to them locally, or of the secrecy that it provides, that they cannot use as they must declare their income locally. These Foundations only have any real use outside Liechtenstein, and it is for that purpose alone that they were created.

There is a second characteristic that most tax havens share in common. They create an environment of secrecy that allows the user of the structures created using its law to do so either wholly anonymously, or largely so. This secrecy may be backed by statute: the Swiss created their banking secrecy laws in 1934 and they have been much copied<sup>11</sup>. Despite claims that this was done to hide Jewish deposits from Nazi investigation it was actually enacted to prevent French authorities making enquiries on Swiss bank accounts to enforce French taxation laws. The facilitation of tax evasion in another country was Switzerland's motive.

Other arrangements are commonplace to ensure secrecy is maintained. Few tax havens require the identity of the real owners of companies to be disclosed; they allow nominee directors to manage such concerns so that those really operating them remain hidden from view and few tax havens require accounts to be placed on public record. Those that do usually provide a mechanism for avoiding the obligation for those rich enough to take advantage of it. For example, when the Wall Street Journal investigated the activities of Round Island One Limited, Microsoft's main operating subsidiary in the tax haven of Ireland, Microsoft took advantage of Ireland's law that allowed companies to register with unlimited liability, so avoiding the obligation to file its accounts on public record in the future.

Most of all, many tax havens guarantee secrecy by making it very hard indeed for a foreign government to make enquiry about the ownership details of a bank account, company or trust registered in their domain, or about its income. Switzerland does this by failing to recognise tax evasion as a crime, so blocking many enquiries on taxation issues. Many other states do so by not holding relevant information. This is, for example, true of many trusts maintained in the UK, which the Swiss say are used to create de facto banking secrecy arrangements as a result, whilst in many of the smaller havens this result is achieved in two ways: either they do not have information exchange agreements with countries that wish to

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<sup>8</sup> Some notes on Liechtenstein foundations may be found at <http://www.investec.com/NR/rdonlyres/14C9811C-D15C-46CA-AD7D-737F237FC5BD/6426/IntroductiontoLiechtensteinfoundations.pdf> accessed 8-5-08

<sup>9</sup> See <http://taxjustice.blogspot.com/2008/02/liechtenstein-emerging-scandal.html> accessed 8-5-08

<sup>10</sup> <http://www.lowtax.net/lowtax/html/jlipetx.html> accessed 8-5-08

<sup>11</sup> <http://swiss-bank-accounts.com/e/banking/secrecy/Handelsbank.html> accessed 8-5-08

make enquiry of them or they do not have the resources to deal with the enquiry when it is received. The outcome is much the same.

What it is important to stress is that secrecy is key to most tax haven operations. Without it many of those using tax haven structures would not do so. This is either because, in the case of those using them for criminal purpose, including tax evasion, they fear they would be too easily identified and so pay for the consequences of their crime, or in the case of those using them for regulatory avoidance (which may be legitimate, but is often ethically questionable) because of the damage that discovery would do to their reputations. This is especially true of the corporate sector and may have been a reason for Tesco suing the Guardian for malicious falsehood even though it is an acknowledged fact that Tesco did set up an offshore structure in the Cayman islands to avoid UK taxation liabilities.

In this context low tax rates and lax regulation, with both designed to undermine obligations elsewhere, are the lure to attract business to tax havens. It is however the secrecy that guarantees that a sale of tax haven services takes place. It is impossible to imagine one without the other.

### **What is an offshore financial centre?**

Offshore financial centres are not the same as tax havens. It is unfortunate that the terms have been confused. OFCs are the commercial communities hosted by tax havens that exploit the structures that can be created using that tax havens legislation for the benefit of those resident elsewhere. In other words, the offshore financial centre is made up of the accountants, lawyers, bankers and their associated trust companies that sell services to those who wish to exploit the mechanisms the tax haven has created.

This means that tax havens and OFCs are very different. Most importantly, the OFC community is very largely expatriate (at least in the smaller tax havens) and is usually very mobile. This characteristic makes the OFC community quite different from the tax haven community, and quite often leaves them in real or potential conflict. That is because the tax haven community is local and committed to their geographic space. The OFC community is international, transient and only interested in following money. If money does, for any reason, leave a tax haven you can be fairly sure that the OFC community will follow it very rapidly. The tax haven community, who are the real local populace, will be left behind to tend the wreckage. This is a scenario imagined recently by the leader writer of Cayman Netnews, the online version of Cayman's leading newspaper, who said<sup>12</sup>:

Regrettably, however, the numbers of people with the long-term interests of the Cayman Islands at heart has been substantially reduced as a result of the rollover policy and the foreign elements in the private sector will, when push comes to shove, take their money and run, leaving everyone else wondering what happened.

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<sup>12</sup> <http://www.caymannetnews.com/cgi-script/csArticles/articles/000149/014910.htm> accessed 8-5-08

Little more graphically demonstrates the relationship between the communities than this. It is a theme to which this report will return.

### **Are all tax havens OFCs?**

Every tax haven aspires to be an OFC. It is the way they make money from the structures whose creation their legislation enables. Unless those entities are created, and the associated fees paid they get no return on their investment from creating that law. In addition, without attracting the employment and spending that an OFC brings into their domain they enjoy little or no growth from being a tax haven.

Despite this it must be stressed that some tax havens have not really achieved the objective of being OFCs. Examples are to be found in the list of havens that follows in this section. More than forty such locations that have been identified at one time or another have not been successful at exploiting that status by attracting sufficient business to be considered OFCs. Some of the British Overseas Territories, such as Montserrat and Anguilla might reasonably be considered to be in this category. Although they allow the creation of tax haven structures, the local financial services communities who seek to exploit these facilities are small in both cases, being just 200 people in the case of Anguilla and 150 in Montserrat<sup>13</sup>. The scale is insufficient to justify the claim that an OFC has been created.

Quite clearly though some places have developed strong OFCs that dominate their local economies. This is, for example, obviously true of places like Cayman and Jersey. In the latter case there are some 11,800 people engaged in the OFC<sup>14</sup> and the activity contributes more than 50% of the island's GDP<sup>15</sup>.

### **The offshore world**

Tax havens and OFCs together make up the 'offshore world'. By implication of course, the accountants, lawyers and bankers who are the main population groups to be found within the OFC community are also key members of the 'offshore world'.

It is important to stress some consequences of this combination if the term 'offshore' is to be understood. Offshore does not describe geography. It most certainly does not refer to island locations (many of which are microstates with populations of less than 1.5 million), even though some tax havens have that characteristic and host OFCs from within their palm-beach lined domains. Liechtenstein is an OFC and is one of only two double land locked states in the world, as if emphasis of this point were needed.

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<sup>13</sup> [http://www.nao.org.uk/publications/nao\\_reports/07-08/07084.pdf](http://www.nao.org.uk/publications/nao_reports/07-08/07084.pdf) table 9, accessed 8-5-08.

<sup>14</sup> Ibid

<sup>15</sup> <http://www.gov.je/NR/rdonlyres/5834907F-A3C1-4D57-BBBF-7B7530A64647/0/JerseyinFigures2007.pdf> page 16 accessed 8-5-08.

The term ‘offshore’ refers to the location of the customers of the OFC, those people the tax haven intended should make use of the structures they allow to be created. What characterises these customers is that they are not in the tax haven where the OFC is located. They are elsewhere, and since this concept was first recognised in London, that elsewhere was ‘offshore’. The term stuck, even when the geography to which it related had little or no meaning.

What this means is this: in the offshore world transactions are recorded in one place (a tax haven) on behalf of parties who are actually elsewhere in the world (offshore). Those transactions might have the legal form of taking place in the tax haven in which they are recorded. The reality is that their substance, and benefit, occurs elsewhere. If that ‘elsewhere’ is in a major state (i.e. with a population exceeding 1.5 million) it is sometimes called ‘onshore’, though this term also has misleading geographical overtones and is therefore best avoided. What onshore should, but does not always, mean is that the substance of the transaction takes place in the location where it is recorded and regulated. There is no conflict between form and substance in this case.

The conflict is created as a consequence of the actions of the accountants, lawyers and bankers working in the OFC. That is their primary purpose. They have been very successful in developing a market for their services. But the very fact that an OFC only houses these professions must be the clearest indication that nothing really happens in such places: they simply provide the legal form for transactions that take place elsewhere. It is this conflict between substance and form, hidden behind a legal veneer protected by considerable secrecy that is the core of the offshore dilemma that justifies the TC undertaking the review in which it is engaged. The offshore world is designed to make things appear other than they are, and by and large succeeds in doing so. This, in a nutshell, is the threat that they pose to the world.

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#### How the ‘offshore world’ came about

This is not the place for a full history of the offshore world. A short note as to the reasons for its development, and the key role of London within that process is, however, appropriate.

The first tax havens were created in the USA when Delaware and other states offered lower taxes and a relaxed regulatory environment to entice the relocation of business out of New York State in the late nineteenth century. Delaware remains the leading location for corporate formations in the USA to this day, for precisely this reason, which only now is the US government considering regulating, with Barack Obama a notable supporter of change<sup>16</sup>.

Further development was limited until after the First World War: the reason is simple to explain. What international trade there was largely within empire blocks before this time and as such subject to a single tax and regulatory administration. A notable exception was the Cobden-Chevalier treaty of 1860, signed between France and Britain, which enshrined the principle of equal protection in law to non-resident person and capital. The Cobden-Chevalier treaty was subsequently adopted as a model treaty by many other states.

After the First World War this changed: cross-border trade increased and problems of double taxation of income between states began to be an issue. Pressure for reform of the UK tax system to prevent double taxation came from a number of sources, including most notably the Vestey family, owners of Dewhurst the butchers and of extensive cattle ranches in Argentina who brought a series of test cases on this issue in those years<sup>17</sup>. Inevitably change followed. It is known that Jersey was first used as a tax haven, exploiting the availability of UK trust law in a reasonably anonymous environment, from the 1920s onwards. In 1929 the House of Lords<sup>18</sup> decided that if the directors of a UK registered company met in another country then the centre of that companies control was outside the UK and, so long as it did not trade in the UK it was not subject to UK tax on its profits. This decision had a profound impact on the development of offshore financial centres. In one decision the 'offshore' company, registered in a domain but neither trading nor taxable within it had been formed. In the years that followed the offshore company became the main selling point of the City of London's many satellite tax haven jurisdictions, and in combination with the UK's almost unique use of trust law created opportunities for secrecy and the avoidance of taxation that Switzerland could only vaguely emulate with its banking secrecy laws of 1934.

The Second World War put a halt to further offshore development: some havens, such as the Channel Islands were put out of action. This provided a curious indication of their own dependence upon world economic and social stability if they are to pursue their own trade that undermines both, as this report will show.

The immediate post-war world was not conducive to much tax planning: there were real issues like rebuilding Europe to deal with, but as the 1950s progressed the consequences of that rebuilding emerged. The Marshall Plan had pumped Europe full of dollars. It is hard now to understand the degree of regulation that existed at that time with regard to

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<sup>16</sup> See [http://obama.senate.gov/press/080501-obama\\_joins\\_lev/](http://obama.senate.gov/press/080501-obama_joins_lev/) accessed 8-5-08.

<sup>17</sup> See <http://www.guardian.co.uk/theguardian/1999/aug/11/features11.g2> accessed 8-5-08

<sup>18</sup> Egyptian Delta Land and Investment. Co Ltd v. Todd [1929] A.C.1

currency dealing, or the repatriation of dollars back to the USA. These dollars, liberated from that constraint stayed in Europe. As a result the Euromarket developed in dollars outside the US (and to some degree in other currencies outside their country of origin, but clearly to much lesser degree: the dollar was the dominant world currency of the period), but once again the UK played a unique role in this process. In October 1957 the UK was confronted with a crisis. Facing mounting speculation against the pound after the Suez Canal crisis, the British government imposed restrictions on the use of pound sterling in trade credits between non-residents. Consequently, British and other international banks sought to use the US dollars in their international dealings. Transaction between non-residents and in a foreign currency (i.e. not the British pound) mediated by banks located in London, British or not, were considered by the Bank of England as if they were taking place abroad or 'offshore', i.e. not under the regulatory laws and supervision of the British state<sup>19 20</sup>.

It was this decision of the Bank of England to treat certain type of financial transaction between non-resident parties undertaken in foreign currency as if they did not take place in London and hence not under the regulatory and supervisory arm of the Bank of England that created 'offshore'. Economic historians are still unable to trace the precise origin of this decision or a recorded rationale for it. What is clear is that whilst the transactions were physically taking place in London and no other regulatory or supervisory agency could intervene they were as a consequence of this action only deemed 'offshore'. The consequence of this decision was that they were unregulated and unsupervised by any jurisdiction. We do not know whether the decision was taken intentionally or not, but we know that the market emerged in September, 1957<sup>21</sup>.

There can be little doubt that the Bank of England had little inkling of what they had given birth to when creating the 'offshore' London Euromarket, but it is equally without doubt that it was the Bank of England which created offshore, and the consequences were rapid and marked.

First, and as a curious by-product of this decision, UK resident banks were excluded by the Bank of England from operating in this offshore market. They rapidly got round this by creating branch operations to achieve the same result in the Channel Islands. This was done with Treasury consent.

This was noticed by US banks too small to have an operation in London, or who needed to overcome the still considerable communication issues that existed across the Atlantic at the time, as well as the important time difference. They realised they could achieve the same result that London banks had achieved in the Channel Islands by setting up similar

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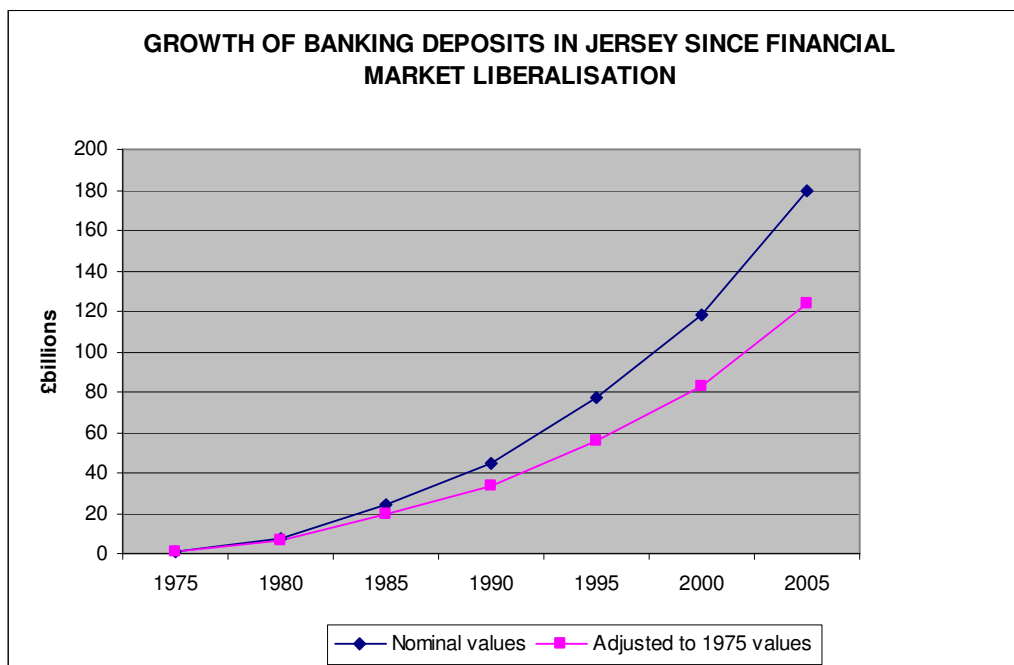
<sup>19</sup> Higonnet, René P., 1985, Eurobanks, Eurodollars and International Debt in Savona, Paolo & Sutija, George Eds. Eurodollars and International Banking. Basingstoke, Macmillan, 1985.

<sup>20</sup> Burn, Gary, 2005, *Re-Emergence of Global Finance*. London Palgrave.

<sup>21</sup> Commentary based on Palan R, Chavagneux C and Murphy R, 2007 unpublished.

operations in the British Caribbean. In the early to mid 1960s tax havens of that area came into being. Cayman, for example, began to develop from 1966 onwards<sup>22</sup>. Eventually the International Banking Facility was offered in New York from 1981, followed by the Japanese Offshore Market (JOM) in 1986. Both were modelled on the Singapore Asian Currency Market (ACU) which was set up in 1968 under the influence of that post Euromarket expansion of the tax haven sector. Bangkok also followed suit by setting up the Bangkok International Banking Facility (BIBF), Malaysia has somewhat similar arrangement in Labuan, as indeed, does Bahrain. According to some estimates, about one third of international banking in the U.S. is undertaken in IBFs and nearly a half of Japanese are in JOM<sup>23</sup>.

The structure of the offshore world now existed: it took one major kick for it to become a fully fledged component of the international financial scene and that came with the onset of capital account liberalisation in the late 1970s and early 1980s. This was driven by an ideology constructed upon ultra-orthodox liberal economic theory, laced with massive flows of petrodollars originating from the Middle East, which had much the same effect as the Eurodollars of the 1950s. The impact was dramatic. This graph shows the rise in cash deposits in Jersey over an extended period, expressed in constant value:



Source: Jersey Finance data analysed by John Christensen, Tax Justice Network

<sup>22</sup> See Sir Vassel Johnson, *As I See It*, Book Guild Ltd, 2000

<sup>23</sup> Palan R, Chavagneux C and Murphy R, 2007 unpublished

The offshore world grew exponentially, stimulated by financial deregulation and improvements in communications and information technology including fax machines and the internet.

But these are not the sole reasons why so many tax havens around the world enjoy British protectorate status or are members of the British Commonwealth. This has arisen because the UK encouraged many of its former colonies to turn themselves into tax havens. The intention was simple: it was hoped that by so doing they would cease to be financially dependent upon the Foreign and Commonwealth Office. This process has been evidenced on a number of occasions, and international opposition to the UK's policy has been documented, for example by academic Greg Rawlings with regard to the creation of the Vanuatu tax haven despite the opposition of the Australian government. The location of tax havens within the offshore world is by no means accident: in many cases it is deliberate and by UK design. This explains why the UK now has a moral obligation to lead the process of remedying the consequences of that short-sighted policy, which is harmful to UK interests, to the interests of developing countries, and those of our trading partners in the developed world.

### **The consequences of tax havens and OFCs being different**

The fact that not all tax havens are OFCs does have serious consequences. The fact that the terms are not synonymous, but are on many occasions used interchangeably is also a matter of serious concern because it has had considerable implication. This is most particularly true with regard to regulation of the 'offshore economy'. This is because, as will be noted later, the regulation of the offshore economy has been focussed almost entirely upon places i.e. the tax havens themselves. They have in turn been expected to regulate the offshore financial centres located within them.

This however ignores two issues. The first is that those OFCs are made up almost entirely of firms with no strong economic ties to the tax haven they are using and are, secondly, staffed by people with, if anything, even lower commitment to that place. It is apparent from the published career information relating to many OFC practitioners<sup>24</sup> that they do not originate from the places where they work and have usually worked in more than one tax haven. They are clearly highly mobile, which creates the real possibility that they will have relatively limited regard for the law of one jurisdiction, knowing how easily they can relocate if problems arise.

The failure to recognise this means that the OFC part of the offshore world is not effectively regulated, with processes of regulation being devolved to authorities that, as will be noted, have few resources to undertake the task devolved to them. The consequence is that regulation of the offshore world remains largely ineffective.

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<sup>24</sup> See, for example, <http://www.cimoney.com.ky/section/aboutus/default.aspx?id=45> accessed 13-5-08

## Types of tax haven

There are broadly speaking seven types of tax haven. These are as follows:

1. Incorporation locations, examples being Montserrat and Anguilla. In these locations there is no effective OFC. The tax haven is primarily used for the registration of entities such as offshore companies used in transactions recorded in other tax havens. These places have tended to be associated with very low effective regulation and minimal information disclosure.
2. Secrecy locations, examples being Liechtenstein, the Turks & Caicos Islands, Singapore and Dubai where secrecy is considered absolutely paramount and is heavily protected.
3. Specific geographic market suppliers. An example being the British Virgin Islands, which creates large numbers of corporate entities to service the Chinese demand for offshore entities, many of which are associated with what is known as 'round tripping'. Other examples include Panama, which serves the US market, and Jersey that specifically targets the London market whilst Vanuatu has served Australia.
4. Specialist service providers. These are tax havens that secure a specific type of business activity. For example, Bermuda and Guernsey target the reinsurance market whilst the Isle of Man has specifically set out to secure a market in companies floating on the UK's AIM market and Cayman has attracted hedge funds.
5. Market entry conduits. These tax havens seek to earn a margin from the routing of transactions through their domain because little tax is charged when this is done. Most seek to exploit their network of double tax treaties in the process and tend to be those that many would not consider tax havens. They include Malta and Cyprus who compete for funds being routed from the developing world into the EU; Mauritius which is a conduit for investment in India; the Netherlands, which acts as a location for holding companies for investment throughout Europe; and Belgium and Luxembourg which have at various times sought similar roles for themselves.
6. High net worth providers. These have the resources to actually manage the funds deposited within their domain by the world's wealthiest people and have the means of access to ensure that those people can get to see their fund manager with relative ease. They include Switzerland, New York and London.
7. The tax raider. This is a country that sets out to attract the relocation of profits to its domain where they are taxed at a lower rate than they might be elsewhere, but where there is a high degree of financial security and limited risk of the transactions being identified as taking place in a tax haven. Foremost amongst these locations is Ireland.

It is stressed, many tax havens play more than one role although by no means all of them combine all these roles. Offshore transactions are designed by offshore advisers to meet the needs of their particular clients and the choice of location in which transactions are registered and recorded (which need not be the same place) may be influenced by factors such as those listed above.

### Where are the world's tax havens?

A number of lists have been prepared over many years that seek to identify the places known as tax havens.

Based upon both an academic literature review and the various lists produced by regulatory agencies and others, mainly over the last decade, the following list of those places suggested to be tax havens over the last thirty or more years has been prepared by Tax Research LLP<sup>25</sup>:

Rank	Location	Int'l Bureau	Charles	Hines	OECD	IMF	FSF	FATF	TJN	IMF	STHAA	Low-TaxNet	Total
		Fiscal Docs	Irish	Rice 1994	2000	2000	2000	2000/02	2005	2007	2007	2008	
		1977	1982										
1	Bahamas	1	1	1	1	1	1	1	1	1	1	1	11
2	Bermuda	1	1	1	1	1	1	1	1	1	1	1	11
3	Cayman Islands	1	1	1	1	1	1	1	1	1	1	1	11
4	Guernsey	1	1	1	1	1	1	1	1	1	1	1	11
5	Jersey	1	1	1	1	1	1	1	1	1	1	1	11

<sup>25</sup> Notes as to sources:

1. International Bureau of Fiscal Documentation 1977 as quoted in Irish C, Tax Havens, Vanderbilt Journal of Transnational Law, 1982
2. Irish C, Tax Havens, Vanderbilt Journal of Transnational Law, 1982
3. Hines, James R, Jr & Rice, Eric M, 1994. "Fiscal Paradise: Foreign Tax Havens and American Business," The Quarterly Journal of Economics, MIT Press.
4. OECD, IMF, FSF, FATF listings in the year noted
5. Hampton M and Christensen J in 'Tax Us If You Can', The Tax Justice Network 2005;  
[http://www.taxjustice.net/cms/upload/pdf/tuiyc\\_-\\_eng\\_-\\_web\\_file.pdf](http://www.taxjustice.net/cms/upload/pdf/tuiyc_-_eng_-_web_file.pdf) accessed 13-5-08
6. Stop Tax Haven Abuse Act, published in the US Senate 2007;  
<http://www.senate.gov/~levin/newsroom/release.cfm?id=269479> accessed 13-5-08
7. Low Tax Net <http://www.lowtax.net/lowtax/html/jurhom.html> accessed 22-1-08

6	Malta	1	1	1	1	1	1	1	1	1	1	1	11
7	Panama	1	1	1	1	1	1	1	1	1	1	1	11
8	Barbados	1	1	1	1	1	1		1	1	1	1	10
9	British Virgin Islands	1	1	1	1	1	1	1	1		1	1	10
10	Cyprus	1		1	1	1	1	1	1	1	1	1	10
11	Isle of Man	1		1	1	1	1	1	1	1	1	1	10
12	Liechtenstein	1	1	1	1	1	1	1	1		1	1	10
13	Netherlands Antilles	1	1	1	1	1	1		1	1	1	1	10
14	Vanuatu	1	1	1	1	1	1		1	1	1	1	10
15	Gibraltar	1		1	1	1	1	1	1		1	1	9
16	Hong Kong	1	1	1		1	1		1	1	1	1	9
17	Singapore	1	1	1		1	1		1	1	1	1	9
18	St Vincent & Grenadines	1		1	1	1	1	1	1		1	1	9
19	Switzerland	1	1	1		1	1		1	1	1	1	9
20	Turks & Caicos Islands	1	1	1	1	1	1		1		1	1	9
21	Antigua & Barbuda	1		1	1	1	1	1	1		1		8
22	Belize			1	1	1	1	1	1		1	1	8
23	Cook Islands			1	1	1	1	1	1		1	1	8
24	Grenada	1		1	1	1		1	1		1	1	8
25	Ireland	1	1	1		1	1		1	1		1	8
26	Luxembourg	1		1		1	1		1	1	1	1	8
27	Monaco	1		1	1	1	1	1	1			1	8
28	Nauru	1	1		1	1	1	1	1		1		8
29	St Kitts & Nevis			1	1	1	1	1	1		1	1	8

30	Andorra	1		1	1	1	1		1			1	7
31	Anguilla			1	1	1	1		1		1	1	7
32	Bahrain		1	1	1	1	1		1	1			7
33	Costa Rica	1	1			1	1		1		1	1	7
34	Marshall Islands			1	1	1	1	1	1			1	7
35	Mauritius				1	1	1	1	1	1		1	7
36	St Lucia			1	1	1	1	1	1		1		7
37	Aruba				1	1	1		1		1	1	6
38	Dominica			1	1	1		1	1		1		6
39	Liberia	1	1	1	1				1			1	6
40	Samoa				1	1	1	1	1		1		6
41	Seychelles	1			1	1	1		1			1	6
42	Lebanon			1		1	1	1	1				5
43	Niue				1	1	1	1	1				5
44	Macau			1		1	1		1				4
45	Malaysia (Labuan)					1	1		1			1	4
46	Montserrat			1	1	1			1				4
47	Maldives			1	1				1				3
48	United Kingdom		1						1	1			3
49	Brunei	1										1	2
50	Dubai								1			1	2
51	Hungary							1	1				2
52	Israel							1	1				2
53	Latvia									1	1		2
54	Madeira								1			1	2

55	Netherlands	1							1				2
56	Philippines		1					1					2
57	South Africa		1						1				2
58	Tonga				1				1				2
59	Uruguay								1	1			2
60	US Virgin Islands				1				1				2
61	USA		1						1				2
62	Alderney								1				1
63	Anjouan											1	1
64	Belgium								1				1
65	Botswana											1	1
66	Campione d'Italia								1				1
67	Egypt							1					1
68	France		1										1
69	Germany								1				1
70	Guatemala							1					1
71	Honduras		1										1
72	Iceland								1				1
73	Indonesia							1					1
74	Ingushetia								1				1
75	Jordan			1									1
76	Marianas								1				1
77	Melilla								1				1
78	Myanmar							1					1
79	Nigeria							1					1

80	Palau					1							1
81	Puerto Rico		1										1
82	Russia							1					1
83	San Marino				1								1
84	Sao Tome e Principe								1				1
85	Sark								1				1
86	Somalia								1				1
87	Sri Lanka		1										1
88	Taipei								1				1
89	Trieste								1				1
90	Turkish Republic of Northern Cyprus								1				1
91	Ukraine							1					1
		32	29	40	41	46	42	37	72	22	34	41	436

It will be noted that there is remarkable agreement over a long time period with regard to the tax haven status of some locations; indeed the Bahamas, Bermuda, Cayman, Guernsey, Jersey, Malta and Panama appear on every list over this extended period. 22 locations appear on at least eight lists.

In practice those that appear on fewer than three lists are unlikely to be of consequence, with the exceptions of Dubai, Latvia, Uruguay, the US Virgin Islands, the USA, the Netherlands and Belgium. In addition Austria has never appeared on any list, but has significant tax haven characteristics. Ghana, although not currently on any of these lists, is creating the basis for becoming a tax haven, joining Somalia as the only other country on mainland Africa with such a status.

In effect this suggests there are about 56 countries worthy of serious consideration as tax havens at present. In saying that it should be noted that this excludes some countries such as Tonga listed as tax havens by the OECD where this activity now appears inconsequential.

**Who are the world's OFCs?**

An indication of where the world's most important OFCs might be found from a review of the locations in which the world's Big 4 firms of accountants<sup>26</sup> operate. The following study was published in February 2007<sup>27</sup>:

Tax Havens	Total Have ns	KPM G 1	KPM G 2	E&Y 1	E&Y 2	PW C 1	PWC 2	Deloit te 1	Deloit te 2
<b>Major Financial Centres</b>									
Belgium		1	1	1	1	1	1	1	1
City of London		1	1	1	1	1	1	1	1
Frankfurt		1	1		1	1	1	1	1
Hong Kong		1	1	1	1	1	1	1	1
Netherlands		1	1	1	1	1	1	1	1
New York		1	1	1	1	1	1	1	1
South Africa		1	1	1	1	1	1	1	1
Switzerland		1	1	1	1	1	1	1	1
Tel Aviv		1	1	1	1	1	1	1	1
<b>Sub Total: Major Financial Centres</b>	<b>9</b>	<b>9</b>	<b>9</b>	<b>8</b>	<b>9</b>	<b>9</b>	<b>9</b>	<b>9</b>	<b>9</b>
<b>Major Havens</b>									
British Virgin Islands		1	1	1	1	1	1	1	1
Cayman Islands		1	1	1	1	1	1	1	1
Cyprus		1	1	1	1	1	1	1	1
Dubai		1	1	1	1	1	1	1	1

<sup>26</sup> Deloitte, Ernst & Young, KPMG, Pricewaterhousecoopers.

<sup>27</sup> In Closing the Floodgates published by the Tax Justice Network  
<http://www.ubuntu.upc.edu/docs/doha/ClosingtheFloodgates.pdf> accessed 13-5-08

Guernsey		1	1	1	1	1	1	1	1
Ireland		1	1	1	1	1	1	1	1
Isle of Man		1	1	1	1	1	1	1	1
Jersey		1	1	1	1	1	1	1	1
Liechtenstein		1	1		1	1	1	1	1
Luxembourg		1	1	1	1	1	1	1	1
Singapore		1	1	1	1	1	1	1	1
The Bahamas		1	1	1	1	1	1		1
<b>Sub Total: Major Havens</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>11</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>11</b>	<b>12</b>
<b>Significant Havens</b>									
Aruba		1	1	1	1	1	1	1	1
Bahrain		1	1	1	1	1	1	1	1
Barbados		1	1	1	1	1	1	1	1
Bermuda		1	1	1	1	1	1	1	1
Costa Rica		1	1	1	1	1	1	1	1
Dominica		1	1		1	1	1		
Gibraltar			1			1	1	1	1
Hungary		1	1	1	1	1	1	1	1
Iceland		1	1	1	1	1	1	1	1
Labuan		1	1	1	1	1	1	1	1
Lebanon		1	1	1	1	1	1	1	1
Macao		1	1		1	1	1	1	1
Malta		1	1	1	1	1	1	1	1
Mauritius		1	1	1	1	1	1	1	1

Netherlands Antilles			1		1	1	1	1	1
Panama		1	1	1	1	1	1	1	1
Taipei		1	1	1	1	1	1	1	1
Turks & Caicos Islands		1	1			1	1		
Uruguay		1	1	1	1	1	1	1	1
US Virgin Islands			1			1			
<b>Sub Total: Significant Havens</b>	<b>20</b>	<b>17</b>	<b>20</b>	<b>14</b>	<b>17</b>	<b>20</b>	<b>19</b>	<b>17</b>	<b>17</b>
<b>Minor Havens</b>									
Andorra		1							
Anguilla		1	1						
Antigua & Barbuda		1	1			1	1		
Belize			1		1				1
Grenada					1	1	1		1
Madeira		1	1		1				1
Monaco					1			1	
Saint Lucia		1	1		1	1	1		
Saint Vincent & the Grenadines		1	1		1				
St Kitts & Nevis					1	1	1		
The Cook Islands		1	1						1
The Maldives		1	1		1	1	1		
Trieste		1	1		1	1	1		
<b>Sub Total: Minor Havens</b>	<b>13</b>	<b>9</b>	<b>9</b>	<b>0</b>	<b>9</b>	<b>6</b>	<b>6</b>	<b>1</b>	<b>4</b>

<b>Notional Havens</b>									
Alderney									
Campione d'Italia									
Ingushetia									
Liberia									
Marshall Islands								1	1
Melilla									
Montserrat									
Nauru									
Niue									
Samoa									
Sao Tome e Principe									
Sark									
Somalia									
The Marianas					1			1	1
The Seychelles			1						
Tonga									
Turkish Republic of Northern Cyprus									
Vanuatu									
<b>Sub Total: Notional Havens</b>	<b>18</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>2</b>	<b>2</b>
<b>Total</b>	<b>72</b>	<b>47</b>	<b>51</b>	<b>33</b>	<b>48</b>	<b>47</b>	<b>46</b>	<b>40</b>	<b>44</b>

Source: Tax Havens from Tax Us if You Can, a TJN publication.

Source: Accountancy and Audit firms column "1" from firm's own websites accessed during the autumn of 2006

Source: Accountancy and Audit firms column "2" from Google search engine accessed during the autumn of 2006

Research undertaken by Chris Steel BSc, ATTAC and TJN Jersey

<http://www.jersey.attac.org/>

It is apparent that some havens have not developed as OFCs. Those that have enjoy remarkably consistent coverage amongst these firms.

It is notable that the firms do not seek to openly declare all locations in which they work, bar PricewaterhouseCoopers.

### **The services tax havens supply**

The fundamental tax haven service is the supply of a means of avoiding the regulation that would be imposed on a transaction if it were to be recorded in the location where that transaction really takes place. This service is combined with secrecy, which ensures that there is limited opportunity for the jurisdiction affected to find out either that the regulation has been avoided, or by whom.

The regulations that might be avoided are:

1. Taxation. This can be with regard to taxation on natural persons (real people) or legal entities (such as companies) and cover issues as diverse as taxes on income, gains, inheritance, sales, gifts, wealth, property or even currency. Payroll and other indirect taxes of those who locate transactions in tax havens can also be avoided.
2. Accounting. Accounting requirements are often lax in tax havens, avoiding obligations that apply in many mainstream democratic nations. In addition, accounts are rarely put on public record in tax havens but are in the majority of mainstream states. Non disclosure of commercial transactions and who might be party to them is a major attraction for those using tax havens;
3. Matrimonial, family and insolvency. Assets are often hidden from spouses, other family members or creditors through tax haven structures;
4. Other regulations. The regulation of states with regard to financial services, health and safety, environmental issues, labour protection, property ownership, monopoly, trade, shipping, and just about any other issue can be avoided through the use of tax havens.

It is a mistake to assume that tax is the primary motive for everyone using the services of tax havens. It is not. However, those seeking to use them for the other purposes noted will typically also avail themselves of the secrecy a tax haven supplies to keep that fact from the authorities in their home location. This might include the tax authorities of that state since it is commonplace for tax returns to be produced in court in many countries when disputes relating to the noted issues arise. As such many will, once they use a tax haven for another purpose fail to report the income they have that arises there and which should be declared to their home authority. Once that happens they are also party to tax evasion, whether or not that was their original intent for using the location.

None of these things is possible without secrecy.

That secrecy is also used to hide criminal activity, but it should be noted that tax evasion and regulatory abuse is by far the most common criminal activity in tax haven. The following practices undoubtedly occur in tax havens, but are not limited to them:

1. Bribery and the purchasing of favour;
2. Hiding the proceeds of corrupt activities;
3. Money laundering the proceeds of crime;
4. Drug and other trafficking, including the trade in people and children;
5. Piracy;
6. Counterfeiting;
7. Racketeering;
8. Illicit political funding;
9. Fraud;
10. Evading political sanctions;
11. Tax evasion (where this is the primary motive of the transaction);
12. Theft (for example, from an employer);
13. Insider dealing.

As a proportion of transactions undertaken these are likely to be more commonplace in tax havens than in other banking systems because of their strongly applied secrecy rules. This does not mean that these transactions are not undertaken and found in other countries or their banking systems.

### **Tax haven secrecy**

Tax haven secrecy takes many forms. Perhaps the most commonplace is **banking secrecy**. It is normal for all banks to provide their customers with banking secrecy and confidentiality, but in many locations (the United Kingdom included) this is considered best commercial practice and is not mandated by law. In the UK, for example, banking secrecy is far from sacrosanct. All banks are, for instance, required to report interest earned on all accounts they maintain to HM Revenue & Customs on an annual basis, so breaking all UK resident persons' right to privacy of information with regard to this source of income.

This is not the case in many tax havens, and some locations which are not considered tax havens, where banking secrecy is protected by law<sup>28</sup>. Switzerland is considered the originator of the legal concept of banking secrecy which it enshrined in 1934. Although the Swiss would like to claim that this legislation was enacted to help Jews seeking to hide assets from the Nazis (and it may subsequently have been used for this purpose it was actually enacted following a public outcry in France, when wide scale tax evasion by eminent French personalities through the use of Swiss bank accounts was discovered. Rather than cooperate with the investigation Switzerland facilitated their tax evasion by guaranteeing bank secrecy by making it a criminal offence for any bank employee to disclose bank information for any reason whatsoever. The right of the government to bank information was also limited, and in most tax havens this combination of legalised banking secrecy combined with a very limited government right of enquiry (usually now restricted to criminal matters, which may exclude tax evasion and anti-terrorist enquiry) remains normal in most tax haven jurisdictions.

One of the exceptional aspects of the Liechtenstein tax scandal that broke in February 2008<sup>29</sup> was that it involved an employee of a Liechtenstein bank selling data stolen from his employer. This is exceptional. Many bank employees in tax havens are relatively low paid and are natives of those locations. They cannot take the risk of breaking bank secrecy laws without facing a long prison term or a lifetime in exile from their natural home. This has made breaches of banking secrecy rare because this group of employees of the offshore financial services industry are, unlike the more highly qualified members of staff within OFCs, internationally immobile.

**Trusts** provide another effective form of secrecy. Trusts can be described as a relationship in which a person or entity (the trustee) holds legal title to certain property (the trust property) but is bound by a fiduciary duty to exercise that legal control for the benefit of one or more individuals or organizations (the beneficiary), who hold “beneficial” or “equitable” title. To put it another way, one person says to a second “please look after this asset for me, but when doing so make sure (for example) that the income goes to this third person during their life and when they die the remaining property goes to another, fourth person”. All trusts are meant to incorporate this split of roles, responsibilities and entitlements. If they did not then there would be no need for a trust. The property would be owned absolutely by one person for their own benefit. This is not the case in a trust, the essential feature of which is that the original owner of the property has gifted it for the benefit of others, but with an intermediary (the trustee) managing that arrangement. For the trust to be effective the person making the original gift should have no further part in the arrangement.

Trusts are a feature peculiar to Anglo-Saxon (English) law but have become commonplace in many jurisdictions, especially in the tax haven world. It should, however, be stressed

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<sup>28</sup> Chile is one of the unexpected countries where this is the case, where it is protected by the constitution and would require an 80% vote in support of change for its abolition.

<sup>29</sup> See [http://taxprof.typepad.com/taxprof\\_blog/2008/02/a-liechtenstein.html](http://taxprof.typepad.com/taxprof_blog/2008/02/a-liechtenstein.html) for many links to original stories

that some countries survive quite happily without the concept, France being a case in point.

Trusts provide secrecy because they do not require any form of registration in most jurisdictions and even where registration is required (as it is with HM Revenue & Customs in most cases in the UK) that registration is not placed on public record. Nor is the trust deed which regulates management of the trust placed on public record, which might in any event not be possible in some cases: it is still possible for a trust to be created verbally and to be adhered to on that basis.

Trusts are very commonplace in the offshore world, and some jurisdictions, such as Jersey, Cayman and the BVI specialise in supplying them. Almost no tax haven is without trust law, however. The attraction is simple: the person creating a trust (the settlor) has considerable secrecy about doing so since the trust deed is not required to be registered in any tax haven, and in some it is not even required that they be named in the trust deed, creating a trust affords considerable anonymity for the settlor.

It is the trustees of a trust who are taxable upon the income they receive on the trust assets unless that income must be paid by them to another person under the terms of the trust deed. Most offshore trusts are what are termed discretionary trusts, where at least notionally the trustees can allocate the income to almost anyone they wish, which is almost invariably the case with a tax haven trust. Since the trustees will be professional people (accountants, lawyers, trust company officials or even trust companies) in the case of an offshore trust this ensures the trust earns and accumulates its income tax free. Because the trust is located offshore it does not have to declare the payment of income that it makes to a beneficiary to any tax authority so long as they do not live in the tax haven in which the trust is located, and there is no reason why they should. The payment of income can, therefore, be paid to the offshore bank account of the beneficiary without anyone in their home jurisdiction knowing. This obviously makes tax evasion through trusts relatively easy and safe.

This is made even easier as a result of legislation that has been created in the last few years in locations such as Cayman (Star trusts), the BVI (Vista trusts) and Jersey (trusts with reservation of powers). These trust arrangements, all of which appear to have been inspired<sup>30</sup> by members of the Society of Trust and Estate Practitioners (a 'professional' body based in London<sup>31</sup>) considerably distort the concept of a trust. As was noted when Jersey proposed this sort of legislation<sup>32</sup>:

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<sup>30</sup> <http://www.thelawyer.com/cgi-bin/item.cgi?id=113609&d=122&h=24&f=46> accessed 13-5-08

<sup>31</sup> <http://www.step.org/showarticle.pl?id=110;n=2500> accessed 13-5-08

<sup>32</sup> <http://www.taxresearch.org.uk/Blog/2006/06/15/jersey-passes-law-allowing-'sham'-trusts-for-use-by-tax-evaders/> accessed 14-5-08

*Jersey will now allow the creation of what can only be called 'sham trusts', although they're calling them trusts with 'reserved powers for the settlor'. What are those reserved powers? Well, the settlor can tell the trustee what to do, which means the trustee only has a nominee role. And the settlor can claim the property back, which means that no gift of assets into trust has taken place since they clearly remain in the ownership [and under the control] of the settlor in that case. And, because they can be claimed back the settlor is always likely to be the beneficiary of such a trust. In other words, the settlor continues to have complete beneficial ownership of the asset and there is in fact no trust in existence at all, just a sham that suggests that there is.*

*In that case what is Jersey actually doing by passing this law? It is creating a situation where a person can claim they have put an asset into trust but the reality is they have done no such thing. This is a completely bogus transaction. And why would Jersey want to do this now? I have no doubt that a primary reason is to assist people who wish to avoid declaring their income under the EU Savings Tax Directive or suffer tax withholding at source, which is the alternative. These new trusts assist that objective and shoot a massive hole through Jersey's claim to only want legitimate business in the Island.*

*There is only one purpose for this new law. It is to promote secrecy, and the prime use for that is to assist tax evasion.*

Jersey was aware of this. In September 2006 the Observer newspaper<sup>33</sup> was sent, apparently in error, an email exchange which showed the alarm within the government and civil service in Jersey at the potential abuse that the new Jersey trust law could be put to use in abusing Jersey's own domestic law by those of its residents who were so minded to evade their responsibility to pay tax in Jersey on their world wide income. The entire transcript was published by Tax Research LLP on behalf of the Tax justice Network<sup>34</sup>. Of note was this comment from Malcolm Campbell (Comptroller of Tax, States of Jersey) issued to the press on this leaked correspondence<sup>35</sup>:

*I am .. content that I will have .. powers to attack any tax avoidance .. on the domestic tax front ... It is a matter for other jurisdictions world-wide to take powers to themselves in their own domestic tax laws if they feel that their citizens are avoiding or evading their own domestic taxes.*

At its core this made clear that Jersey knew of the potential use of these new structures in what it called tax avoidance (but which was actually tax evasion) but whilst it was content

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<sup>33</sup> <http://politics.guardian.co.uk/economics/story/0,,1874125,00.html> accessed 14-5-08

<sup>34</sup> <http://www.taxresearch.org.uk/Blog/2006/09/18/jersey-what-was-really-said/> accessed 14-5-08

<sup>35</sup> Quoted in <http://www.taxresearch.org.uk/Blog/2006/09/18/jersey-callously-indifferent-to-tax-evasion/> accessed 14-5-08

to say it had powers to deal with the matter it was entirely indifferent to the tax loss that might arise to any other country as a result of their use. This is the tax haven attitude summarised succinctly.

The fact that places like Jersey, Cayman and the BVI have developed abusive structures of this sort since the crack down in regulating them has got under way shows that they are committed to their tax haven status, are committed to providing the means for tax evasion and are committed to developing what they consider to be innovative products that ensure they stay ahead of the regulators and their desire for information.

With this form of structure now available the offshore trust is doubly dangerous. Whilst this once provided anonymity for those who had genuinely placed assets into trust offshore, now it is little more than a legitimised sham behind which fraud can be hidden, unbeknownst to those tax officials and regulators making enquiry who have reasonable right to assume they are dealing with a legitimate entity created under law passed by a legislature acting with reasonable and legitimate intent.

## Companies

Alongside trusts, companies are the most common offshore entities.

The limited company is an invention of English law, dating back to the Elizabethan era, but becoming readily available without separate Acts of Parliament for each company incorporated from 1844<sup>36</sup> and with limited liability from 1855<sup>37</sup>. Yet again, a key feature of the offshore world is a UK invention.

A limited company is a corporation whose liability is limited by law. Most tax haven registered companies are limited by shares. That means each shareholder (either a natural or a legal person, and quite possibly a trustee) acquires one or more shares in the company (and it is rare that more than two shareholders in total are required, with one now being quite commonplace) and so long as they have paid the full subscription price for the share, which rarely exceeds one US dollar, a Euro or a pound sterling, the member will have no further liability for the debts of the company even if it becomes insolvent and is unable to pay its creditors.

A company is regulated by its Memorandum of Association, which states what it may do, and its Articles of Association which outlines how it will manage its business.

The company is run by a director or board of directors and its legal affairs are managed by its company secretary. The latter is not required in all tax havens. It is unusual for more than one director to be required.

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<sup>36</sup> The Joint Stock Companies Act 1844 (7 & 8 Vict. c.110)

<sup>37</sup> The Limited Liability Act 1855 (18 & 19 Vict. c.133)

A company is a legal entity in its own right and in the vast majority of tax havens has to prepare accounts annually to record the transactions it has undertaken. It is now rare for these to be required to be audited. A copy of the accounts should usually be supplied to the shareholder of the company.

So far this seems entirely reasonable. However, when the UK Parliament granted limited liability it realised that this was a privilege that might be abused and consequently built in a series of safeguards intended to protect both shareholders and those trading with a company from potential abuse. Those safeguards included:

1. Maintenance of a public register of companies, listing all those in existence;
2. A requirement that each company have a registered place of business at which it might be contacted;
3. A requirement that the company place on public record its Memorandum and Articles of Association so that those trading with it might know the powers that it had to engage in trade;
4. Details of its issued share capital and the names and addresses of those owning that capital so that an assessment might be made of its likely financial capacity to undertake its proposed trade, and that those providing it might be known;
5. Full information on its directors and company secretary had to be placed on record;
6. Its annual accounts had to be filed for public inspection;
7. If it borrowed money on a mortgage this had to be declared so that those trading with it might know there were preferential creditors who had higher claim upon its assets than they did.

In addition, laws were developed on what was, and was not, proper trading that regulated the conduct of directors.

Only with these safeguards in place was the right to trade with limited liability, which clearly prejudices the financial entitlements of others, granted to those willing to comply with the obligations placed upon them.

In tax havens almost none of these safeguards are in operation. Put simply, the information noted above that is required to be placed on public record to protect those dealing with a tax haven company can either be kept secret in a tax haven, or a nominee name can be used to hide the true identity of the person really undertaking the function that must be registered. So, and for example, it is very rare for Memorandums and Articles of Association to be on public record. If a registered office is filed it is simply a 'brass plaque' address and has no bearing upon the real location of the entity. Directors, shareholders and company secretaries can all be nominees. Accounts are almost never on public record in a tax haven. In most tax havens they need not be sent to any regulatory authority, including those responsible for tax because no tax is due by most tax haven companies. As such there is almost no oversight of the action of limited companies in a tax haven by the authorities located within it, simply because they have ensured that they have no information to

appraise for regulatory purposes. This cannot be by chance: we suggest that this is deliberate and undermines the whole intent of the regulatory process imposed on such places by the Financial Action Task Force and others (as referred to later in this report).

Shareholdings can in some places be issued in the form of 'bearer shares' which means that simply possession of share certificate is indication of ownership of the share. That ownership need not be registered. This is mechanism that can be - and is - used for money laundering.

Regrettably it must be highlighted that the UK is also a party to great many of these abuses. It is possible to use nominee registered offices, shareholders, directors and secretaries in the UK. Bearer shares are allowed<sup>38</sup>. Accounts are required to be filed, but little action is taken by Companies House if they are not: indeed there are perverse incentives to never file them because of the structure of the penalty arrangements. The UK acts as a tax haven in this respect and has to remedy these defects in its own company administration arrangements as a matter of priority to stop the tax evasion that doubtless occurs as a result.

The consequence is that tax haven companies provide an obvious opportunity for abuse of almost anyone who might trade with them.

This problem has been exacerbated by an offshore innovation that has also been developed in the last decade in response to the increase in offshore regulation. This is the creation of the process known as **redomiciliation**. The legal basis for redomiciliation was adapted from Delaware law. The process involves relocating the legal domain in which a company is registered from one territory with the power to register companies to another. So, for example, a company registered in Gibraltar might be redomiciled to the Isle of Man. Most tax havens now allow this process. Upon redomiciliation, the original date of incorporation and company existence remains the same and are unaffected by the change but the statute under which they are registered, the law that governs their regulation, the regulator with responsibility for them and the place of their registered office (which is invariably required to be in the domain of registration will all have changed. The advantages to the tax evader are obvious. At the first hint of an enquiry arising within a domain they can apply to have their company redomiciled to another location. It then legally ceases to exist in the place where the enquiry has arisen and is now somewhere else. The agency making enquiry of the company now has to (expensively and laboriously) start the process of enquiry all over again in another place. Of course, there is nothing to stop this game of cat and mouse happening time and again, in which case all chance of securing effective information exchange from a persistent abuser has virtually been lost. It cannot be chance that such structures have been created: the tax havens of the world have created this opportunity to facilitate tax evasion. There is no other logical reason for redomiciliation. Unsurprisingly

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<sup>38</sup> See <http://www.coddan.co.uk/s-4-uk-company-formation.html> for a supplier of many of these services.

many financial intermediaries operating offshore promote the attraction of redomiciliation<sup>39</sup>.

Other forms of limited liability entity have also been developed in the last decade to promote secrecy and to protect tax haven registered companies from claims. Amongst these are **limited liability partnerships (LLP)**. These are now to be found in the UK, but only because the Big 4 accountancy firms PricewaterhouseCoopers and Ernst & Young promoted legislation to create similar entities in Jersey, and threatened to leave the UK if not provided with similar opportunity in the UK<sup>40</sup>. These entities or variations upon them are now widely available in tax havens. They have a particular role in tax planning of major corporations as they are considered 'tax transparent'. In other words, whilst they legally exist in the tax haven they have no tax residence in that place and the embers of the entity are instead taxed as if they undertook the limited liability partnerships transactions. This allows legal ownership of assets and the location in which income arising from them to be split between countries, and this arrangement has featured in much complex tax planning, and much recent anti-avoidance legislation in the UK, including some to be included in the Finance Act 2008 with regard to both stamp duty avoidance and the loss of corporation tax. For those wishing for secrecy LLPs add another layer of opacity to obscure ownership of and entitlement to assets.

Protected cell companies (PCCs), and their variants achieve the same result. These entities were first created by Guernsey in 1997<sup>41</sup>. That territory has a specialisation in the provision of offshore re-insurance arrangements. In effect a PCC operates as if it were a group of separate companies except all are part of the same legal entity. There is, therefore a 'parent level' which provides management services for the company but in addition there are a number of further segregated parts called cells. Each cell is legally independent and separate from the others, as well as from the 'parent level' of the company.

As has been noted<sup>42</sup>:

*The undertakings of one cell have no bearing on the other cells. Each cell is identified by a unique name, and the assets, liabilities and activities of each cell are ring-fenced from the others.*

*If one cell becomes insolvent, creditors only have recourse to the assets of that particular cell and not to any other.*

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<sup>39</sup> See for example, and without any suggestion of impropriety being made <http://www.claristrustees.com/maltacompanyredomiciliation.htm> accessed 14-5-08

<sup>40</sup> For a description of what happened see <http://www.parliament.the-stationery-office.co.uk/pa/cm199899/cmselect/cmtrdind/59/81201a19.htm> accessed 14-5-08.

<sup>41</sup> [http://www.legalinfo-panama.com/articulos/articulos\\_41a.htm](http://www.legalinfo-panama.com/articulos/articulos_41a.htm) accessed 31-1-07

<sup>42</sup> [http://www.offshore-fox.com/offshore-corporations/offshore\\_corporations\\_030404.html](http://www.offshore-fox.com/offshore-corporations/offshore_corporations_030404.html) accessed 31-1-07

This use within the insurance sector is worrying. Anyone insuring with such an entity cannot be sure what assets might be used to cover their risk. No doubt that is the intent of those using them. More worrying though is their further possible use, of which some are now becoming aware<sup>43</sup>:

*The astute offshore practitioner can employ an offshore protected cell company as an effective asset protector and privacy enhancer.*

*With an offshore insurance corporation, it is market practice that provides tangible benefits; with the protected cell company, it is the structure of the entity itself -- think of a house with a locked front door, and rooms inside, each with a separate lock and key.*

*Protected Cell companies have -- in concert with other entities -- been used to construct what has been called "an impenetrable wall" against creditors and prying eyes. Whilst these claims can only be tested by time, this novel use of a PCC for asset protection and financial privacy is an interesting approach and a valuable piece of intellectual property.*

This is the logic of offshore: professional people use legislatures to create structures that they can sell to those wishing for secrecy, the only realistic use for which is the evasion of obligations arising under the laws of other countries, even if the motivation for creation of the original entity was honourable and had commercial logic inherent in it.

Guernsey is no longer alone in supplying these companies. It was quickly followed by Delaware, Bermuda, the British Virgin Islands, the Cayman Islands, Anguilla, Ireland, Jersey, the Isle of Man, Malta, the Seychelles and Gibraltar and others. They are now becoming commonplace. Information exchange arrangements will have to take them into account, although as yet it appears that no one has considered how to do so.

So rapid is development of structures in the tax haven world that Guernsey is now having to revise its 1997 laws for these entities because of the degradation in regulation offered in the intervening periods by other jurisdictions if it is still to attract entities wishing to use this form of structure to its territory. This is clear evidence of a regulatory 'race to the bottom'.

**Foundations** are another example of secretive structures. Most commonly associated with Liechtenstein and Panama, foundations might best be described as a form of trust that is recognised as having separate legal existence akin to a limited company.

The Liechtenstein foundation, which is that tax haven's principal product, has existed since 1926. There is almost no official record of the activities of a foundation so long as it is set

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<sup>43</sup> *ibid*

up for personal or family use by a person not normally resident in Liechtenstein. The name of the person creating the foundation is not recorded. The foundation must have a constitution, or deed but many of the foundations used for tax evasion will not require any form of registration at all to acquire their legal identity. Their existence is known only to the lawyers and bankers supplying services to them. They are bound by absolute secrecy by law. If registration is required (for example, because the foundation is charitable) no information of any sort concerning the foundation, including even its name is available to the public.

Foundations that do not trade in Liechtenstein do not keep to keep accounting records if they do not wish to do so. No accounts ever have to be sent to any authority. A tax charge of between 1/2% and 1% of the value of the foundation's capital assets is paid annually, although without records being required this is presumably not policed. Despite this 30% of Liechtenstein's state income comes from this source.

In combination this absolute secrecy backed by some of the strictest banking secrecy laws in the world mean that Liechtenstein offers no transparency at all.

The foundation's success arises from its combination of secrecy, legal existence separate from the layer managing it and from the settlor and non-taxable status.

This has not gone unnoticed. At the very time when the Liechtenstein foundation was creating massive new stories Jersey was proposing its own foundation laws <sup>44</sup>. The race to the bottom in regulatory abuse goes on.

### **Tax haven tax**

It is generally assumed that the attraction of tax havens are the low tax rates they have to offer. Quite clearly, this has to be true. Secrecy would be of no benefit if tax liabilities were not being hidden behind the veil it provides. Similarly, if tax evasion was not commonplace as a result of the low tax rates tax havens offer that secrecy would not be needed. The same is almost universally true of the other regulatory abuse that tax havens have to offer.

That said, tax havens do not offer low taxes without reason: the primary reason for them offering tax haven services is to raise revenue. They have economic interest in this process. They also do, of course, have their own domestic revenues to raise and the idea that they are tax free zones is not true. They have governments to run, and governments need revenue, however it might be raised. The nature of tax in tax havens does, therefore, need to be explained.

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<sup>44</sup> See <http://www.jerseyfinance.je/content/2553/index.html> accessed 15-5-08

A central feature of tax haven taxation is the ‘ring fence’. This arises when the tax haven decides to charge its resident population to a tax that it does not wish to apply to those using its tax haven services. For example, it might apply income tax on a worldwide basis on its resident population (Jersey, Guernsey, the Isle of Man, Switzerland and Liechtenstein do this, for example) but provide a mechanism that ensures that high net wealth individuals (HNWIs or Hen-Wees) using its domain do not suffer some or all of that charge. The UK operates such a ring fence through operation of the domicile rule<sup>45</sup>. More importantly, perhaps, the UK Crown Dependencies and some other tax havens have charged locally owned companies to income tax on their corporate profits but do not do so on companies owned by person not resident within their territory. This is a blatant ring fence, discriminating against that local population who also suffer serious anti-avoidance legislation to ensure they cannot make use of tax have services offered by other territories without suffering taxation penalty<sup>46</sup>.

The OECD described a ring fence as follows<sup>47</sup>:

*Some preferential tax regimes are partly or fully insulated from the domestic markets of the country providing the regime. The fact that a country feels the need to protect its own economy from the regime by ring-fencing provides a strong indication that a regime has the potential to create harmful spillover effects. Ring-fencing may take a number of forms, including:*

- a regime may explicitly or implicitly exclude resident taxpayers from taking advantage of its benefits.*
- enterprises which benefit from the regime may be explicitly or implicitly prohibited from operating in the domestic market.*

Many countries have operated these in the past. As will be noted below, The EU Code of Conduct on Business Taxation has been particularly effective in removing them from the taxation regimes of many EU member states but some tax havens, notably the Isle of Man, Malta and Jersey remain committed to them with regard to the taxation of corporate profits, and the UK has retained the domicile rule despite its abusive nature. In each case this means that significant taxation is raised from resident populations whilst non-resident populations and those claiming non-domiciled status maintain low or no taxes.

Other tax havens have no such issues. They do not operate taxes on income. These include, for example, Cayman, where most tax is raised from tourist levies and import duties. In that case there is no direct discrimination between local and non-resident tax rates and this particular feature of tax haven abuse does not arise.

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<sup>45</sup> For a discussion of the UK’s domicile rule and why it contravenes the UK’s race Relations’ laws see <http://www.taxresearch.org.uk/Documents/UKDomicileLaw03-07.pdf>

<sup>46</sup> Section 134a of the Income Tax (Jersey) Law 1961 is a general anti-avoidance provision designed in part to achieve this aim, and believed to be effective in doing so.

<sup>47</sup> <http://www.oecd.org/dataoecd/33/0/1904176.pdf> accessed 15-5-08

All tax havens charge fees for the operation of non-resident entities. For example, in Vanuatu it costs US\$150 to register a company and \$300 a year to maintain it on the register of companies<sup>48</sup>. In the Isle of Man the annual fee for a non-resident company is somewhat more at £320 a year<sup>49</sup>.

These sums can constitute a significant contribution to a tax haven economy, but how much is hard to assess. For example in the Cayman Islands the most recent published budget is for 2004/05<sup>50</sup> and a breakdown of government income was not included in the hundreds of pages of published data. Tax haven secrecy extends this far.

This secrecy is commonplace. It has, for example, been used to hide the fact that the government of the Isle of Man has enjoyed subsidies from the UK government now amounting to more than £200 million a year, a fact little known even in its direct competitors of Jersey and Guernsey. This is the result of the so called ‘common purse’ agreement<sup>51</sup> by which VAT revenues between the UK and Isle of Man are supposedly shared, but which has been designed since 1911 (in an earlier incarnation) to provide subsidy to the Isle of Man, since at that time it was suffering near famine conditions amongst its population. This is, of course, no longer the case, it having GDP per head greater than the UK, despite which the subsidy continues. The UK’s reason for granting this subsidy, renegotiated<sup>52</sup> as recently as 2007, cannot be established and has been seriously questioned recently.

The UK’s National Audit Office has also noted the anomaly of other, smaller subsidies such as the considerable cost the UK bears for regulating civil aviation in places like the British Virgin Islands even though they too have GDP per head higher than the UK<sup>53</sup>.

Even some forms of regulation intended to prevent tax haven abuse have actually boosted the coffers of the havens. For example, the EU Savings Tax Directive<sup>54</sup> requires that banks and other financial institutions in havens for which the UK and the Netherlands have responsibility as well as Switzerland and Liechtenstein deduct tax at a current rate of 20% on payment of interest to individuals resident in an EU state if the account holder refuses to disclose information on the income they have earned to their home state. The haven perversely receives 25% of the sum deducted as an illogical reward for its facilitating the tax evasion that is taking place.

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<sup>48</sup> <http://www.hawkeslaw.com.vu/default.asp?main=4&sub=18> accessed 15-5-08

<sup>49</sup> <http://www.gov.im/lib/news/fsc/budgetchangesmar.xml> accessed 15-5-08

<sup>50</sup>

<http://www.cayman.gov.ky/pls/portal30/docs/FOLDER/SITE8/20042005BUDGET/20042005BUDGETDOCFOLDER/2004-5+STRATEGIC+POLICY+STATEMENT.PDF> accessed 15-5-08

<sup>51</sup> [http://en.wikipedia.org/wiki/Common\\_Purse\\_agreement](http://en.wikipedia.org/wiki/Common_Purse_agreement) accessed 15-5-08

<sup>52</sup> For an in-depth analysis see <http://www.taxresearch.org.uk/Blog/2007/03/18/the-uk-paying-the-isle-of-man-to-be-a-tax-haven/> accessed 15-5-08

<sup>53</sup> See [http://www.nao.org.uk/publications/nao\\_reports/07-08/07084.pdf](http://www.nao.org.uk/publications/nao_reports/07-08/07084.pdf) accessed 15-5-08

<sup>54</sup> [http://ec.europa.eu/taxation\\_customs/taxation/personal\\_tax/savings\\_tax/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/index_en.htm) accessed 15-5-08

## 4. The use of tax havens

Describing the services havens supply is one thing: describing how OFCs exploit them on behalf of their clients is another issue altogether.

### Basic money laundering

The classic tax haven operation is sold as a package by many tax haven operators. Hawkes Law, a correspondent firm of KPMG in Vanuatu, offers a classic tax haven package to its clients. They advertise it as follows<sup>55</sup>:

*International Company, Bank Account & Trust Package*

*For individuals requiring an additional level of confidentiality.*

*Services Provided:*

*Setting up a discretionary trust*

*Trust maintenance fees to 30 June*

*Incorporation of an international company*

*Registered agent/office fees to 30 June*

*Assistance with a Vanuatu corporate bank account application, including debit card and internet banking.*

*US \$2,350*

It is stressed: there is nothing abnormal about this package. The combination of a trust, using local people as trustees, owning a company, using local nominees as director, secretary, shareholders and of course for the registered office. The agents introduce a bank (almost certainly from Australian banks Westpac or ANZ<sup>56</sup>) who will supply an internet service so the account can be run by the real owner from anywhere in the world, and a debit card is issued. This is commonplace. Debit cards issued by either Visa or Mastercard are now widely used for money laundering. This web site<sup>57</sup> offers anonymous credit card services, advertised as tax free when operated from offshore:

<sup>55</sup> <http://www.hawkeslaw.com.vu/default.asp?main=2&sub=1> accessed 15-5-08

<sup>56</sup> <http://www.theaustralian.news.com.au/story/0,25197,23652068-2702,00.html> accessed 15-5-08

<sup>57</sup> <http://www.offshoreatm.com/offshore-credit-card/prepaid-mastercard.php?gclid=CPLjkoOcqZMCFQOuFQodPzXz3g> accessed 15-5-08

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On phoning this company on 15 May 2008 the caller was advised that this was a New Zealand owned company based in the tax haven of Uruguay that could provide the services noted.

The debit card of this sort allows a person to spend the money they have deposited illegally in an offshore bank account in their home jurisdiction with little risk of discovery. Prepaid

debit cards have the same function. The role of credit card companies in providing these services through many tax havens has to be seriously questioned. It is hard to see what legitimate function they think these services could fulfil.

In combination these facilities provide a classic money laundering operation, regardless of whether the funds come from drugs trafficking or tax evasion.

The tiering of the operation, using a trust to hide a company which in turn may not have its name on the debit card is classic tax haven practice: it makes the arrangement harder to break when enquiry arises. Redomiciliation might allow the company to flee to a new jurisdiction if enquiry does arise. These arrangements usually fail for one reason: the card user has goods supplied to their home address making them easy to connect with the card.

### **More complex structures**

The majority of tax haven deposits, excluding those of an inter bank nature are believed to be by individuals, not major corporations. The Tax Justice Network estimated that in 2004 some US\$11.5 trillion<sup>58</sup> was held by individuals in the tax havens of the world using data from sources such as Cap Gemini, Merrill Lynch and Boston Consulting Group.

The basic structure noted above does have risk in it, not least because it is all in one jurisdiction. More sophisticated operations take this matter further, and will frequently use multiple jurisdictions in the course of their transactions. In doing so they seek to exploit the 'secrecy spaces' that tax havens allow an OFC operator to create. The secrecy space is created by the 'ring fence' that exists within any tax haven. The ring fence, whether of direct tax consequence as noted previously or not, has the purpose of determining in which section of the tax haven a transaction is located. In every tax haven there are of course real transactions that take place within that economy, and which are accounted for and even regulated within it. These are not a matter of concern. They can be located somewhere: that somewhere is the tax haven.

There are however other transactions that whilst notionally taking place within the tax haven actually have little or nothing to do with it. They take place 'elsewhere'. For example, in the case of the Vanuatuan offshore package noted above, the transactions that the structure will permit will notionally take place in Vanuatu, but in practice they will have little or nothing to do with that Pacific location. The nominees who supposedly run the trust and company that is being supplied will have little or no knowledge whatsoever of what it actually does, or why, and will not seek to know in all likelihood. The real operation will be run 'elsewhere' by a person operating a computer in their country of ordinary residence and the debit card will enable the transactions they control to be settled. These transactions, as far as Vanuatu is concerned are 'elsewhere' in a 'secrecy space' (simply defined as 'somewhere not here' (or 'offshore')).

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<sup>58</sup> [http://www.taxjustice.net/cms/upload/pdf/Price\\_of\\_Offshore.pdf](http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf) accessed 15-5-08

As was the case with the Bank of England when establishing the offshore world in 1957, those in the tax haven permitting this to happen will simply turn a blind eye to what is happening either entirely or in very large part because they know that any infringement of regulation is not happening where they are. This does not just happen in remote places like Vanuatu. In May 2008 the president of the Swiss Bakers Association, Pierre Mirabaud told journalists that his members don't regard themselves as responsible for their clients' actions. "We are not a tax authority and we are not a police authority," he said<sup>59</sup>. It should be assumed that this attitude to what happens elsewhere is commonplace. This is despite the fact that tax evasion in another state is defined as money laundering in the law of most countries. In section 2.7.5 of its new money laundering handbook (which has the basic force of law) the Jersey Financial Services Commission says<sup>60</sup>:

#### *2.7.5 Fraud related offences*

*Fraud, including fiscal offences (such as tax evasion) and exchange control violations, are commonly and mistakenly regarded as distinct from other types of crime for money laundering purposes. They are not. Any fraud related offence is capable of predicated an offence of money laundering in Jersey where it satisfies the requirements of the definition of criminal conduct within the Proceeds of Crime Law.*

It is these secrecy spaces that the OFC world manipulates, whether the law allows them to or not. It is the secrecy spaces that really make up the 'offshore' world where the transactions that cause concern take place. The space cannot, of course, exist without the secrecy jurisdictions that create them. It is, however, not in those jurisdictions, at least for legal purposes (and this will usually be made very clear in local law, for example on company residence). As such in many, if not most cases, the secrecy jurisdiction will argue it has no duty to regulate the transaction undertaken using the mechanisms it supplies from within the secrecy space, its logic being that these transactions are undertaken 'elsewhere'. That is why some Swiss banks comment as they do, as noted above, though for the record we would note that other Swiss Bankers are more overtly aggressive in their attitude: in an interview in Der Spiegel published in May 2008 Konrad Hummler, a partner in Wegelin & Co., Switzerland's oldest private bank justified tax evasion as a legitimate defence by citizens attempting to "partially escape the current grasp of the administrators of a disastrous social welfare state and its fiscal policies. . . .". Saving outside the system, he argued, is something to which not only the wealthy, but also productive small and mid-sized businesses are entitled: "These people must be protected," he said.

It is important to note that this lack of clarity over the location of transactions was not always the case. For example, when in 1929 the concept of the 'offshore company' was created by the House of Lords in the United Kingdom those seeking to prove that their

<sup>59</sup> <http://www.iht.com/articles/ap/2008/05/05/business/EU-FIN-Switzerland-Banking-Tax-Evasion.php> accessed 15-5-08

<sup>60</sup> [http://www.jerseyfsc.org/pdf/hbk%20part%202%20april%202007%20\(mlo1999\).pdf](http://www.jerseyfsc.org/pdf/hbk%20part%202%20april%202007%20(mlo1999).pdf) accessed 15-5-08

company was not in the UK for tax purposes did at the same time have to prove it was somewhere else, not just elsewhere. This concept of 'somewhere' is important. If a company created in a tax haven operates outside its regulated area but it is known despite that to be operating somewhere else then the risk of regulatory abuse is limited. The regulatory environment might be weakened by being located across more than one domain but regulation is intact. This diagram might make this clear:

	'Here'	'Somewhere'
Country providing the transaction structure	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B
Transaction type	Onshore	Regulated offshore

It is stressed: this diagram describes regulated transactions. What is happening here is entirely legal. Jurisdictions A and B might, for example, fully cooperate to ensure that the transaction is properly accounted for. But, as a matter of fact, for Jurisdiction A to consider that the transaction is 'somewhere' it must know the identity of Jurisdiction B and that that location in question has assumed responsibility for the transaction. If it does not know that then the claim that the transaction is regulated somewhere else is wrong.

Now the concept of 'elsewhere' as created by tax havens has to be added into this diagram.

	'Here'	'Somewhere'	'Elsewhere'
Country providing the transaction structure	Jurisdiction A	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B	Unknown
Transaction type	Onshore	Regulated offshore	Secret offshore

The secret space has now been created and the transaction that takes place within that space is now categorized. This concept of 'elsewhere' is critical: without understanding it the ideas and motivations of those working in the secrecy space in which 'elsewhere' is usually to be found cannot be appreciated.

There is one other transaction type to be noted. These are those that take place 'nowhere'. 'Nowhere' is the space that is the ultimate goal of the operator in the offshore world. If added to the diagram it looks like this:

	'Here'	'Somewhere'	'Elsewhere'	'Nowhere'
Country				

providing the transaction structure	Jurisdiction A	Jurisdiction A	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B	Unknown	Nowhere
Transaction type	Onshore	Regulated offshore	Secret offshore	Unregulated offshore

‘Nowhere’ in this case means that the jurisdiction which supplies the regulatory structure for the transaction cannot be identified. In the diagram it is Jurisdiction A that should have obligation to identify where the transaction undertaken by an entity created under its law is regulated. It does not do so though because it is a secrecy jurisdiction and has, therefore, no intent of making enquiry of the use made of such entities beyond its domain. In fact, even if it were to do so no jurisdiction can be identified in which the transaction is located for regulatory purposes, even if enquiry is made<sup>61</sup>.

This does not happen by chance. It happens through the interaction of ‘secrecy spaces’ provided by tax havens. An example might be where a person resident but not domiciled in the UK creates a trust in a tax haven such as the British Virgin Islands that in turn owns a company incorporated in the Isle of Man that has a bank account in Jersey and directors in Cayman. The income of that company and trust are retained within the company. This sort of structure is costly, but that is a price of being ‘nowhere’. This structure might achieve the aim of being unregulated almost everywhere and lightly regulated at best in just one location, being that where it has its bank account.

This is because the individual creating this trust is allowed to do so without breaching UK law subject to meeting the non-domicile requirements of that country. If they can then they are not taxable in the UK on their income arising outside the UK even though they are resident in the UK. Nor do they have to make any declaration of that income or their involvement with the trust in question to the UK tax authorities, or any other tax authority assuming they are not resident anywhere else (and are not a citizen of the USA, which uses a citizenship rather than residence basis to determine liability to its taxes). If this is the case the regulation of this trust does, with regard to the settlor, happen nowhere.

This can happen because trusts do not have to be registered or file tax returns in most tax havens. Nor do most tax haven companies have to file accounts with anyone. And if a bank account is located in a different tax haven from the company that owns it who regulates it? Maybe the jurisdiction of location is responsible for money laundering aspects of the account, but in the vast majority of cases they will satisfy themselves that tax evasion is

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<sup>61</sup> Examples of this phenomenon are to be found in the report of the US Senate Permanent Subcommittee on Investigations Hearing: Tax Haven Abuses: The Enablers, The Tools & Secrecy that reported in 2006. See <http://www.senate.gov/~levin/newsroom/release.cfm?id=260036> accessed 15-5-08

not taking place by simply noting that no liability could arise in the jurisdiction in which the company was incorporated because no tax could be due there. Splitting structures in this way over different jurisdictions makes it much easier for offshore financial intermediaries spread across a variety of jurisdictions to state that they have satisfied their local requirement to prevent money laundering even though the structure as a whole is abusive<sup>62</sup>. Having the directors in a location with no tax achieves the same result.

The combined result is that a structure can be created which is nowhere for tax purposes, and almost entirely so for all other purposes and yet apparently quite legitimately so.

More than that though, none of those involved, be they the settlor, the trust or trustees, the company or its directors, would need to file a tax return in that capacity anywhere by reason of this careful choice of structure. This is the ultimate aim of the offshore operator. For regulatory purposes this structure is nowhere. Achievement of this might not be possible in the physical world, but it is in this strange regulatory and secrecy space.

There is a final twist in the diagram that this represents. Another line is needed to explain what is, and is not in the secrecy space. This is indicated as follows:

	'Here'	'Somewhere'	'Elsewhere'	'Nowhere'
Country providing the transaction structure	Jurisdiction A	Jurisdiction A	Jurisdiction A	Jurisdiction A
Country providing regulation of the transaction	Jurisdiction A	Jurisdiction B	Unknown	Nowhere
Transaction type	Onshore	Regulated offshore	Secret offshore	Unregulated offshore
Space name	The transparent, regulated space		The secrecy space	

It is clear that there is a substantial difference between the transparent space, which includes transactions undertaken internationally where full disclosure is made to all who have need of information relating to that transaction, and the secrecy space where transactions are either legitimately not disclosed (when they take place 'nowhere'), or where required disclosure is suppressed (which is the case of those transactions that are 'elsewhere').

### Offshore providers

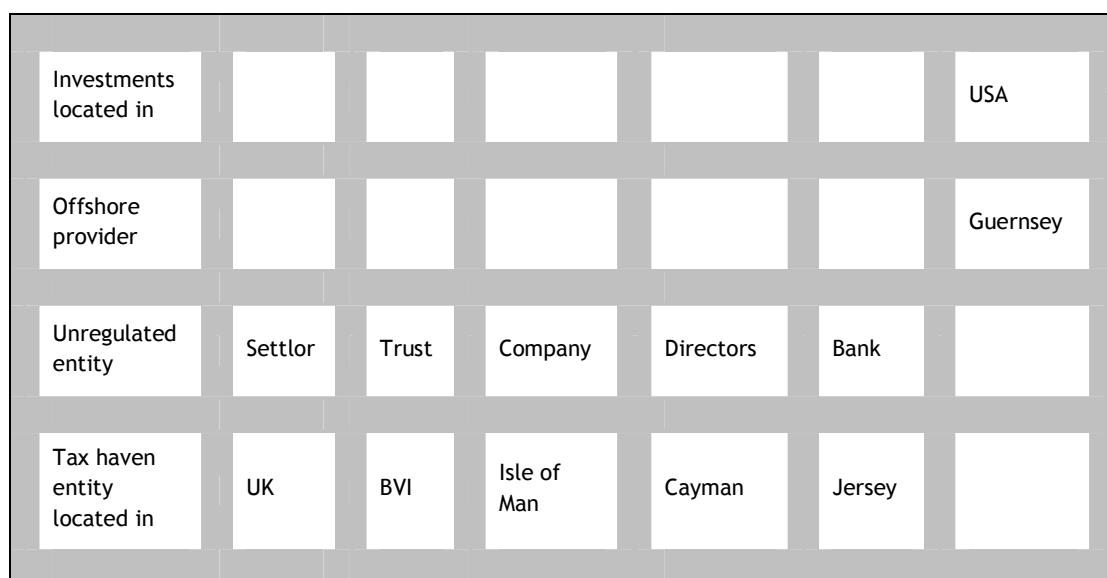
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<sup>62</sup> For examples, *ibid*.

There is then a further matter to be addressed. Quite clearly structures of the sort described in the preceding paragraph do not come into place by chance. They are created by people seeking to exploit the secrecy spaces which tax havens permit. These people may be (and often are) located in a tax haven themselves. They might even seek to establish their own operations in a secrecy space. But they are not part of the structure of any one tax haven, nor are they part of the secrecy space, which they exploit but do not create.

These people are the secrecy providers. They are the lawyers, accountants, bankers, trust companies and other financial intermediaries who provide the services needed to manage transactions in the secrecy space. Working in combination, these providers form the nucleus of Offshore Financial Centres. Individually they are offshore providers.

Using the definitions noted here the following diagram of a not untypical, but complex, offshore structure spread across many tax havens can be created for an arrangement where a Guernsey adviser creates a structure for a UK non domiciled person who has a trust in the BVI owning a company in the Isle of Man which has directors in Cayman, banks in Jersey and manages investments in the USA:



The importance of this diagram is not so much the white space. That white space is the identifiable geographic location in which certain structures, people and commercial organisations can be located. It is even possible to locate the offshore provider and the target for the whole structure within the white space: that investment target is in the USA in this example. But the important point is not the white space. The real issue about this structure is the grey space. That grey space is the secrecy space.

It is in the secrecy space that the unregulated entities, none of which have a duty to report to anyone, operate. The secrecy space surrounds, but is not in any of the secrecy jurisdictions. The secrecy provider might work from within a secrecy jurisdiction (very

often, indeed, they might sell services to unregulated entities working within that same jurisdiction) but they too, by selling services into the secrecy space can also work (at least in part) outside the regulated place in which their activity resides, and very often regulation exists to make sure that this can be achieved.

So it is in the grey secrecy spaces that the unregulated market exists, established by secrecy providers using unregulated entities registered in tax havens to move transactions from the regulated local or international sectors that are 'here' or 'somewhere' else that is identifiable into the secretly or knowingly unregulated spaces that are in mythical locations 'elsewhere' or, maybe 'nowhere' at all.

It is the grey, secrecy space that is the offshore world that the sophisticated user of tax havens seeks to exploit.

### **The corporate use of tax havens<sup>63</sup>**

International tax planning can take place whenever a company trades across an international boundary, but it is much more likely to take place when a company actually undertakes its activities in more than one country. When this happens it becomes a multinational corporation (MNC). It is likely that less than 10 per cent of the world's companies are part of MNCs<sup>64</sup> and maybe less than 1 per cent are the parent companies of multinational groups but it is estimated that their intra-group sales (i.e. transactions across international borders but between companies with common ownership) account for more than 60 per cent of world trade<sup>65</sup>.

To understand this it is important to note that whilst MNCs like to appear to be one entity, and indeed will publish accounts that suggest this is the case, MNCs typically consist of large numbers of separate companies. A parent company usually owns all or most of the others, and controls all the others because ownership of a company's shares provides that right in company law. The companies that the parent owns are called its subsidiaries. There can be just a few of these. There may be thousands. For example, a recent count at BP suggested it had more had more than 3,000 subsidiary companies around the world<sup>66</sup>.

This means that whilst the corporation may like to present a single front to the world, and one published glossy set of accounts, the reality is that when it comes to taxation there is

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<sup>63</sup> This section is based, in part, on Chapter 4 of 'Closing the Floodgates' published by the Tax Justice Network in February 2007 and produced with financial assistance from the Norwegian government. Available at <http://www.innovativefinance-oslo.no/pop.cfm?FuseAction=Doc&pAction=View&pDocumentId=11607> accessed 16-5-08

<sup>64</sup> This is based on the fact that only 0.5 per cent of all companies in the UK are plcs. Even if each has 20 subsidiaries on average in the UK that means 90 per cent of the register is UK based. Proof of this is not possible.

<sup>65</sup> OECD Observer April 2002

<sup>66</sup> BP Annual Return appendices dated 5 May 2005, lodged at Companies House in the UK

no such thing as an MNC. Each company that makes it up is taxed separately. It will usually be taxed in one of two places. The first is the country in which it is incorporated. For example, a company established under English law is always taxable on its worldwide income in the UK. Secondly it may be taxed where it trades. So, for example, a company incorporated in England but which has a branch in France will be taxed in France in the first instance on the income of the French branch and then, for a second time in the UK, but with credit given for the French tax already paid under the terms of the double tax treaty between the UK and France which has as its intention the elimination of double taxation. It is precisely because of the complications that this arrangement causes that most MNCs have separate companies for each activity they undertake in each country in which they operate. As a by product the resulting complex structure is guaranteed to provide enormous opportunity for an MNC to plan its taxation liabilities, and this is only increased when the options that tax havens create are added to the list of options available.

The ways in which a company can plan its tax affairs might include decisions on the following:

1. Where it will incorporate its head office:
2. Where it will incorporate its subsidiary companies:
3. Whether it will use tax havens or not;
4. What companies it will, or will not include in its group structure (which means which ones are added into the glossy accounts, and which ones are not);
5. On what terms it will trade between group companies.
6. Where it will record its sales;
7. Where it will incur its costs;
8. Where it will locate its assets;
9. Where it will employ its staff;
10. Where it will borrow money;
11. Where it will locate its intellectual property;
12. How it will structure its operations;
13. Whether it will seek special tax privileges.

This is a long list. Tax havens can be used at almost every stage. Each needs to be explored to show how a group of companies might plan its taxation affairs.

#### **1. Where to locate a head office.**

This requires deciding in which country a head office will be located. Sometimes the decision relates to what are called 'intermediate holding companies' instead.

The importance of the decision is determined by the fact that a company usually has to pay tax in the country in which it incorporated. So, choosing to locate a company in a high tax territory such as the USA (which has amongst the highest corporate tax rates in the world) can be expensive. However, major quoted companies usually need to be incorporated in a major financial centre such as London, New York or Frankfurt. The result is that tax cannot be minimised in those locations, although this is an arrangement now being challenged as some companies quoted on the London Stock Exchange seek to do so via parent entities registered in Jersey and tax resident in Ireland<sup>67</sup>.

Instead companies set up what are called 'intermediate holding companies'. These are owned by the parent company and in turn own the operating subsidiary companies. Little or nothing happens in the intermediate locations, except that they collect dividend income from the subsidiary companies they own and then usually loan, but not pay as dividends, the resulting cash that they hold to the parent company in London, New York, or wherever. The intermediate location is chosen for having low tax rates on dividend income received, a lot of double tax treaties with other countries to ensure that it is not treated as a tax haven (even though it is) and a favourable regime for taxing interest income, of which it may have a great deal. The most popular locations are Ireland, the Netherlands, Luxembourg and Switzerland, all of which offer these arrangements.

As has been noted above though, the possibility of this situation changing and what has, to date been the intermediate location now becoming the parent looks possible now, at least for London Stock Exchange companies. This is a process called 'corporate inversion', which was popular in the USA until about 2002, using Bermuda as the place to relocate a head office to achieve considerable tax savings. It was stopped by a combination of public outcry and legislation<sup>68</sup>.

## 2. Where a company will incorporate its subsidiaries.

A combination of tax law and other regulation makes it almost certain that an MNC will have subsidiary companies in each territory in which it operates. But then it has to decide if it needs others in locations that are purely tax driven.

Non-tax haven countries tend to have higher tax rates than the tax havens. A few geographically smaller developed countries, such as Ireland and the Netherlands also offer low tax rates on profits of some or all sorts. In this they join with the tax havens in seeking to increase their tax revenues by attracting profits to their shores which were not earned there but which are relocated to that country using some of the mechanisms described elsewhere in this report.

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<sup>67</sup> See <http://www.telegraph.co.uk/money/main.jhtml?view=DETAILS&grid=&xml=/money/2008/04/15/bcnshire115.xml>, for example. Accessed 16-5-08

<sup>68</sup> See <http://news.bbc.co.uk/1/hi/business/2167602.stm> accessed 16-5-08

Any group of companies has a simple decision to make. It has to decide if it wants to relocate its profits from the place in which they were really earned to places in which they may be declared, with reasonable chance of getting away with the relocation, with lower taxes being paid in consequence.

Many MNCs claim they have a duty to their shareholders to minimise the tax that the company pays<sup>69</sup>. There is in fact no such requirement in the law of most countries, including that of the UK where a much wider degree of discretion is provided to the directors of companies as to how they might manage the affairs of the entity they manage<sup>70</sup>. This claim of a 'duty' is actually used as an excuse to justify chosen corporate behaviour which palpably benefits the self-interest of the directors.

### 3. Whether a company will use tax havens or not

This question is related to that of where subsidiaries may be located, but not entirely. There may of course be a valid reason for locating a subsidiary in what is called a tax haven if a real trade is undertaken there. For example, a retail company running a store in Guernsey may wish to have a Guernsey based company for that purpose, and no suggestion of tax avoidance would result. However, when planning a group structure a company does have to decide if it not only wants the tax advantages some countries, such as the Netherlands, supply but also the lack of transparency that is also usually associated with tax havens where accounts and even proper ownership details do not have to be filed on public record.

Some companies undertake transactions which they would prefer not to disclose to the public, their shareholders, competitors, or regulatory agencies, including tax authorities. The anonymity provided by tax havens allows them to obscure the reporting of the trades they undertake in order to secure profit for their groups of company.

It is now almost universally agreed that transparency reduces risk, enhances the quality of corporate governance, reduces corrupt practices (including fraud) and must therefore be of benefit to society. But not all companies behave as if the interests of society coincide with those of their shareholders. If that is their opinion tax havens may well be attractive to

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<sup>70</sup> This issue was the subject of much debate during the passage of the UK's Companies Act 2006 through Parliament and it is clear as a result that whilst profit is important a much broader range of obligations need also to be considered by UK company directors. See section 172, Companies Act 2006 available at [http://www.opsi.gov.uk/ACTS/acts2006/ukpga\\_20060046\\_en.pdf](http://www.opsi.gov.uk/ACTS/acts2006/ukpga_20060046_en.pdf) accessed 25-1-07

It would be interesting to speculate what change in behaviour might result from explicit changes in legislation in this area. Clauses requiring companies to comply with the spirit of taxation law in all the territories in which they operated were introduced to the House of Lords during the debate on the UK Companies Act (partly at the suggestion of the Tax Justice Network) but were rejected by the government.

them because the risk of their trade being subject to serious scrutiny is reduced. On the other hand, they face questions as to the reasons for their choice of location from both taxation authorities and others, but might believe this a price worth paying for secrecy.

Such decisions are rarely made for taxation reasons alone.

#### **4. Which companies will, or will not be included in the group structure**

It seems logical to assume that all companies over which an MNC has control should be included in its group accounts and so be subject to scrutiny as part of its operations. Many companies, however, choose to hide transactions “off balance sheet”. This may be because the companies in question include liabilities that they would rather not recognise since they would make the MNCs’ finances look weaker; or those companies are being used to undertake transactions that change the view of the MNCs financial results e.g. by inflating profit (as was the case in the notorious situation of Enron).

MNCs can take advantage of situations where they can create ‘orphan’ companies. These are usually companies which are heavily dependent on the MNC for the trade that they undertake but which are theoretically not owned by it. This is usually achieved by placing ownership of the orphan company in a charitable trust located in a tax haven. This structure is then claimed to move both ownership and control of the orphan company outside the group so that its transactions may be treated as if undertaken by an independent third party. This technique is often used for financing debt e.g. from credit card customers, the customers of utility companies or mortgages, but the technique can also be used for other purposes, as Enron proved all too clearly<sup>71</sup>.

The use of what are clearly artificial structures created by professional people e.g. lawyers and accountants who claim independence from their clients whilst clearly working under their direction and control, raises questions about the ethical standards of these professions and the companies that use their services.

#### **5. What terms of trade will be used between group companies**

When companies engage with their customers or suppliers (‘third parties’) it is assumed that each party is out to get the best deal possible for themselves and that the resulting prices set for the trade will reflect that fact. These are called ‘arms length prices’. However, when two companies that are under common ownership trade with each other they do not necessarily want the best price for each individual company but may be motivated to set a price that gives the best overall result for the MNC of which they are a part. This will be influenced by the amount of tax that is, or is not, paid as a result of the consequent allocation of profit between the two subsidiary companies. For example, a

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<sup>71</sup> For a broader discussion of this issue see pages 12 - 17 of a report written by the author of this paper for a Scrutiny Committee of the States of Jersey available at <http://www.taxresearch.org.uk/Documents/4180-12935-2962005.pdf> accessed 25-1-07

company in Cyprus (tax rate 10 per cent) selling to a French company (tax rate 33.33 per cent)<sup>72</sup> has a strong incentive when both are owned by a UK parent company to overstate the selling price in Cyprus if the third party selling price in France is fixed because this will mean more profit is taxed in Cyprus at a lower rate than is charged in France than would otherwise be the case. This process of selling between related companies in an MNC is called ‘transfer pricing’ and is completely legal. Abuse of transfer prices may be illegal however, depending upon the countries involved.

MNCs have to set transfer prices. There can be no trade within the group if they do not. When doing so, however, they are in a position to make choices. Since before the Second World War the principle has been established in international law that prices between related companies in an MNC should be set on an ‘arms length basis’. This is believed to result in the allocation of the profit earned to the country in which it was generated and this is considered a just and equitable outcome.

Companies can decide whether they want to achieve this outcome. They can use their best endeavours to do so. It must be stressed however that this is not straightforward. There may be no way of determining the ‘third party’ price for some products transferred across international borders e.g. the price of a part finished component that will never be sold in that state to a customer has by definition no ‘arms length price’ and so estimates have to be made. Such process of estimating can be undertaken in good faith, or with the intent of disguising the reallocation of profit. Likewise, companies can decide to only operate ‘arms length prices’ in locations where a challenge to their policy is likely e.g. in the major developed economies where these matters are now subject to routine enquiry by tax authorities. This is not the case in developing countries. In December 2004 the multinational accounting business Deloitte reported in South Africa that they had never seen a successful transfer pricing challenge out of Africa<sup>73</sup>, and most countries in Africa do not at present have the legislation, the expertise or the legal and political confidence to raise such challenges against the MNCs that operate there.

## 6. Where a company will record its sales

It is inevitable that an MNC will trade internally. When doing this it can relocate transactions to give rise to favourable outcomes for taxation and other purposes. One transaction that can be relocated is where a sale is recorded.

Some products can be recorded as being sold from almost anywhere, and it is hard to prove that the claim is wrong. This is particularly the case with software and other intellectually based products sold on-line over the internet or where the sale represents a licence to use knowledge.

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<sup>72</sup> <http://www.kpmg.com/Services/Tax/IntCorp/CTR/> accessed 7-11-06

<sup>73</sup> Reported in *tax us if you can* TJN 2005 available from [http://www.taxjustice.net/cms/upload/pdf/tuiyc\\_eng\\_-\\_web\\_file.pdf](http://www.taxjustice.net/cms/upload/pdf/tuiyc_eng_-_web_file.pdf) accessed 25-1-07

Where real, physical products are involved it can be harder to relocate where a sale is recorded, but by no means impossible. For example, in the case of a mining company ore is extracted from the ground. That ore is, in the vast majority of cases destined for export. Decisions can be made as to where the sale of that ore is to be recorded. In the first instance, there must be a sale from the country in which it was extracted. That is obvious. But the condition in which it is sold is clearly a decision, and that can be tax driven. If the tax rate in the country of extraction is high, the ore may be shipped in unprocessed state even if that increases transport costs. The added value resulting from processing then takes place elsewhere, with lower tax charged. Alternatively, the ore can be processed first. That changes its value. The decision as to where to undertake this process changes the location in which the sale of the processed ore is located, and the tax bill that arises.

Even if the ore is not processed, alternative arrangements can be made for its sale. For example, it might be sold straight to a third party for processing. Alternatively, it may be sold within the MNC to a central marketing organisation (a common arrangement) which then adds a profit margin for the work it undertakes. This marketing organisation may be (and typically is) located in a tax haven. As a result part of the sale price has been relocated from the country of origin of the ore to the country in which the marketing operation is located, and this may well be a tax based decision.

Some of these decisions may be determined by genuine external factors e.g. the capacity of the country of origin to process the ore. Often they are not.

## **7. Where a company will incur its costs**

Just as there is an incentive to shift sales to low tax areas, there is an opposite incentive to shift costs to high tax areas where they will benefit from the greatest value of tax relief. This can be of importance for developing countries with relatively high tax rates. For example, many South American countries engaged in the extractive industries have nominal tax rates in 2006 of around 25 per cent.

Companies may decide to load costs into territories with relatively high tax rates. This trend may be exacerbated if this ‘cost loading’ gives rise to other benefits as well. Such a benefit might arise by inflating the apparent cost of production in the extractive industries, which can have the benefit of both reducing tax and reducing the proportion of production due to the host government under some mining and oil concessions, so giving a double benefit to the company engaging in such practices.

Cost loading can be as hard, or harder, to identify than sales mis-pricing since in many cases it will be even harder to establish a market price for the items in question. The principle of the ‘arms length rule’ of pricing still applies in these cases, but companies have considerable discretion over how they can interpret that obligation.

Amongst the costs that can easily be loaded are finance charges, central management costs, insurance, charge for the use of intellectual property and brands and the cost of supply of staff on secondment. In the widely reported case of WorldCom, accounting firm KPMG created an entirely new intellectual property right termed “management foresight” which was used to shift billions of profits offshore, though the foresight in question clearly failed to predict that company’s dramatic demise.

## 8. Where a company will locate its assets

A company has to buy certain physical property to undertake a lot of the work that it does. In the extractive industries, for example, this might include all the mining or drilling equipment it uses. Logically these would be owned in the country in which they are used by the entities which have the benefit of using them in their operations. In tax planning little is that simple.

The reason is that many countries offer special incentives to companies that invest in capital assets and give them tax reliefs and allowances which are much more generous than the accounting charges made for their use in the owning company’s published reports. The result is that the effective tax rates of the companies are reduced and the dates for payment of tax are deferred.

These reliefs can be exploited when combined with asset leasing arrangements. Some countries provide tax relief on the cost of assets that are leased to the legal owner i.e. the lessor. Others provide it to the lessee who hires the asset. If the lessor company gets the tax relief on ownership then it is also liable to tax on the income arising on the asset. Conversely, in countries where the lessee gets relief on the expenditure incurred on creating the asset they rent the lessor who has legal ownership of that asset is usually exempt from tax on most of the income it gets from renting it.

Companies can decide to exploit these rules for their benefit. They do this by a process called ‘tax arbitrage’ where they chose to locate transactions so that they get maximum tax benefit from them by trading off the rules of one country against the rules of the country that is taxing the other side of the arrangement.

So, for example, they might lease an asset from a country which gives generous reliefs both for expenditure on capital assets and also on the incomes received by the lessor company. The outcome of these favourable treatments is that the lessor company generates considerable up front tax losses on the deal, which are only cancelled out over a considerable period, and that company then leases the asset to a territory where the lessee company gets the relief on the capital cost of the expenditure, but no tax relief on the rentals paid. This means that the companies also obtain considerable up-front tax relief compared to cash expense incurred. The result is something called ‘double dipping’ in tax terms, where two lots of tax relief have been generated on one expense in effect, with in this case the transaction taking many years (maybe 25 years) to reverse, about which no

one cares much since they will no longer be in their jobs by the time any reversal of the effect takes place.

As a result assets are frequently legally owned in locations far removed from those where they are actually used.

## 9. Where a company will employ its staff

It seems logical that a company would employ its staff where they work. And so it can be for those who are on average earnings for the location in question. The company is likely to rely on these people to be the backbone of their operation, and those people are also unlikely to be either significantly mobile as to the location in which they wish to work or to be willing to engage in any serious tax planning on their employer's part.

But this might not be true for the more senior management of an MNC, many of whom will have joined it precisely because it offers the opportunity to work in a number of locations. They will most probably be internationally mobile and will be willing to participate in tax planning for their own and their employer's benefit.

The result is that these senior managers might be employed in locations which suit tax planning even if their duties are undertaken elsewhere. In fact, the split between the employment location and the place in which duties are undertaken may be deliberate. The reasons are:

- a. Managers might obtain a favourable tax treatment for their earnings if they are employed in a location which is not their long term home. This is because part of their income might not be taxed anywhere.
- b. The employer may choose to place the employment in a location where the tax or national insurance charges on employing the manager are low, as is typically the case offshore.
- c. Having a manager employed offshore allows the employer to create a new business based in the offshore location which supplies 'management services', the value of which for transfer pricing purposes is hard to prove so that profit can be extracted in this way from the company that receives the charge for these services.

A company might decide to organise their employment structures in this way for three reasons:

1. It allows them to manipulate their tax arrangements by adding another international service into the group which can be used for the purposes of profit reallocation to low or zero tax jurisdictions;
2. It can reduce the cost of employing staff;
3. It can increase the net reward to staff, so encouraging them to stay at no extra cost to the employer.

But in each case the local market for labour is upset. Overseas staff are favoured over local people. Allegiance to the company is greater as a result than allegiance to place. The duty of the staff to any particular country is undermined. And mobile staff who are dependent on their employers to create artificial structures which inflate their earnings tend to be more compliant, less inclined to whistle blow and more tolerant of other abuses if they happen within or without the company because that culture will pervade their own employment environment.

Companies might also engage staff through tax havens to save their own payroll obligations. This is currently an issue in the USA where many defence contractors with staff in Iraq and elsewhere engage their services through locations such as Cayman to avoid social security and health insurance costs. This has been the subject of much media and political debate<sup>74</sup>.

## 10. Where a company will borrow money

All business activities require finance to establish a physical presence in a location and to fund the day to day activities of the business. This money can be provided in two ways: share capital or loan capital. Share capital earns dividends payable from profits. Loan capital is paid interest regardless of whether or not profits are generated. Loan capital can be supplied by an external source e.g. a bank or venture capitalist group, or from an internal finance company within a group of companies. Internal finance companies are often set up offshore in locations such as the Netherlands and Ireland which have deliberately created tax structures to attract such 'businesses'.

Interest is much more favourably treated for tax than dividends. Interest is deducted from the paying company's profits for tax purposes and so reduces its tax bill. This does not apply to a dividend. Dividends can be subject to tax withholding from the country in which they arise i.e. part of their value has to be paid to the host country government. This is by no means always true of interest. A company can often arrange to receive interest in a low tax area and create a permanent tax saving. This is harder to achieve for dividends, especially if there has been tax withholding before they are paid.

The outcome of this different treatment is predictable. Companies have a bias to loan capital. So great is this incentive that by choice they will use almost no share capital and will have substantial loan capital in a foreign subsidiary. This is called 'thin capitalisation'. This reduces the profits in high tax areas because interest is paid from them, and also reduces the overall tax bill within the group because it allows for the interest to be received in a low tax area. The company might also, unless there is regulation in place to stop it, seek to charge whatever rate of interest it likes to maximise the profit it can extract from subsidiary company in a high tax area to then transfer it to a low tax location.

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<sup>74</sup> See [http://www.newsvine.com/\\_news/2008/05/07/1474618-ap-impact-an-islands-tax-haven-for-us-defense-contractor](http://www.newsvine.com/_news/2008/05/07/1474618-ap-impact-an-islands-tax-haven-for-us-defense-contractor) for example, accessed 16-5-08

Companies undertake this activity to maximise their financial return from the activities in which they invest by creating what can, quite often, be arbitrary financial structures motivated not by the needs of group financing but by a desire to abuse tax rules for the sake of increasing the after tax profit.

The abuse is often complex. For example, third party funds are borrowed in territories with relatively high tax rates and efficient capital markets where there is no restriction on the use of those funds when it comes to giving tax relief. The UK is an example of such a location.

The funds are then lent with very low margins earned to a financial centre e.g. Dublin. From there they are loaned on to foreign subsidiaries and the charge is inflated, especially if that subsidiary is in a high risk area such as a developing country, with the justification being that the funds to be used there if borrowed directly would have been subject to a higher rate of interest even though the group itself is not.

In effect this is another form of transfer pricing abuse, but this time on financial products created specifically for this purpose.

This practice is normally well regulated in developed countries, but this is not generally the case in developing countries.

## **11. Where the company will locate its intellectual property**

This decision perpetuates a recurring theme throughout this discussion, which is one of how an MNC might structure its affairs in order to maximise the number of transactions crossing international borders. Doing this maximises the opportunities for relocating profit to low tax areas.

Intellectual property comprises patents (on which royalties are paid) and copyrights (on which licence fees are paid). There are other variations on this theme but these two categories are sufficient to cover most issues.

Intellectual property may have been acquired by an MNC from a third party or, more likely, has been created by it. For example, Audi claim they filed 9,621 patent applications when creating their new A6 car. Any company might decide where it wishes to locate ownership of its patents or copyrights and this need not be the country of their creation, with little or no tax penalty arising on relocating them to a low tax country before they have been used and have therefore been proved to have commercial worth. The same is true of copyright material, such as logos. The Virgin corporation, for example licences the use of its Virgin logo to all Virgin operations from the British Virgin Islands. Microsoft holds the copyright of

most of its products for sale outside the USA in Ireland - a low tax state<sup>75</sup>. The result is that it appears to be largest company in Ireland, though the vast majority of its income in that country has little to do with its activities located there.

It is notoriously difficult to prove the value of intellectual property. This means it is an especially popular mechanism for shifting the location of profits from both developed and developing countries into low tax locations.

Almost any company can 'create' licensed intellectual property. Even its own name can fall into this category. In many cases the legal registration of this property is quite unnecessary. The charging of a fee for its use is quite often even less justified.

An MNC has to decide if it wants to undertake this activity which is largely designed to facilitate the shifting of profits to tax havens. This issue is at the core of the debate in the UK in 2008 on companies seeking to leave as a result of the UK's threat to tax income earned in tax haven subsidiaries from exploitation of intellectual property as if those tax haven companies were located in the UK<sup>76</sup>.

## 12. How a company will structure its operations

This theme brings together a number of previous threads. It involves decisions on:

1. Where to incorporate;
2. Where to borrow;
3. Where to place subsidiaries and intermediate holding companies.

Each of these, and indeed the other issues addressed above, can be seen as discrete decisions. But they are also viewed collectively by most MNCs. What they are seeking to do is to create a structure for their MNC which minimises tax. In doing so they are likely to:

1. Make full use of taxation treaties between countries to ensure that the least possible tax is deducted at source from any dividends, royalties, interest or licence fees paid, thus ensuring they arrive in the parent company with as little paid in tax as possible;
2. Secure favourable tax treatment by accumulating reserves in low tax jurisdictions such as the Netherlands, Ireland and Switzerland with an extensive range of double tax treaties;
3. Seek to use 'conduit' companies to turn income from relatively unacceptable sources e.g. those subject to a tax holiday (e.g. in a developing country) into an acceptable source to which a double tax treaty exemption from further taxation can be applied. Cyprus is frequently used for this purpose.

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<sup>75</sup> For an extract of the Wall Street Journal article on this see [http://www.finfacts.com/irelandbusinessnews/publish/article\\_10009467.shtml](http://www.finfacts.com/irelandbusinessnews/publish/article_10009467.shtml) accessed 16-5-08

<sup>76</sup> See <http://www.accountancyage.com/accountancyage/analysis/2216631/uk-corporates-moving-overseas> accessed 16-5-08

4. Seek to exploit loopholes between double tax treaties to minimise tax obligations e.g. by double dipping as noted above. This practice has recently been attacked by a number of tax authorities.

Other possibilities occur and are exploited by some companies.

The decision the company makes on this issue is essentially political. It is one of deciding whether the corporation exists within national spaces called countries, and is therefore subject to the rules and regulations of those spaces, or whether it wishes to float above and between those spaces and exploit the gaps between them by finding loopholes in the double taxation treaties that regulate the international taxation environment. These spaces are, of course, the secrecy spaces referred to in the preceding section of this chapter.

The current structure of accounting encourages MNCs to see themselves as independent of any nation state. The accounts that they publish are 'consolidated'. They do not actually represent the results of any individual company within the group. Instead they represent the net outcome of the transactions between all the MNCs and third parties. But transactions within the MNC are entirely eliminated from that reporting. In this way consolidated accounts do themselves create another special form of secrecy space in that they are an artificial construct that hides much from view, to the advantage of those who can use them.

As a result the local base for each and every company within the MNC is ignored in the published accounts, which consequently float above the national spaces as if independent of the locations in which the company works.

This perception is one that many companies now replicate in their tax planning. They can create complex group structures knowing that they do not have to report on them. They can also exploit the gaps between the countries in which they either work, or in which they choose to locate operations for the benefit (as they see it) of their investors (even though they are, inevitably rooted in those self same national spaces) because whatever they do is similarly unaccountable.

The structures of international tax have also until recently encouraged this because they have been poor at exchanging information between nation states or at enforcing international taxation liabilities. The consequence has been that an ethos of abuse has developed, with the interests of the company being seen as superior to those of the state.

The company has to decide whether to accept this philosophy, or not.

### 13. Whether a company will seek special tax privileges

There is a final option available to companies. They might simply ask the state for special tax concessions.

Sometimes these are given by way of grants or subsidies. On occasion they are given by special tax allowances e.g. by granting accelerated tax allowance for capital expenditure in certain industries which have the effect of ensuring that MNCs in that sector do not pay tax for an extended period even though they are profitable. They can simply involve taxation holidays granted to particular companies whilst they are establishing themselves in a territory e.g. a ten year period is common in this respect. Alternatively, they can involve specially negotiated tax rates as is frequently possible in tax havens.

The final option is to negotiate what is called a 'fiscal stability clause' which guarantees the company that the state's tax laws will not be changed to its prejudice for the foreseeable period. This period can be 25 years or more. These provide certainty to the company undertaking inward investment but seriously limit the scope for future economic management through use of fiscal policy on the part of the country that offers them.

The acceptability of these practices varies. Some subsidies and grants are almost above suspicion. Special tax allowances are usually beyond international reproach if offered to both local as well as incoming businesses. This is sometimes acceptable to a government because there is almost no local trade of similar type. Tax holidays and negotiated tax rates are widely frowned upon and income subject to such regimes is usually denied the benefit of the favourable treatment often afforded by double tax treaties. However conduit tax havens such as Cyprus can often be used to convert income of this unacceptable sort into income that is acceptable under double tax treaties.

In all cases there is a direct conflict in these arrangements between the state and the MNC, with the balance being decided between the amount of estimated economic benefit the state secures when traded against the tax it loses. If, however, the incentives offered are linked to unacceptable commercial practices the balance of the equation quickly moves into areas where fraud and other malpractice is either suspected or occurs in practice. When that is the case the state is unlikely to benefit from the negotiated arrangements even if the MNC does.

In deciding whether to avail itself of these options the company has to assess the risk to its reputation from doing so. A company might also consider whether it is allowing tax to cloud its commercial judgement: there are studies showing that tax incentives often result in business activities being undertaken in areas which are not favourable and that the outcomes do not meet the expectations of either the business or the government.

There is limited risk in taking opportunity of available tax reliefs or grants. There is increasing risk as a company moves into negotiating special allowances, tax holidays, special rates and fiscal stability clauses. Some companies choose not to do this. Others use the opportunities provided by the rules of corporate reporting, which allow intra-group transactions to be largely ignored to suppress details of such trading. This is done in the

hope that the negative aspects of such deals can be kept out of scrutiny whilst the positive advantages to cash flow are enjoyed.

Along with many of the decisions to be taken by a company with regard to the issues listed in the paper, this is an ethical choice and the MNC has a position to take on this issue which it cannot avoid, and about which it should be open and accountable.

### **The use of tax havens by individuals**

The use of tax havens by corporations can, in many cases, be legitimate, even if the consequence may appear unacceptable to many.

In contrast the use of tax havens by individuals tends to be for illegal purposes, although there are, of course, exceptions. The main uses individuals' make of tax havens have already been discussed in chapter 2 and are not repeated here.

### **Conclusion on the use of tax havens**

Tax havens are used for a range of purposes. In most cases though the secrecy spaces that they permit, and which accounting rules also permit, are abused to ensure that transactions take place in secret, beyond apparent regulation or accountability.

This results in considerable harm. First they hide corrupt practices. This usually involves bribery or the corruption of public officials, and this is the definition of corruption that has been widely promoted by Transparency International, who state it to be “the misuse of entrusted power for private gain”<sup>77</sup>. This issue is of great significance, and often involves the use of tax havens, but its role should not be overstated. When estimating the relative importance of different forms of capital flight, almost all of which go through tax havens, Raymond Baker of Global Financial Integrity has estimated that just 3% relate to corruption<sup>78</sup>. Baker's figures are accepted by the World Bank as the best currently available.

There is no doubt though that this corruption, which would be hard to undertake without the existence of offshore, is immensely harmful. It undermines confidence in aid, which reduces aid budgets. The process of government in many countries in the world is also fundamentally harmed by widespread corruption, which because it permeates from the heart of government down to all layers of the administration erodes the relationships of trust between people and government, causing incalculable harm to the economies of the countries in question, failure of the rule of law, difficulty in promoting local enterprise because of the increased cost of capital that results and the misallocation of resources in

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<sup>77</sup> [http://www.transparency.org/news\\_room/faq/corruption\\_faq](http://www.transparency.org/news_room/faq/corruption_faq) accessed 2-6-08

<sup>78</sup> [http://www.gfip.org/index.php?option=com\\_content&task=view&id=109&Itemid=74](http://www.gfip.org/index.php?option=com_content&task=view&id=109&Itemid=74) accessed 2-6-08

these places. The arising cost, whilst impossible to estimate, is largely attributable to tax havens.

Tax havens also facilitate crime, whether it be money laundering, drugs trafficking, human trafficking, racketeering, fraud, insider dealing, piracy, and the purchasing of favour. Baker estimates that this represents 30% to 35% of illicit financial flows<sup>79</sup>. Terrorism financing, which is of course a principal focus of the FATF, makes up a tiny part of this. It is apparent that these activities, all of which also lead to tax evasion, are the cause of considerable harm to society. The closure of tax havens would not eliminate these activities, but it would make them harder. This is an area where Britain could act unilaterally since some locations, such as the British Overseas Territories, are known to be vulnerable to these activities due to their poor application of money laundering rules.

As importantly, tax havens promote tax evasion and aggressive forms of tax avoidance (the distinction between the two often being hard to make because of the interaction of laws). Baker estimates that tax driven illicit cash flows amount to 60-65% of all illicit flows. This suggests that flows motivated for this purpose have a value of between US\$600 billion and US\$1 trillion a year. Half of this might come from developing countries.

The Tax Justice Network has estimated that US\$11.5 trillion of funds are held offshore by individuals, based on data published by major banks and financial services institutions in 2004<sup>80</sup>. They estimate that US\$255 billion of tax is lost to the countries of the world as a result.

The OECD estimates a lower level of funds held offshore, at between US\$5 - US\$7 trillion, but their estimate excluded non-financial assets, which the Tax Justice Network estimate included.

Christian Aid has estimated that the cost of lost corporate taxes to the developing world is currently running at US\$160bn a year (£80bn). That is more than one-and-a-half times the combined aid budgets of the whole rich world - US\$103.7bn in 2007. As a result of transfer pricing abuse alone they estimate that lost revenue contributes to the death of 350,000 children a year<sup>81</sup>.

These though are the more obvious impacts of tax havens. Their indirect consequences are at least as harmful, and yet have been almost entirely ignored by economists although the reality is that economic theory provides the clearest evidence that tax havens must harm the health of the global economy. This is because neo-classical market economics says that three things are needed to ensure an optimal outcome results from the operation of a market. Those things are equal access to capital, equal access to markets and the

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<sup>79</sup> ibid

<sup>80</sup> [http://www.taxjustice.net/cms/upload/pdf/Price\\_of\\_Offshore.pdf](http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf) accessed 2-6-08

<sup>81</sup> <http://www.christianaid.org.uk/images/deathandtaxes.pdf> accessed 2-6-08

availability of perfect information to ensure the optimal allocation of economic resources to efficient activity.

Tax havens deliberately set out to subvert all three of these requirements. They do this by exploiting the one, so called, competitive advantage they have. That advantage is not low tax rates. Indeed, the tax rates for many ordinary people who live in tax havens are not that low when compared to middle classes elsewhere. It is secrecy that provides that advantage, coupled with the fact that only some, highly selected groups of people are can hide behind that secrecy veil to claim that they locate their activities in tax havens that gives them their advantage.

That secrecy is used to ensure that those who can use these places, legally or illegally, have access to capital at lower rates than those who do not have that access. This lower cost of capital results from the fact that those who can hide behind the veil of tax haven secrecy accumulate their capital faster because it is in a tax free environment.

Second this limited access to tax haven secrecy is used to deny access to markets on an equal footing. Of course this happens in the tax havens themselves: in most such places tax haven operations are ring fenced from the local economy for fear they will undermine local markets and tax revenues. The irony of this is extraordinary.

More importantly though, given the inevitable and appropriate nationally based measures to tackle tax avoidance and evasion that countries must implement if they are to fulfil their democratic mandate, most ordinary people and almost all small and medium sized businesses in the world cannot use offshore structures to access the markets that the wealthy, law breakers and multinational businesses can access at lower cost using tax haven facilities. This puts the ordinary person, the law abiding person and small business at a deliberately constructed competitive disadvantage.

Third, the secrecy that allows this to happen also undermines all the principles of open access to information that are essential to ensure that the effective decision making resulting in optimal allocation of resources in market economies takes place.

The result is obvious. Tax havens set out to undermine effective markets, and that is the goal they succeed in achieving. As a result tax havens do not extend liberty, as some would claim, they are actually designed to grant monopoly rights to a privileged few, and that is exactly what they do.

Those few are the wealthiest of the world, the largest businesses of the world and the lawbreakers of the world. Those groups exploit that monopoly advantage as all monopolists do, to close down effective competition. The result is simple. The richest have got wealthier at the expense of the middle class and the poor who have to pay the taxes to provide the services multinational business demands. Multinational business meanwhile squeeze out medium and small nationally based business that have an unfair higher cost structure than their larger rivals and the poorest nations of the world that do not have the

resources to challenge the haemorrhage of illegal and mispriced money from their shores subsidise the tax take of the richest nations of the world. Throughout all this democracy is undermined, as is the rule of law.

The economics of this then are simple, and unambiguous. Tax havens must, and do, harm economic well being for all but the minority who can use them because they do wrongly allocate economic resources and inappropriately allocate the reward of economic activity.

In that case it is unsurprising that attempts have been made to regulate tax havens. It is to these attempts that we turn next.

## 5. The silence of the regulators<sup>82</sup>

Tax havens and OFCs have emerged as one of the key areas of concern for international economic organisations in the past fifteen years. Due their complexity and diversity they have attracted the attention of a number of organizations for different reasons. As a result, a number of campaigns, running in parallel, are currently aimed at tax havens/OFCs. The main actors in these campaigns are the familiar international financial institutions (IFIs) joined, from time to time, by national agencies such as tax authorities, treasury departments, trade and other agencies of the state. The international organizations have been primarily concerned with four issues: harmful tax competition, financial stability, money laundering and the need to track terrorist financing.

The principal campaign against tax havens in terms of resources and political capital invested began in the late 1980s and is concerned with laundering the proceeds from narcotics trafficking and, more recently, terrorist finance. This campaign has been led by the Financial Action Task Force for Money Laundering (FATF) with support from the IMF, the World Bank and the Financial Stability Forum (FSF).

The second campaign, initiated in the late 1990s, was concerned with harmful tax competition. This campaign has been led by the OECD, but the EU has subsequently emerged as a significant player, with a number of national tax authorities, including the UK, and more surprisingly, the Irish and the U.S. playing a significant part.

A third concern is with financial stability and the so-called New International Financial Architecture (NIFA). The organizations most concerned with these issues are the International Monetary Fund (IMF), the Financial Stability Forum (FSF) and the Bank of International Settlements (BIS).

Perhaps unsurprisingly, each of these organisations has defined tax havens and the issues relating to them in different ways, resulting in their taking differing approaches to the campaigns they have pursued. That said, in many cases their involvements overlap with each other and between themes. Importantly, despite the plethora of initiatives, there are major gaps on issues where the IFIs have been largely silent, most notably in respect of commercially related illicit financial flows arising from trade mispricing, and tax evasion. This silence is significant since the available evidence suggests that trade related illicit financial flows account for the major part of illicit capital flight from developing countries into the financial centres linked to the North.

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<sup>82</sup> This chapter is based on **What's in a Name? Tax Havens, Offshore Financial Centres and Global Governance** Ronen Palan, Richard Murphy and Christian Chavagneux, Paper presented at the SGIR conference, Torino 13-15<sup>th</sup> of September, 2007, with permission.

This section offers an analysis based on the approach each organisation has taken to the campaign against tax haven activity. This analysis is followed by a commentary on the effectiveness of these campaigns and analysis of how the tax havens have reacted to them.

### The Bank for International Settlements (BIS)

Among the premier international organizations, the Bank for International Settlements (BIS), the so-called central banker's bank, whose customers are central banks and international organizations, has been most assiduous in insisting on use of the term OFC when engaging with the tax haven issue.

The BIS used to describe OFCs as territories whose financial activities did not develop 'organically'. The BIS, however, never defined the meaning of organic growth of financial centres. More recently, the BIS has adopted a variant of the IMF definition of offshore centres as 'an expression used to describe countries with banking sectors dealing primarily with non-residents and/or in foreign currency on a scale out of proportion to the size of the host economy' (BIS, 2000).

The BIS has over time had difficulty in defining those countries and territories it considers to be OFCs. In 1995 it maintained two lists of countries reporting to it in which OFCs might be located, being industrialised reporting countries and what it described as 'other banking centres'. The major industrialised countries included:

- |            |                    |
|------------|--------------------|
| 1. Austria | 10. Japan          |
| 2. Belgium | 11. Luxembourg     |
| 3. Canada  | 12. Netherlands    |
| 4. Denmark | 13. Norway         |
| 5. Finland | 14. Spain          |
| 6. France  | 15. Sweden         |
| 7. Germany | 16. Switzerland    |
| 8. Ireland | 17. United Kingdom |
| 9. Italy   | 18. United States  |

Other banking centres were:

- |                    |                          |
|--------------------|--------------------------|
| 19. Bahamas        | 22. Hong Kong            |
| 20. Bahrain        | 23. Netherlands Antilles |
| 21. Cayman Islands | 24. Singapore            |

(BIS, 1995, p.5)

The principal anomaly with this list has to do with those classified as 'other' centres which are clearly tax havens as well as OFCs (as previously defined). However, the report notes that:

‘The reporting includes in the case of the United States and Japan separate information on the International Banking Facilities and the Japan Offshore Market respectively. As far as the other reporting centres are concerned, two of these (Bahrain and Singapore) include in their data only those institutions, or departments of institutions, that are exclusively engaged in offshore business. In the case of Bahrain these are the so-called "Offshore Banking Units" (OBUs), while for Singapore they are the "Asian Currency Units" (ACUs) of the commercial banks and merchant banks operating in the country’ (1995, p5).

The BIS recognised, therefore, as early as 1995 the problem in the distinction it made between industrialized and ‘other’ OFC centres as it is clear that the U.S. IBFs and the Japanese JOM as offering something equivalent to Bahrain and Singapore.

Over time the BIS has sought to widen participation in order to improve the quality of its data. In doing so it achieved considerable success. Among the latest reporting countries providing locational banking data, the BIS lists Guernsey (from 2001), the Isle of Man (2001), Jersey (2001), Bermuda (2002), Panama (2002) and Macao SAR (2006). As a result of the addition of these tax haven states to its list of reporting territories, the BIS replaced the category of ‘other’ centres with a new category of OFCs listed under the heading of ‘Caribbean and Asian offshore centres’. The list of Caribbean and Asian OFC is changing from time to time and includes, rather inconveniently, some European centres as well. Currently the list consists of Aruba, Bahamas, Bahrain, Barbados, Bermuda, Cayman Islands, Gibraltar, Guernsey, Hong Kong SAR, Isle of Man, Jersey, Lebanon, Liberia, Macau SAR, Mauritius, Netherlands Antilles, Panama, Singapore, Vanuatu, and something rather nebulously called ‘West Indies UK’.

Notably, and importantly, the money markets of London are not regarded by the BIS as an offshore financial centre, despite London being the epicentre of the offshore financial market, as the Financial Stability Forum has noted:

For example, the growth of London as the largest offshore banking centre has been linked directly to regulations imposed on the U.S. banking sector (FSF, 2000, 11, footnote 1).

This raises the obvious question: why has the BIS chosen to not categorise the City of London as an offshore financial centre? To add to the obvious confusion within the BIS, their database on global FDI flows treats London as an OFC!

The BIS is clearly tied up in knots over what definition it should use for the Euro-currency market and OFCs. This is not surprising: as a club of central bankers the BIS is bound to shy away from controversy. In classifying offshore financial centres as it does, the BIS is undoubtedly catering to its constituencies, such as the American Fed, the Bank of England or the Bank of Japan, who do not wish to be treated as OFCs. Furthermore, the BIS has no particular agenda with regards to tax havens, but seeks to obtain best available information from different corners of the world. It accepts, therefore, the self-

denomination of reporting countries as OFCs at face value regardless of the ensuing conceptual and analytical confusion that results. In so doing, it sets the tone for those who follow in its wake.

### **The Organization for Economic Cooperation and Development (OECD)**

The OECD has positioned itself on the other end of the spectrum from the BIS among the premier international bodies. Established in 1961, The OECD serves as a ‘think tank’ for the world’s advanced industrialized countries; those countries that are committed, in the OECD’s own words, to democracy and market economies.

The OECD is located in Paris and is considered to be particularly sensitive to the interests of the European powers, such as Germany and France; countries that have traditionally been critical of tax havens.

Since launching a campaign against ‘harmful tax competition’ in 1998 at the request of the (then) G7 group of nations, the OECD has never shied from describing tax havens by that name. This is almost certainly because the OECD is concerned largely with the question of taxation, and less with the nature of tax havens as offshore financial centres. As such to describe them as tax havens suits their purpose. In summary, the OECD considers there to be four key factors that help define whether a jurisdiction is promoting harmful preferential tax regimes and as such might be considered a tax haven. They are:

- Whether that jurisdiction imposes no or only nominal taxes on some or all activities legally located there;
- Whether there is a lack of transparency within the jurisdiction;
- Whether there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation; arrangements the jurisdiction provides;
- Whether there is an absence of a requirement that the activity undertaken in the jurisdiction be substantial.

This said, the OECD has also recognized the concept of OFC. A 1995 OECD report provides the following rather straightforward definition. OFCs, it said, are:

‘Financial centres set up to avoid regulations or taxation by operating outside the countries of the main parties to financial transactions’ (quoted in Edey and Hviding, 1995).

In contrast to the BIS, who stress the high ratio of non-resident finance in its definition of OFCs, the OECD definition emphasizes avoidance as the defining characteristic of OFCs, demonstrating a long term concern with tax matters.

The OECD was forced, however, to shift its position by 2001 and as a result has been increasingly using the more neutral term OFC in the way the BIS does. This change has

arisen as a result of international pressure. The original OECD report of 1998 saw no problem in denouncing what it described as harmful tax competition. Many states, led by Switzerland, Luxembourg and the Caribbean havens argued that a tax regime is a sovereign prerogative, and the OECD campaign amounted to a new form of imperialism whereby powerful states dictated terms to weaker states. This argument gained a powerful ally once the first Bush administration came to power in 2001 and broke ranks with the OECD, notably just before 9/11.

The first George W Bush administration was critical of the OECD harmful tax competition campaign on two grounds. First it agreed, implicitly, with the imperialist theory and as such it came to the defence of the sovereign right of even the smaller states in the world to create whatever tax regime they wished. Second, the Bush administration advanced the theory that just as market competition is good in principle, so tax competition is good as well, because it prevents governments from imposing unnecessarily high and punitive taxation. Hence, the US administration argued the tax haven campaign should not be aimed at competition, whether in taxation or anything else, per se.

In more recent documents the OECD has succumbed to these pressures and as a result has shifted the onus of its definition of tax haven away from the level of taxation as such, to the question of preferential treatment of foreign residences. According to the new definition, countries can impose zero taxation, and not be considered a tax haven provided they impose such taxation uniformly on those resident and non-resident in the territory. Of course, countries who wish to maintain very low level of taxation would have then to find other source of income. This has had significant impact, as will be noted later, but not, it must be said, as a consequence of OECD pressure, but mainly as a result of that emanating from the EU.

The OECD also appears to be more ambiguous in its attitude to the Eurocurrency market. In the early 1980s, the OECD commissioned a number of studies of the fledgling Euromarket. A study from 1983 into the effect of the Eurocurrency on global stability begins by noting the conventional definition of the Euromarket as a market for non-resident currencies (Bryant 1983). Bryant attributed the rapid rise of the Eurocurrency market to growing interdependence among nations (interdependence was a popular theory in the 1980s), but, significantly, he adds,

‘A second explanation is also important. Banks have been able to offer somewhat higher deposit rates and extend credits at somewhat lower lending rates in international banking than in traditional domestic banking by exploiting differences in national regulatory and tax environments. Eurocurrency banking in particular has benefited from this phenomenon.’

Edey and Hviding, in a report written twelve years later for the OECD, stress already the lack of regulation and avoidance as the defining characteristic of Euro-currency market. They speak of a shrinkage of the regulatory base which

‘occurred through various types of regulatory avoidance (for example, the development of offshore financial centres and off-balance-sheet methods of financing by banks) as well as through a more general tendency for banks and other regulated institutions to lose business to the less regulated parts of the financial sector’ (Edey and Hviding, 1995, p.2).

This suggests that the OECD is aware of the difference between OFCs and tax havens, and yet now seeks to avoid the distinction. One explanation is that there is genuine confusion in the OECD as to the difference, and this has been observed during meeting at which they have attended. More likely though is the possibility that the OECD does not wish to create internal divisions among its members, some of which would be classified as offshore financial centres if the 1995 definition noted above were to be used. By avoiding this issue it manages to concentrate on tax alone where OECD members appear, on the whole, in much better position, and to be more unified (in the main) than non-OECD members - provided, of course, that we exclude the British and Dutch dependencies from the equation.

### **The Financial Stability Forum (FSF)**

Both the Financial Stability Forum (FSF) and the Financial Action Task Force for Money Laundering (FATF) refer to tax havens from time to time, without offering any clear definition of such entities. Both prefer the term OFC. The FSF, in particular, has taken a rather positive attitude to OFCs, arguing that under the right set of circumstances - circumstances defined, of course, by the FSF- these centres have a positive contribution to make to the world economy.

The FSF was convened in April 1999 by the G-8 group of nations to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The FSF works closely with the IMF and the OECD. Its definition of an OFC does, however, differ from both. The FSF agrees that ‘OFCs are not easily defined’, continuing ‘they can be characterized as jurisdictions that attract a high level of non-resident activity’ but adding:

Traditionally, the term has implied some or all of the following (but not all OFCs operate this way):

- Low or no taxes on business or investment income;
- No withholding taxes;
- Light and flexible incorporation and licensing regimes;
- Light and flexible supervisory regimes;
- Flexible use of trusts and other special corporate vehicles;
- No need for financial institutions and/or corporate structures to have a physical presence;
- An inappropriately high level of client confidentiality based on impenetrable secrecy laws; and
- Unavailability of similar incentives to residents.’

(FSF, 2000, 12)

The list of attributes that ‘traditionally’ were attached to the OFC is, it will be noted, almost identical to the one that the OECD used to characterize tax havens. This is unfortunate and has contributed to confusion on this issue.

Despite the secrecy and lax regulation, the FSF claims that it does not object to OFCs in principle. Indeed, it declares, ‘there are, however, highly reputable OFCs that actively aspire to and apply internationally accepted practices, and there are some legitimate uses of OFCs’ (FSF 2000). Precisely what the legitimate uses of (for example) ‘light and flexible supervisory regimes and/or flexible uses of trusts and other special corporate structures’ are is not made clear.

Reading between the lines, it appears that OFCs can play a positive role in world finance, (according to the FSF) because all the major financial centres are OFCs and hence they must, by default, play a positive role. The FSF recognizes the problem this poses by implication:

‘While OFCs are commonly perceived to be small island states, a number of advanced countries have succeeded in attracting very large concentrations of non-resident business by offering economic incentives either throughout their jurisdiction or in special economic zones’ (FSF 2000).

In other words it recognises that ‘incentives’ to non-residents are common practice. As a result it appears to recognise, implicitly, that some advanced countries may be considered as OFCs.

True to its task of international financial stability however, the FSF is interested in large scale financial flows and the potential difficulties lack of regulation and transparency may lead to. As a result and not surprisingly the FSF plays down the role of tax issues in its analysis, despite its list of characteristics of OFCs which centres on tax, because it does not help its main purpose to strengthen the ‘regulatory, supervisory, cooperation and information exchange arrangements’ between OFCs and advanced industrialized countries. In order to co-opt tax havens into its regime, recognising their value by noting ‘some legitimate uses of OFCs’, the FSF appears willing to compromise on definitional accuracy to achieve that goal.

### **The International Monetary Fund (IMF)**

The IMF has gone through an interesting transformation on the tax haven issue. The IMF was among the first international economic organizations to raise the alarm about tax havens (Cassard 1994). In the early years of the new century (and facing its own crisis of identity), the IMF is attempting to wrest the lead in analytical and research work on tax havens from other organizations (helped in this by the FSF) and as a result it is conducting some of the more innovative analytical work on tax havens.

Like other organizations, the IMF notes the objective difficulties in identifying what tax havens and OFCs are, and how to differentiate them. Perhaps because of its failure to properly address this issue the term ‘tax haven’ creeps into IMF documents without attendant definition. Officially the IMF recognizes only the term OFC. In a widely cited ‘background paper’ it sought to define OFCs as centres:

where the bulk of financial sector transactions on both sides of the balance sheet are with individuals or companies that are not residents of OFCs, where the transactions are initiated elsewhere, and where the majority of the institutions involved are controlled by non-residents. Thus many OFCs have the following characteristics:

1. Jurisdictions that have financial institutions engaged primarily in business with non-residents;
2. Financial systems with external assets and liabilities out of proportion to domestic financial intermediation designed to finance domestic economies; and
3. More popularly, centres which provide some or all of the following opportunities: low or zero taxation; moderate or light financial regulation; banking secrecy and anonymity’ (IMF 2000).

This by now familiar definition creates great confusion because it lumps tax havens together with OFCs. That is because this background paper of 2000 is (atypically) rather muddled and confusing: the more so since it begins with the following entirely different definition:

Offshore finance is, at its simplest, the provision of financial services by banks and other agents to non-residents’ (IMF, 2000).

It follows, the document logically concludes, that ‘any financial centre where offshore activity takes place’ is an OFC, although such definition, the briefing paper admits, ‘would include all the major financial centres in the world.’

If all the major financial centres in the world are OFCs, which is the logical conclusion, then the IMF must either accept that OFCs are fine, or that global finance must undergo fundamental change if OFCs are an issue that needs addressing. The IMF seeks, however, a third position, that the global financial architecture is fit for purpose but some action is required to reform centres that provide some or all of the following services:

- low or zero taxation;
- moderate or light financial regulation;
- banking secrecy and anonymity.’

This clarification, in the name of ‘practicality’, pulls the IMF in the direction of stressing lack of regulation as defining characteristics of offshore. It also pulls the IMF towards the suggestion that OFCs are really, for all intent and purpose, tax havens.

There is little doubt as a result that this IMF briefing paper of 2000 is conceptually problematic. The IMF never conceded its contradictory position, but clearly felt that something was not right with its 2000 briefing paper. In a recently published working paper (Zoromé 2007), the IMF appears to have shifted its position - although the working paper clearly states that it does not represent the views of the IMF.

In this paper, which is devoted entirely to the definitional problem, Ahmed Zoromé argues that all existing definitions fail to capture the essence of the OFC phenomenon. According to him the essence of an OFC is ‘the provision of financial services to non-residents, namely, exports of financial services’ (Zoromé 2007, p.8). This is problematic as well because all financial centres service non-resident as well. Zoromé says, therefore, ‘Although one could argue that any given economy, to some extent, provides financial services, the peculiarity of OFCs is that they have specialized in the supply of financial services on a scale far exceeding the needs and the size of their economies’. As a result Zoromé suggests therefore the following definition of OFCs.

An OFC is a country or jurisdiction that provides financial services to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy’ (2007, pp.12-3)

Zoromé provides an objective definition of offshore centres which does not rely on biases or prejudices, but nonetheless still conflates the jurisdiction (the tax haven) with the hosted sector (the OFC). He proposes techniques for measuring and defining the size of the financial service sectors vis-à-vis domestic needs. His methodology shows very clearly that countries such as Luxembourg, Switzerland as well as the City of London do, indeed, host offshore financial centres - which is certainly the case. His methodology also reveals Latvia as a new and surprising addition to the list of OFCs (which is not a great surprise, though, to residents of the former Soviet Union).

There are, however, problems with such methodology. First, a statistical methodology shows only the relatively successful tax havens/OFCs. There are a good number of ‘failed’ OFCs among the small Pacific Islands and some Caribbean islands which tried but failed to develop from being a tax haven to hosting a functional OFC, and hence do not show up in his methodology. Second, statistical data is not available for many of the territories identified by other agencies as both tax havens and OFCs and as such this approach is limited in application and might result in incomplete outputs as a result of incomplete inputs. Third, Zoromé’s methodology fails to acknowledge what may be described as ‘inner’ tax havens; states or regions within federal states such as the U.S. (Nevada, Delaware) or Russia (Ingushetia) or Malaysia (Labuan) which use relative autonomy within a domestic market to enact similar type of laws to those usually associated with tax havens. Fourth, there must be doubt about the wisdom of thinking of offshore financial centres as a

‘service’ economy in the traditional sense of the word, or of ignoring completely the issue of taxation as Zoromé does.

In conclusion, the IMF seems as confused as the other agencies noted so far when tackling this issue and remains largely silent on matters relating to tax evasion.

### **The Financial Task Force on Money Laundering (FATF)**

The Financial Task Force on Money Laundering (FATF) was established by the G-7 summit held in Paris in 1989, in response to mounting concern over money laundering. The FATF secretariat sits in the OECD building in Paris, a fact probably of some significance when it comes to the definitional problem.

Early on the FATF decided to stay away from the definitional debate on the nature of tax havens and OFCs. Instead it concentrated on issues relating to drugs money laundering, and since 2001, terrorist financing. The FATF has identified certain practices as such as lack of regulation and obstacles on customer identification as potentially facilitating the flow of money laundering. As a result it created a list of ‘non-cooperative countries and territories’ (NCCTs), or countries that had detrimental rules that might facilitate laundering. Their list of required actions to address money laundering initially contained forty recommendations. Another nine were added after 9/11 to address terrorist financing issues<sup>83</sup>. In practice these, in combination, describe tax havens.

### **The European Union**

The European Union is surprising one of the most effective players in the attack on tax havens. Their work has resulted from two initiatives. The first (and from a definitional point of view by far the most important) is the EU Code of Conduct on Business Taxation. This Code was issued in 1997 by a committee that was chaired for a decade by Dawn Primarolo in her capacity as the UK’s Paymaster General. It was notable that when issuing the report the EU said that:

The Council, when adopting the Code, acknowledged the positive effects of fair competition, which can indeed be beneficial. Mindful of this, the Code was specifically designed to detect only such measures which unduly affect the location of business activity in the Community by being targeted merely at non-residents and by providing them with a more favourable tax treatment than that which is generally available in the Member State concerned. For the purpose of identifying such harmful measures the Code sets out the criteria against which any potentially harmful measures are to be tested.

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<sup>83</sup> [http://www.fatf-gafi.org/pages/0,2987,en\\_32250379\\_32235720\\_1\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html) accessed 2-6-08

In so doing the focus was specifically on tax issues, but the term tax haven was not itself used. However, as reflected the mood of the period, the focus was on inducements, whether offered by taxation or lax regulation that encouraged the relocation of business activity by means that the EU considered unfair. There can be little doubt that this meant that the Code was intended to tackle tax haven activity, and that the actions of OFCs were considered secondary in this matter. This is clear from the fact that the EU said that the criteria for identifying potentially harmful measures included<sup>84</sup>:

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned;
- tax benefits reserved for non-residents;
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- granting of tax advantages even in the absence of any real economic activity;
- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD;
- lack of transparency.

The EU's Finance Ministers established the Code of Conduct Group (Business Taxation) to assess the tax measures that may fall within the scope of the Code of Conduct for business taxation. In its report of November 1999 the Group identified 66 tax measures with harmful features. Notably, of these forty were in EU Member States, three were in Gibraltar (which has an unusual status in Europe, being for its purposes part of the UK) and twenty three were in the dependent or associated territories of the UK and the Netherlands. The latter were considered to be included since the respective nations have responsibility for the foreign affairs of the territories in question.

For beneficiaries of those regimes in use on or before 31/12/2000, a "grand-fathering" clause was provided which provided that the benefits of the schemes had to lapse no later than 31/12/2005. In addition, an undertaking was provided by all states and associated territories that they would not introduce new measures that contravened the Code and the standing committee set up to monitor the Code was tasked with ensuring this did not happen. Unfortunately that committee has always met in secret, making it nigh on impossible to assess its progress towards achieving its remit, but what can be concluded with certainty is that on this issue the EU was concerned with tax haven activity, and in so doing was remarkably broadminded, taking action that affected almost all its members states as well as their associated tax havens. There can be little doubt that this bold step, which meant most EU member states had to take action of some sort, contributed to the success of this initiative, as noted later.

The other EU initiative of importance is the EU Savings Tax Directive. As the EU noted:

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<sup>84</sup> [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/harmful\\_tax\\_practices/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm)  
accessed 1-6-08

The Directive on taxation of savings income in the form of interest payments adopted on 3 June 2003, formed one element of the "Tax Package" aimed at tackling harmful tax competition in the Community.<sup>85</sup>

In practice the negotiations to implement this package had begun in the mid 1990s, and are another indication of the concern on tax haven activity that arose during that decade. As the EU noted<sup>86</sup>:

The need to avoid distortions to the movement of capital and allow effective taxation of interest payments received by individuals in Member States other than the Member State of residence have led to the adoption of a Directive on the taxation of savings income in the form of interest payments. This Directive enables such interest payments to be made subject to effective taxation in accordance with the laws of the Member State of residence of the individuals concerned.

In plain English, the Directive is intended to tackle tax evasion on interest earned in tax haven states where the failure to implement effective tax information exchange agreements has made it difficult for tax authorities to secure the data they need to effectively tax their residents on their world-wide income, as is their normal intent.

Starting on 1 July 2005, the provisions of the Directive were applied by all EU Member States, ten dependent or associated territories of EU Member States through the implementation of bilateral agreements signed by each of the 25 EU Member States with these jurisdictions; and equivalent measures have been applied, from the same date, in five European third countries, including Liechtenstein, Switzerland, San Marino, Monaco and Andorra.

Just three member states - Belgium, Austria and Luxembourg - were allowed to withhold tax from payments of interest made to non-residents instead of undertaking to make automatic information exchange with the country of normal residence of the recipient. They joined the British Virgin Islands, Guernsey, the Isle of Man, Jersey, the Netherlands Antilles and the Turks and Caicos Islands in offering this arrangement, which also applied in the five European third party countries. Anguilla, Aruba, the Cayman Islands and Montserrat have all undertaken to provide for automatic exchange of information.

The focus of this initiative has been unambiguous: it is targeted at tax haven activity and does little to disguise the fact. In consequence the EU's approach to these issues is about as far removed from that of the BIS, with which this review started, as it is possible to be whilst tackling fundamentally similar issues.

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<sup>85</sup> [http://ec.europa.eu/taxation\\_customs/taxation/personal\\_tax/savings\\_tax/rules\\_applicable/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm)  
accessed 1-6-08

<sup>86</sup> *ibid*

## The confused regulator

This review has revealed that:

1. The terms OFC and tax havens can be defined to mean the same thing or things that are quite different. The terms have been treated as though they are synonymous even when applied to regulation of, on the one hand governmental bodies, and on the other, private sector financial intermediaries.
2. This confusion on the part of regulators has undoubtedly had an impact on the focus of their activities and, as will be shown, upon the effectiveness of actions taken.
3. The lack of consistency in approach between these international regulators, all of whom are dominated by a small group of powerful countries, has been to the advantage of the tax havens who have, to a considerable degree, been able to exploit this difference for their own benefit.
4. The policy change on the part of the US administration in 2001 undermined the effectiveness of the combined efforts to tackle tax haven activity that existed to that date. Again, as will be shown, it is only the FATF and the EU that have been able to make significant progress in their dealings with tax havens since that time.

The consequence of this is clear. Lack of clarity in defining the issues and risks surrounding tax havens and offshore financial centres has reinforced misconceptions and held back progress towards creating effective regulatory systems designed to tackle systemic problems. Achieving this clarity may be the biggest single issue to be addressed in the tax haven debate at this time.

## 6. Regulation and the tax haven response

Having noted that a range of bodies have tried to regulate tax haven activity it is important to now note what form that regulation has taken and what the response of tax havens to that regulation has been.

The attempts at regulation have been, it should be noted, aimed almost entirely at tax havens. The regulation of the OFCs that operate from them has been made their national responsibility. This is a major omission in the whole regulatory environment to which further attention will be given later.

The regulatory processes that have been created have a number of themes, as follows:

1. The creation of regulation to reduce the risk of illicit financial flows occurring. This type of regulation is most closely associated with the work of the FATF with its initial 40 and subsequent further nine requirements for rules required to be in place to mitigate this risk. In practice, this has also been the focus of the IMF in this area, which has used its resources to monitor compliance in this area. It has done this through its Reports on the Observance of Standards and Codes in member states, a process that has been extended to almost all the major tax havens. These reports are published<sup>87</sup>.
2. The publishing of 'black lists' of states not in compliance with required international standards. The process has been most notably associated with the OECD initiative on harmful tax practices, and gave rise to considerable controversy, as is noted below. It was also used by the EU when listing harmful tax practices. The latter had the advantage, however, of being able to enforce its requirements on its own member states.
3. The issue of specific directives. This has been an activity particularly associated with the EU which has undertaken this activity on both money laundering and with regard to tax evasion (the latter being the EU Savings Tax Directive). As a member organisation with the power to require compliance this has been an opportunity peculiarly available to this organisation, but no other.
4. The regulation of specific activities, especially relating to the financial sector. This is the focus of the work of both the BIS and FSF, the latter for example, most recently looking at issues relating to prudential oversight of capital, liquidity and risk management, enhancing transparency and valuation, changes in the role and uses of credit ratings, strengthening the authorities' responsiveness to risks and the

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<sup>87</sup> <http://dsbb.imf.org/Applications/web/dqrs/dqrsroscs/> accessed

creation of robust arrangements for dealing with stress in the financial system. Some, but by no means all of this, relates to tax havens.

It is the first three of these types of regulation that are the focus of attention here, the latter being too generic to require specific comment even though it has tax haven impact.

### **The impact of regulation**

The responses to the processes of regulation have varied significantly in each case. It could quite reasonably be argued that the FATF has been by far the most successful regulator. Put simply, governments, including without exception those of the tax havens, have responded to its demands by creating legislation which does, by and large comply with the FATF requirements. This is an extraordinary achievement in a period of a decade. What was once an almost unregulated sector, especially offshore, is now subject to substantial regulation, worldwide. The scope of that regulation is also regularly monitored. For example, the UK's National Audit Office was able to review the IMF ROSC assessments for the British Overseas Territories and produce this summary of regulatory compliance in November 2007<sup>88</sup>:

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<sup>88</sup> [http://www.nao.org.uk/publications/nao\\_reports/07-08/07084.pdf](http://www.nao.org.uk/publications/nao_reports/07-08/07084.pdf) accessed 2-6-08

**8** International Monetary Fund assessments regulation of offshore financial services in Overseas Territories<sup>1,2</sup>

	Test assessment results, showing the extent of compliance with global standards	Gibraltar 2001	Anguilla 2003	Montserrat 2003	British Virgin Islands 2004	Bermuda 2005	Cayman Islands 2005	The three Crown Dependencies 2003 <sup>4</sup>
		%	%	%	%	%	%	%
Banking	Compliant	73	19	12	36	62	63	63
	Largely compliant	27	33	19	14	38	37	34
	Materially non-compliant	—	33	54	39	—	—	2
	Non-compliant	—	15	15	11	—	—	—
Money Laundering	Compliant		41	38	53	59	65	81
	Largely compliant		34	28	38	19	29	19
	Materially non-compliant		22	31	6	22	6	—
	Non-compliant		3	3	3	—	—	—
Insurance <sup>3</sup>	Observed	76			76	38	47	70
	Largely observed	18			6	13	18	26
	Materially non-observed	6			18	44	35	2
	Non-observed	—			—	6	—	2
Securities <sup>3</sup>	Implemented	86			25	40	46	81
	Broadly Implemented	14			31	37	19	8
	Partly Implemented	—			44	23	31	11
	Not Implemented	—			—	—	4	—

Source: National Audit Office

**NOTES**

1 The table shows the first round of IMF assessments for each jurisdiction. At the time of this report, the first second round report, for Gibraltar, had been published, with highly favourable results. Assessments in Turks and Caicos Islands, Anguilla and the British Virgin Islands had been deferred at local request, and the reports on Bermuda and the Cayman Islands had not yet been published.

2 The table summarises compliance in six of the seven Offshore Financial Centres. Turks and Caicos Islands were excluded because the International Monetary Fund has not published its detailed breakdown of results. Percentages are rounded and may not always add to 100 per cent.

3 The smaller centres were not assessed for insurance and securities business.

4 The Crown dependencies are Jersey, Guernsey and the Isle of Man.

It is not clear why Gibraltar was not assessed for money laundering, but it is apparent that in most cases systems of regulation exist and that, with few exceptions noted (e.g. insurance in Bermuda and banking in Montserrat) those regulations are more than 50% compliant with required standards. Full compliance is, it should be noted, rare, but it is also fair to note that the same can also be said of many major nations and that overall the level of regulatory compliance in the Crown Dependencies and Gibraltar is good.

This apparent success gives an altogether false picture though. As the same report shows, having regulation in place does not mean it is used. For example, the key requirement of much of the regulation noted is that those operating in the financial services industry within the OFCs located in the above noted territories should report any suspicious transactions that they note in the course of their work to the local regulatory authorities. As the Jersey Financial Services Commission Handbook for the Prevention and Detection of

Money Laundering and The Financing Of Terrorism for Regulated Financial Services Businesses<sup>89</sup> says (page 6):

The Jersey Financial Services Commission (the “Commission”) strongly believes that the key to the prevention and detection of money laundering and the financing of terrorism lies in the implementation of, and strict adherence to, effective systems and controls, including sound customer due diligence procedures based on international standards. The Handbook therefore establishes standards which match international standards issued by the Financial Action Task Force on Money Laundering (the “FATF”).

Suspicious transaction reports are to be made, it says, when money laundering is suspect, but it then fails to define just what money laundering is. This omission also occurs in the Money Laundering (Jersey) Order 2008. This is remarkable, and no doubt contributed to the fact that whilst such Orders exist, and the Jersey Financial Services Commission is dedicated to regulating the local financial services industry, and produces a mass of paperwork in the course of doing so, much of which makes clear the duty to report any suspicion of money laundering to the Joint Financial Crime Unit of the Jersey police, the official report of that police service for 2006 made clear that no suspicious activity reports were received by that unit in that year<sup>90</sup>. Maybe that is because Jersey is also extremely circumspect about defining tax evasion as money laundering. It managed to do so in paragraph 2.7.5 of the April 2007 version of its money laundering handbook<sup>91</sup> this has been removed from the latest version, issued in February 2008<sup>92</sup>.

It should also be noted that in the 2007 Jersey Police Report it was said that 1,517 suspicious activity reports were submitted in that year, and that apparently 1,034 had been in the previous year. However, only one case of money laundering crime was detected as a result. The evidence remains clear: the rate of compliance with regulation is incredibly low in a jurisdiction rated as having good systems in operation and the conviction rate so abysmal that there is no implicit risk to the money launderer at all. The lessons are obvious:

- First, regulation has failed to deter money laundering;
- Second, the regulations are in place but the commitment to using them is low;
- Third, if this is the case in Jersey then it is likely to be much worse in the smaller and more remote jurisdictions covered by the National Audit Office report.

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<sup>89</sup> [http://www.jerseyfsc.org/pdf/AML%20Handbook Consolidated Version 26 March 2008.pdf](http://www.jerseyfsc.org/pdf/AML%20Handbook%20Consolidated%20Version%2026%20March%202008.pdf) accessed 2-6-08

<sup>90</sup> <http://www.taxresearch.org.uk/Blog/2007/03/02/jersey-officially-a-money-laundering-free-zone/> accessed 2-6-08

<sup>91</sup> [http://www.jerseyfsc.org/pdf/hbk%20part%202%20april%202007%20\(mlo1999\).pdf](http://www.jerseyfsc.org/pdf/hbk%20part%202%20april%202007%20(mlo1999).pdf) accessed 2-6-08

<sup>92</sup>

It is reasonable to conclude that no effective measures to prevent money laundering have been created as a result of all the effort expended to date. This is implicit in Table 9 of the same NAO report which shows the following rates of suspicious transaction reports and prosecutions:

**9** Levels of monitoring and investigating suspicious financial activity in the Territories are variable

Territory	Number of suspicious activity reports (2005)	Estimated number employed in Financial Services	Reports per hundred employed <sup>1</sup>	Financial Intelligence and Investigative capability <sup>2</sup>	Number of successful local prosecutions <sup>3</sup>
Bermuda	313 (2006)	4,000	8	11	0
Cayman Is.	244	5,400	5	21	2
British Virgin Is	101	1,600	6	5.5	0
Gibraltar	108	1,500	7	8	0 (1 pending)
Turks and Caicos Islands	17	700	2.4	5	0 (3 pending)
Anguilla	2	200	1	1	0
Montserrat	1	150	1	1	0
External contexts					
Jersey	1,162	11,800	10	22 (2003) <sup>4</sup>	0
Isle of Man	1,652	7,010	24	22	0

Source: Summarisation by National Audit Office, and latest IMF assessment reports

**NOTES**

- 1 Very high levels of reporting can be indicative of defensive reporting of trivial cases, so the numbers here indicate relative reporting activity and not performance against a benchmark.
- 2 Full time equivalents. Professional staff.
- 3 In some cases investigations are ongoing and charges have been laid. Cayman authorities report five successful domestic prosecutions since 1997.
- 4 Included at the time seven staff seconded from the UK.

## The impact of blacklisting

The impact of the OECD's campaign that sought to shame the tax havens into compliance with the wishes of major OECD nations has been almost as limited as the campaign to prevent money laundering through regulation.

Whilst the campaign was supported by the US administration of President Clinton it appeared to have a real chance of success. Some of the tax havens on whom pressure was placed gave letters of undertaking to remove their harmful tax practices prior to 2001. Others resisted, assisted, quite notably by the Commonwealth Secretariat<sup>93</sup> who seemed to consider it their duty to support the small tax haven members of the Commonwealth on this issue without apparently taking account of the impact of tax havens on the development of non-tax haven members of the Commonwealth.

<sup>93</sup> See for example

[http://www.thecommonwealth.org/press/31555/34582/34632/joint\\_commonwealth\\_oecd\\_working\\_group\\_on\\_h.htm](http://www.thecommonwealth.org/press/31555/34582/34632/joint_commonwealth_oecd_working_group_on_h.htm) from 201, accessed 3-6-08

The thrust of the argument of those opposing the OECD was simple but effective: the OECD had acted discriminately in targeting the 35 blacklisted locations because some OECD member states, and most especially Switzerland, but to a lesser degree London, New York and other significant tax havens, offered similar facilities to those the OECD considered harmful when offered from microstate jurisdictions. This, they claimed, created an 'unlevel playing field' which discriminated against them. In an effective counter-attack, the blacklisted tax havens represented the OECD campaign as anti-competitive behaviour on the part of a 'cartel' of major states.

It was a powerful image successfully exploited by two organisations. The first was formed with the direct assistance of the Commonwealth Secretariat and is called the International Trade and Investment Organisation<sup>94</sup>, which appears heavily influenced by the Isle of Man, the UK based Society of Trust and Estate Practitioners<sup>95</sup> and UK law firm Stikeman Elliott, which appears to have created a speciality business out of opposing OECD and other tax haven initiatives<sup>96</sup>.

The second was a US think tank, seemingly spun out of the Heritage Foundation and Cato Institute, both of which are committed to very low rates of taxation, called the Center for Freedom and Prosperity<sup>97</sup>. They mounted a campaign, supported by the likes of Milton Friedman, who argued in a letter to President Bush on its behalf in June 2001<sup>98</sup> that:

We urge you to reject the OECD's so-called harmful tax competition initiative. Tax competition is a liberalising force in the world economy, something which should be celebrated rather than persecuted.

It forces governments to be more fiscally responsive lest they drive economic activity to lower-tax environments.

These arguments won the day with President Bush: in August 2001 he withdrew his support for the harmful tax competition dimension of the OECD's work even though just a month later, following 9/11 he rushed the Patriotic Act through the US Congress to impose harsh money laundering rules, and set in chain the FATF initiative on this issue which has impacted significantly on the volume of regulation in tax havens, even if not its effectiveness.

The withdrawal of US support empowered the tax havens in their relationship with the OECD and after this change of heart most tax havens agreeing to cooperate with its

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<sup>94</sup> <http://www.itio.org/> accessed 3-6-08

<sup>95</sup> <http://www.step.org/> accessed 3-6-08

<sup>96</sup> <http://www.stikeman.com/cps/rde/xchg/se-en/hs.xsl/Profile.htm?ProfileID=16087> accessed 3-6-08

<sup>97</sup> <http://www.freedomandprosperity.org/taxhavens-facts/taxhavens-facts.shtml> accessed 3-6-08

<sup>98</sup> <http://www.telegraph.co.uk/money/main.ihtml?xml=/money/2001/06/06/cnoecd06.xml> accessed 3-6-08

activities have done so on the basis of what has been called the Isle of Man condition, which said that further cooperation with the OECD on harmful tax practices was conditional on the same requirement being imposed on all OECD members as was imposed on it.

In effect the promotion of this condition and the change of heart by the USA fundamentally undermined the OECD initiative. Since 2001 it has evolved into an initiative aimed at promoting information exchange agreements, particularly in the form of what are called Tax Information Exchange Agreements (TIEAs) between major nations and the world's tax havens. In practice, useful as this initiative might be the number of agreements signed to date are fewer than fifty in number, most involve a very few havens (the Crown Dependencies leading the field in this respect) and the use of those agreements that have been in place for some time is believed to have been very limited. For example, the Cayman - United States agreement signed in 2001 is not believed to have been used on more than ten occasions. This is because the terms of these agreements make it very hard for an enquiring nation to assemble a request for information, since they basically have to be in full possession of all the facts they are requesting before actually making the request, and it is very easy for the tax haven to refuse the information on the grounds that they do not think there are reasonable grounds for supplying it. The whole arrangement does, therefore, appear to be a window-dressing exercise designed to imply progress rather than any real indication that such progress is being made.

As a result the boldest initiative on tackling tax havens has failed.

### **The EU initiatives**

The EU initiatives on tax havens have enjoyed considerably better fortune than those already reviewed. There is good reason for saying this. First, while the other initiatives mentioned have only impacted on legislation on money laundering, with almost no consequential apparent change in behaviour, the EU initiatives focussed on tax. The changes in legislation there almost invariably have impact. Second, whereas compliance with the other initiatives has been, if not quite voluntary because of the power of political pressure that those creating them can exert, at least little more than token. In contrast, the EU has effective power to require compliance, even with the Code of Conduct on Business Taxation, which has not had statutory backing.

The result has been that both EU initiatives have been enforced. However, neither has had quite the expected outcome, which makes this an appropriate moment to consider how the tax havens have reacted to regulation, rather than just consider what that regulation might be. We start by looking at the EU initiatives and then explore some of the other changes in tax haven practice over the past decade or so.

The EU code of Conduct on Business Taxation would have drawn little notice if it had only applied to the EU's member states. It is true that as a result of it many of them had to reform their tax practices, withdrawing many tax regimes considered harmful ranging from head office coordination arrangements in Belgium, to rules on foundations in Austria; from

rules on non-resident companies in Ireland to rules for the film industry in the UK. It was, however, the extension of the package to the overseas dependents of the UK and the Netherlands that cause most controversy.

This extension had least impact in the British overseas territories, largely because relatively few have taxes on business. The impact on the Crown Dependencies was significant because their reliance on taxes on corporate profits is high, especially in the cases of Jersey and Guernsey: the former deriving up to 50% of its state tax income from taxes on corporate profits<sup>99</sup>. The ratio is slightly lower in Guernsey, but much lower in the Isle of Man where taxes on corporate profit represent just 7.5% of total state income in 2006<sup>100</sup>.

### **The EU Code of Conduct - how the Crown Dependencies have responded**

The wide disparity is important. Jersey and Guernsey relied on taxing the banks and other financial services institutions that had located in their domains to provide their state income. The Isle of Man had a quite different strategy. Under an agreement with the UK dating back to 1911 (the so-called 'common purse') it had charged sales based taxes applying in the UK in the Isle of Man and received a disproportionate share of the resulting revenues, this being intended as a subsidy when the Isle of Man was an impoverished island. Since 1973 this has applied to VAT, which the island charges as if a member of the EU, which it is not.

As Tax Research LLP showed in research published in March 2007<sup>101</sup>, as a result of this pooling arrangement the UK government provides the Isle of Man with a hefty subsidy each year, amounting to a sum of not less than £220 million per annum. Although the arrangement was renegotiated for the first time in many years in 2007 the level of subsidy is not thought to have changed. So absurd is the subsidy that Tax Research showed that the VAT income of the Isle of Man is 21.7% of the Island's GDP, an impossible ratio when the tax rate is only 17.5%. In contrast, the ratio of VAT contribution to government income to GDP in the UK is just 6.1%.

The Isle of Man quite deliberately exploited this difference in relative fiscal strength when the EU Code of Conduct was announced. In June 2000 the Isle of Man announced that it would comply with the EU requirement that ring fences be removed from within its domestic tax arrangements by introducing a zero per cent corporation tax for all companies, whether Manx resident or not, with the sole exception of some banks and finance companies which would have to pay 10% (which arrangement would allow it to retain part at least of its existing revenues, most of which came from that source).

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<sup>99</sup> <http://www.gov.je/NR/rdonlyres/51BA5C8E-5F8F-4397-8012-26523D932FCD/0/FinalBudgetStatement061019KLB.pdf> page 30 accessed 5-6-08

<sup>100</sup> <http://www.gov.im/lib/docs/treasury/budget/2006/budget0607pinkbook.pdf> page 9 accessed 5-6-08

<sup>101</sup> <http://www.taxresearch.org.uk/Documents/TRIoM3-07.pdf> accessed 5-6-08

There can be little doubt that this was not the arrangement that the EU (or the OECD, come to that) had anticipated in response to the requirement to eliminate dual tax rates. It is likely that they assumed that there would be an increase in the rates charges to tax haven companies registered in the Isle of Man instead.

This policy initiative from the Isle of Man, which it could easily afford because of its heavy state subsidy amounting to almost half its state income from the UK, gave its closest tax haven competitors, Jersey and Guernsey almost no choice but to follow suit and introduce the same arrangement. The Isle of Man has had its zero / ten arrangement in force since 2006 and Jersey and Guernsey have had these tax rates since 1 January 2008.

But all is not as it seems. First of all, whilst Guernsey has genuinely introduced the tax rate that it advertises for all companies, and has also increased social security rates to make good its shortfall (probably wishful thinking on their part), the Isle of Man and Jersey have been devious in their approach. This has been so much the case in the Isle of Man that its new tax laws have been deemed non-compliant with the EU Code of Conduct. As an Isle of Man press release on the issue said<sup>102</sup>:

The EU Code Group met on 16 October 2007, and considered the Distributable Profits Charge (DPC). It considered the DPC only and not the Isle of Man's '0/10' taxation system for companies which conforms to the principles of the Code of Conduct. The DPC, however, was found by the EU Code Group not to conform to the principles of the Code of Conduct.

This statement was disingenuous. The 0/10 tax system the Isle of Man has (and which Jersey and Guernsey has copied) is simply a system where companies are charged to 0% corporation tax unless they are finance companies when they're charged to 10%. The Code of Conduct was never meant to regulate tax rates. As such the Isle of Man has always been free to set whatever tax rates it likes and the EU is going to do nothing to stop them.

That means that the Distributable Profits Charge was in fact the only part of the new tax system that had to meet EU approval. This charge, according to the IoM:

is not a corporate income tax; it is a measure designed to maintain income tax revenue flow from individuals now that the standard rate of corporate income tax is 0%. It is a charge on Manx resident members of companies: accounted for by the company on their behalf, and creditable against their personal income tax liability when distributions are eventually made.

Which is true, but far from the whole truth. The purpose of the charge was succinctly summarised in the same press release noted above:

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<sup>102</sup> <http://www.gov.im/lib/docs/treasury/incometax/pdfs/dpcreplacementproposaldocument.pdf> accessed 5-6-08

The introduction by the Isle of Man of a standard corporate income tax rate of 0% in 2006 could have led to broader loss of revenue. Manx resident individuals and the trustees of certain trusts ... owning companies taxed at the standard rate could have chosen to leave profits in the company rather than paying them out as distributions which would be taxable as part of their personal income. The DPC was introduced at the same time as the 0% corporate tax rate specifically to limit the impact of this sort of planning.

And as the IoM then notes:

We understand that as the DPC is paid by companies on behalf of their Manx resident shareholders only, it is viewed by the EU Code Group as differentiating between resident and non-resident owned companies and therefore 'ring fencing' the latter group from parts of the tax system. Ring fencing is considered harmful in the context of the Code of Conduct.

The EU Code Group was absolutely right: the DPC was a deliberate ring fence introduced even though the IoM had given an undertaking to remove them. Curiously the Tax justice Network had warned them of this since 2005, during which year Richard Murphy, an adviser to the Tax justice Network, issued a similar warning to Jersey when advising a committee of the States of Jersey. That warning was subsequently endorsed in comments PricewaterhouseCoopers made to Guernsey, but the Jersey authorities proceeded with their tax reform none the less.

The IoM now says it has:

given a commitment to the EU that its business taxation system will conform to the principles of the Code of Conduct.

They say this will do this by introducing a new charge to tax which is different from that rejected by the EU in just one way, which is hard to spot. The explanation of the difference requires a little understanding of the two schemes:

1. Under the DPC regime if an IoM company that had IoM resident shareholders did not distribute 55% of its profits as calculated for tax purposes to its shareholders then it had instead to pay 18% of that profit to the IoM government. This payment was deemed to be income tax paid by it on behalf of those shareholders. Of course the EU realised that this was in fact a corporation tax on the profits of locally owned companies by any other name and the claim that these companies therefore paid tax at 0% was disingenuous, to say the least, not least because the company had to pay the tax as deemed agent on behalf of its members.
2. The new arrangement is called the Attribution Regime for Individuals (ARI). Under it the way of calculating the profits of IoM companies does not change at all. And companies with IoM resident shareholders still have to distribute 55% of their profits

to their members or the ARI comes into play (notice the similarities with the DPC already?). And if they do not make that distribution then, as the IoM notes:

The ARI will apply to Isle of Man resident individuals with an interest (in effect a shareholding) in a "relevant company". Such individuals will be taxed on their appropriate share of the distributable profits of the company (the "attributed profits"). Distributions out of such attributed profits when subsequently received by resident individuals will be tax-exempt.

Isle of Man resident individuals will generally be treated for income tax purposes as receiving any attributed profits 12 months after the end of the accounting period of the relevant company.

It is not a coincidence that the tax due by most such shareholders will be due at 18%, because that is the basic rate of income tax in the Isle of Man. So the tax due will be calculated as:

Distributable Profit x 55% x 18%

But this is identical to the formula for the DPC except the formula now reads:

Attributable Profit x 55% x 18%

Attributable and distributable profits are the same in both formulas. As a result the way in which this tax charge is calculated has not changed at all. The only change is that now the company will not be required to pay the tax on the individual's behalf. Instead it will have to tell the IoM tax authorities what those individuals might owe and then the person to whom the profit is attributed will have to pay the tax instead of the company, regardless of whether or not they have actually received a penny.

That is the total change the Isle of Man is making to its unacceptable tax to seek to make it EU compliant. It is not changing the tax at all. It is instead seeking to claim that the tax is now outside the scope of business taxation and therefore the EU Code of Conduct on Business Taxation does not apply to it.

This is a charade since to make the ARI work the company is going to have to:

- 1) Be sure whether it has Manx resident shareholders or not. If it has not its taxable profit is likely to be zero and no tax computation is needed. Indeed, no tax return will be submitted. On the other hand, if it has local shareholders it has a whole raft of tax accounting to do. That, of course, is a tax ring fence in its own right. The simple difference in the basis of calculation of the liability is enough in itself for this to leave the ARI in breach of sections 4 and 5 of the EU Code;

2) It will have to calculate its taxable profits using tax rules, not accounting ones, but only if it has Manx resident shareholders. And then it will have to tell those shareholders what that taxable profit is and how much of it is attributable to them. It will not have to do this for non-resident shareholders. That communication requirement is another ring-fence.

3) Then it will have to tell the Manx tax authorities what its taxable profits are, and what part is attributable to which shareholder, as it has to under the DPC. After all, how otherwise will the tax authorities know that tax is being paid in the correct amount by the right person?

4) Finally, the shareholder will have to pay the tax whether or not they have received any income from the company - which seems to be a blatant abuse of human rights - and the IoM has legislation on this.

So the only change is that the Isle of Man now has no recourse to the company to recover the tax due. But since the company has at all other stages to be a party to the process of supplying the information so that the tax can be paid this is a tiny change in the system. As the above makes clear, the difference in procedure for locally owned and internationally owned companies remains massive. That difference is designed to maintain the ring fence to ensure that, as the IoM itself says, its residents cannot enjoy the benefit of owning companies paying 0% corporation tax, although that benefit is offered to the residents of all other countries that wish to incorporate a company in the Isle. That is in direct contravention of section 2 of the Code.

In the process a massive abuse of human rights is introduced and Manx owned companies are effectively forced to distribute an arbitrary 55% of their profits, putting them at a competitive disadvantage to foreign owned companies working in their economies who can retain all their profits to finance growth at lower cost than locally owned companies. This is in breach of section 4 of the Code.

It is obvious as a result that the ring fence is still alive and well, and bar recourse to the company, operates exactly as in the case of the now outlawed DPC. That's because both are designed to ensure that the tax advantages of the 0% tax rate are:

ring fenced from the domestic market so they do not affect the national tax base.

Those words come straight from the Code of Conduct and are a criteria for rejection of any tax practice as harmful. The DPC was harmful. So is the ARI. And to claim it is not within the scope of business taxation when its sole purpose is to collect tax due on business profits is pushing credibility beyond any acceptable limit. As a result I have no doubt the ARI will be as unacceptable to the EC as was the DPC.

It is worth noting, Jersey is trying a variant on the same trick.

Both make clear one thing, which is that they remain committed to acting as tax havens, with all the inherent abusive structures identified as existing in those places being retained, albeit under different names.

### **The EU Code of Conduct - the consequences for Jersey and Guernsey**

There is, however, another dimension to this. Whilst the Isle of Man can take a robust approach to these matters Jersey and Guernsey cannot: they have been dependent on taxes on corporate profits to support their government spending, which despite their apparent low tax rates is actually at rates equivalent to those found in OCED counties.

To make good the shortfall in revenues they will inevitably face from 2008 onwards they have taken different steps. In Guernsey they have introduced higher rates of social security: a move that penalises the local population and that is both regressive and a disincentive to work. In Jersey they introduced a Goods and Services Tax in May 2008 at the rate of 3% on almost all sales. This is equivalent to the UK's VAT in all but name, though without the exemptions on food, children's clothing, etc, which render the UK scheme less regressive in its impact on low income households. There has been massive social resistance to the GST scheme: 19,000 of the island's total 87,000 population signed a petition opposing the move in 2007<sup>103</sup>. This gives an indication of a particular feature which is now being noted within several tax havens: local opposition to these places having this continuing status from those long terms resident in the places<sup>104</sup>. The reason is obvious: these places became tax havens to attract revenue to reduce the burdens on their local populations. Now their local populations are suffering a burden to support the existence of a tax haven within their domain. The logic of this is becoming increasingly hard for real local people to appreciate and in those places where there is a democratic mandate the possibility of real political change as a result of this change in perception now exists.

This possibility is increased in the case of Jersey and Guernsey because the tax charges they are imposing on the local populace will not make good the shortfall in tax lost as a result of introducing zero / ten tax strategies. Local politicians deny this, saying that the gains in competitiveness that the locations will secure from offering zero corporation tax rates will attract sufficient new business to ensure that enough financial services workers will be attracted to the locations to make good the deficits because they will pay additional tax. This argument must be wrong because:

1. Many of the local financial services markets, such a securitisation in the case of Jersey have virtually collapsed as a result of the credit crunch;
2. The EU Savings Tax Directive is having greater impact as the rate of tax withholding rises;

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<sup>103</sup> <http://news.bbc.co.uk/1/hi/world/europe/jersey/7084731.stm> accessed 6-6-08

<sup>104</sup> <http://www.taxresearch.org.uk/Blog/2008/05/06/is-this-a-trend/> accessed 6-6-08

3. The breaking of local tax secrecy by HM Revenue & Customs in 2007 will have substantially reduced confidence in these locations;
4. The locations lack sufficient room to house new workers;
5. The new zero tax rate only affects businesses really located in the islands; those using it as a tax haven always enjoyed this rate. There is little physical capacity to accept real businesses in the islands and their cost base is very high, precisely because hosting the offshore financial centre on such scale has exerted huge inflationary pressures within their domestic economies.

This has led to widespread belief that there will be a ‘black hole’ in Jersey’s finances. Some local politicians have suggested the figure might be £95 million<sup>105</sup>. Others have suggested a figure as high as £118 million<sup>106</sup>. The States finance minister has agreed a figure of £80 to £100 million<sup>107</sup>. Each has any income from GST offset against it, but the States Budget for 2008 has no such estimate in it: by 2012 it says the deficit will be only £12 million<sup>108</sup>:

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<sup>105</sup> <http://www.taxresearch.org.uk/Documents/BlackHole.pdf> accessed 6-6-08.

<sup>106</sup> <http://www.taxresearch.org.uk/Blog/2006/10/10/jersey-gets-it-rong-again/> accessed 6-6-08.

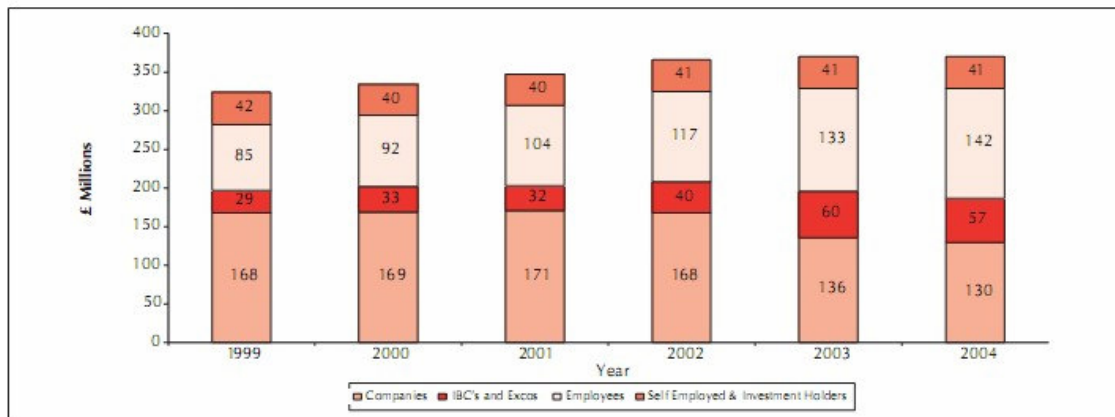
<sup>107</sup> <http://www.statesassembly.gov.je/scrutiny/documents/reports/23176-45789-2722006.htm> accessed 6-6-08

<sup>108</sup> <http://www.gov.je/NR/rdonlyres/C85FBFB-7040-4E6E-A321-89B72BD60026/0/AMENDEDFINALBudgetStatement2008.pdf> accessed 6-6-08.

Actual 2006	Probable 2007		<----- Forecasts ----->				
			2008	2009	2010	2011	2012
£m	£m		£m	£m	£m	£m	£m
		States Income					
398	440	Income Tax	460	480	495	515	535
-	-	Q/10% Corporate Tax Structure	-	(9)	(77)	(82)	(87)
-	-	Goods and Services Tax	30	45	46	47	48
53	52	Impôts Duty	52	52	52	52	52
23	26	Stamp Duty	27	28	29	29	30
-	-	Tax/Stamp Duty on Share Transfer	1	1	1	1	1
42	34	Other Income	33	32	28	25	24
9	10	Island Rate	10	11	11	11	11
525	562	States Income	613	640	685	698	614
		States Expenditure					
465	482	Net Revenue Expenditure	505	525	546	565	583
39	42	Net Capital Expenditure Allocation	40	38	39	39	40
504	524	Total States Net Expenditure	545	563	585	604	623
		One-off expenditure					
-	-	Income Support - Transitional relief	10	6	4	2	1
21	38	Revised Forecast Surplus/(Deficit)	58	71	(4)	(8)	(10)

In doing so, however, it assumes that at least £45 million a year can be raised from GST, and those designing the tax thought that unlikely, and that income taxes will, despite the cut in the corporate tax rate for all local companies by at last 50%, increase in total amount collected from £460 million in 2008 to £535 million in 2012. This is utterly implausible, not least during the financial recession after the dot.com crash in 2000 Jersey's state income tax income flat lined for five years:

Table 10.2  
Sources of Income Tax Revenues



Source: Jersey budget, 2008

The top line would read 1999, £324m; 2000, £334m; 2001, £347m; 2002, £366m; 2003, £370m; 2004, £370m. The actual income in 2004 was, according to the 2006 budget £363m and 2005 was £370m. So, for five years (2001 - 2005) real growth was 1.5% on aggregate, and effectively 0% from 2002 to 2005 inclusive, a real decrease when inflation is considered. But on the back of two good years Jersey is now forecasting growth of 5% when there is every sign that it's only core business sector is in crisis. 0% might be a very optimistic substitute at present.

If the loss of tax revenue from the zero / ten policy of £118 million is used rather than the modest £77 million which Jersey forecasts, and growth in other revenues is projected at a much more likely 1.5% then Jersey's forecasts becomes:

	2006 £m	2007 £m	2008 £m	2008 £m	2010 £m	2011 £m	2012 £m
Per Jersey budget	398	440	460	480	495	515	535
If grows at 1.5%	398	440	447	453	460	467	474
Gap	0	0	-13	-27	-35	-48	-61
Revenue loss per Jersey	0	0	0	9	72	82	87
Likely revenue loss	0	0	0	30	118	130	145
Extra loss	0	0	0	-21	-46	-48	-58
Total gap	0	0	-13	-48	-81	-96	-119

Source: Tax Research LLP<sup>109</sup>

The conclusion is obvious. Jersey is facing a significant budget deficit. It has at best strategic reserves of around £500 million<sup>110</sup>. With the level of deficit it might be facing it could shortly be bankrupt. Guernsey faces the same dilemma.

### The EU Savings Tax Directive<sup>111</sup>

After intense negotiation the EU Savings Tax Directive came into force in July 2005. The Directive applies in all EU member states and the dependent or associated territories of EU member states, being Anguilla, Aruba, British Virgin Islands, Cayman Islands, Gibraltar, Guernsey, Jersey, Isle of Man, Montserrat, Netherlands Antilles, and the Turks and Caicos Islands. In addition other jurisdictions that have agreed to participate are Andorra, Liechtenstein, Monaco, San Marino and Switzerland.

Singapore, Hong Kong, Macao, Bermuda and Barbados have been asked to participate and have so far declined to do so.

The main method of application of the Directive is to permit the exchange information between tax authorities. The automatic exchange of data on interest paid has been agreed by all member states except Austria, Belgium and Luxembourg. This means that details of interest paid to a person who is resident in another EU member state is automatically sent to that other member state annually. This enables tax declarations by the person receiving the interest to be checked for accuracy, and allows each state to collect its own taxes appropriately.

As a temporary measure, the option of a withholding tax is allowed, and has been agreed for Austria, Belgium, Luxembourg and in all the non-EU jurisdictions that participate. This allows the taxpayer to choose either to have data on the interest paid to them sent to their country of normal residence, or to have tax deducted at source from the interest payment made to them. If they choose to be taxed at source, details of the interest paid are not exchanged with their usual country of residence. The tax collected this way is shared between the country collecting it (25 per cent) and the country where the person earning that interest resides (75 per cent).

These options are significantly different. The first option ensures that the correct tax should be paid by the resident of a country in that country. The second option ensures only that a withholding tax is paid, which is likely to be lower (the rates are given below) than

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<sup>109</sup> <http://www.taxresearch.org.uk/Blog/2007/11/26/jerseys-black-hole/> accessed 6-6-08

<sup>110</sup> Jersey in Figures 2007, States of Jersey

<sup>111</sup> This section based on [http://www.taxjustice.net/cms/upload/pdf/European\\_Union\\_Savings\\_Tax\\_Directive\\_March\\_08.pdf](http://www.taxjustice.net/cms/upload/pdf/European_Union_Savings_Tax_Directive_March_08.pdf) with permission accessed 6-6-08

the full liability due in the recipient's country of residence. In addition, part of the benefit also goes to the country where the account is held, rather than that in which the recipient resides. For these reasons, the second option is not an effective measure to stop tax evasion, and has only been accepted as a temporary measure by the EU, which does eventually need to eliminate this option if the prevention of tax evasion is its objective. It is notable that it is the tax haven states that have opted for this sub-optimal alternative, the only possible reason for doing so being that they know this facilitates continued tax evasion in their banking systems by the residents of other countries.

The Directive applies to any individual who is resident in one EU country who has interest paid to them in another EU country or participating state. The Paying Agents (usually banks) are required to verify the residence of the beneficial owner of any interest they pay, under the regulations enacted by the country where the account is held, which must comply with the general principles of the EU law.

Perhaps the biggest single indicator of a lack of willing to report suspicious transactions that might involve tax evasion in another state occurring in tax havens results from this requirement that paying agents know the identity and location of their clients. Every bank in a tax haven state operating tax withholding under the EU Savings Tax Directive has to ask their client if they want to information exchange or have tax withheld. In each and every case where there has been a refusal to exchange information the suspicion must exist that this is because of a desire to tax evade on the part of the customer: it is hard to think of another plausible reason for not exchanging. But there is no evidence that any suspicious transactions have been reported for this reason. This failure of the paying agents and the authorities in the locations in question is exceptionally hard to explain given the nature of their money laundering laws.

If withholding rate apply they are:

- 15 per cent from 1<sup>st</sup> July 2005 until 30th June 2008.
- 20 per cent from July 1st 2008 until June 30th 2011.
- From January 1st 2011 tax will be deducted at 35 per cent.

The impact of the EU STD has been modest to date. For example, in 2006 Jersey collected just £21.9 million of tax under the EUSD. Some £67 billion was on deposit from the EU in Jersey in December 2006<sup>112</sup>. Interest paid on those deposits probably exceeded £2.7 billion in that year and it is claimed that 50 per cent of all relevant accounts were subject to information exchange. A withholding of £21.9 million in that case suggests that only 11 per cent of all EU resident owned cash on deposit in Jersey is subject to the Directive, giving some indication of how easy it is to avoid. It can be avoided by:

- Placing the funds on deposit in the name of a limited company.

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<sup>112</sup> Source: Jersey Finance statistical data

- Transferring the sums on deposit into a trust or foundation. In these arrangements the funds on deposit are usually held by professional nominees on behalf of the beneficial owners. These arrangements are not covered by the Directive.
- Moving the investment out of cash and into any other form of investment e.g. shares.
- Putting the investment into an insurance "coat" or "wrapper": popular in many European countries.
- Moving the sum deposited to a non-participating location such as Singapore or Dubai.

There can be no doubt that all these options have been heavily promoted in the tax haven states to which the Directive applies.

Four actions are needed to remedy the defects in the EU Savings Tax Directive:

- The withholding tax option should be removed so that information exchange is required in all cases;
- The Directive should be extended to all legal entities, especially private companies and trusts;
- The income covered should be extended to include all forms of investment income and insurance based products and not just interest on bank deposits;
- The provisions of the Directive should be extended to places like Hong Kong, Singapore and Dubai which are currently marketing themselves on the basis of being outside this scheme and so available for use by tax evaders.

These actions should be taken immediately without waiting until the current transitional arrangements are supposed to expire in 2011. The EU should make it clear that it cannot accept economic cooperation with countries that refuse to accept these standards of disclosure.

So far, the EU has been trying persuasion, although acceptance of the Directive has also been proposed as a condition in the current EU negotiations for an economic agreement with Singapore. Non-cooperating countries have far more to lose from a worsening of economic relations than the EU. It is time to take a strong line and insist that financial liberalisation also requires cooperation to enforce regulations, including taxes.

If these changes are made the resulting standard should be considered the template for negotiation of international agreements to help tackle tax evasion on a global basis.

The tax that might be recovered as a result of these changes is hard to estimate. However, for the UK alone, and based on data for investments held denominated in sterling in Jersey, Guernsey and the Isle of Man alone, the total tax loss from tax evasion is likely to be at least £3.6 billion a year. This indicates the enormous scale of tax recovery likely from full reform of the EU Savings Tax Directive, and the ending of the cloak of secrecy provided by tax havens for banking, investment flows and the beneficial ownership of assets.

## Other response to the attacks from regulators on tax havens

It is already clear that many of the attempts at regulation of tax havens have had little impact. Those that have had impact have been resisted, or to borrow tax parlance, aggressively avoided by the tax havens so that the OFCs that are located within them, and their clients, can continue to evade tax.

There have been other significant reactions with tax havens to the attacks upon them. The three main legal ones have been changes to trust laws, the creation of protected cell companies and the creation of the concept of redomiciliation. Each will be dealt with in turn.

As noted in chapter 3, trusts are an instrument normally only available in Anglo Saxon common law. A trust can be defined as:

a relationship in which a person or entity (the trustee) holds legal title to certain property (the trust property) but is bound by a fiduciary duty to exercise that legal control for the benefit of one or more individuals or organizations (the beneficiary), who hold “beneficial” or “equitable” title.

Note that a trust is an arrangement where the settlor gives the property away. This imposes a cost on the settlor. Few like the risk implicit in this: giving their funds to a professional person who they do not know who then has unfettered power over that cash is not a risk all tax evaders wish to take. Jersey and some other jurisdictions, including Cayman and the British Virgin Islands sought to get round this in the early years of this century using guidance that appears to have been provided by the Society of Trust and Estate Practitioners, based in the UK. The consequences have already been noted in chapter 3. The result is the existence of trusts in many of the major tax havens of the world which bear no relationship with those arrangements as found, for example, in the UK. They are mere nominee arrangements or shams in which professional people in those locations lend their names to persons who can wish to use them for little other purpose, it would see, than evading tax.

Second, protected cell companies have been created, as noted in chapter 3. Once again the intention seems unambiguous when their use is extended beyond the reinsurance market: they extend secrecy and prevent effective information exchange.

Third, as noted also in chapter 3, redomiciliation now allows companies as well as natural persons to flee a tax haven when enquiry is made of their activity. There can only be one purpose for the creation of this legal concept: it is to help the tax evader escape the consequence of their crime.

Finally, and as importantly, tax havens have at the same time as they have been agreeing to some very limited information exchange agreements under the terms of the OECD

initiative have been doing all they can to divest themselves of information they might exchange. So, and for example, one of the consequences of the zero / ten taxation now in operation in the Crown dependencies is that, at least theoretically, companies no longer pay tax in those places. As a result they no longer have to submit tax returns to the local tax authorities. The consequence is simple: they no longer have information to exchange, so undermining the whole principle of information exchange agreements into which they have entered. This, it is suggested, is not coincidence. This is deliberate policy.

## Conclusions

Regulation of tax havens has failed to date.

The offshore financial centres that operate from them remain unconstrained in their activities.

New methods of tackling the offshore economy are now needed.

These will be considered later in this report, but first it is necessary to consider the UK's role as a tax haven.

## 7. The UK as a tax haven

In the context of this report it is important to note why comments about tax havens must refer to the UK as well as those territories more often considered to have that status.

In July 2007 Alistair Darling said<sup>113</sup>:

claims that the UK was a tax shelter were seriously flawed'. ....[T]he IMF does not categorise the UK as a tax haven. This was suggested by some organisations on the back of some seriously flawed experimental methodology for identifying tax havens. The government is committed to ensuring that everyone pays their fair share of tax.

The truth was that it was Darling who was making the wild claim: although the methodology used by Ahmed Zoromé for the IMF<sup>114</sup> had flaws within it, they were, as previously noted, ones mainly of limitation of scope due to lack of data. The conclusion that the UK was an offshore financial centre was justified despite the reluctance of many in the UK to recognise this fact.

This section of the report presents the case for the UK being considered a tax haven, a case that can be made, as will be noted, under many headings.

### Historical consideration

As has previously been noted, it was in the 1920s that the UK created the concept of the offshore company, where registration could take place in one location but residence could be considered elsewhere. This has been central to the development of tax havens.

The UK has also contributed the concept of the trust to the world, and codified regulation with regard to their use in 1925 in the Trustee Act of that year<sup>115</sup>, which is still in use and which codified the regulation of trusts, so spreading their availability. Crucially, it enshrined the secrecy of trusts, neither requiring that they be registered unless taxable, or that they have accounts on public record, so creating the perfect instrument for offshore secrecy that could be easily incorporated into the legislation of tax havens by simply copying and developing this legislation.

Then in October 1957 the Bank of England created the regulatory concept of offshore when it declared that transactions that took place in London but which were undertaken between two parties resident outside the UK were not subject to UK financial regulation as

<sup>113</sup> <http://www.accountancyage.com/accountancyage/news/2194525/darling-offensive-against-uk> accessed 3-6-08

<sup>114</sup> [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=986815](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=986815) accessed 3-6-08

<sup>115</sup> [http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1925/cukpga\\_19250019\\_en\\_1](http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1925/cukpga_19250019_en_1) accessed 3-6-08

they were deemed to take place somewhere ‘elsewhere’ to London, even though it was obvious to all involved that this was a fiction. As such the UK created all the key components that underpin the fiction of the ‘secrecy space’ that is critical to offshore activity. Only banking secrecy was created elsewhere, but since, as the Swiss like to point out, the same result can be achieved by the use of UK trusts owning UK companies registered in the names of nominees even this distinction is somewhat arbitrary.

Finally, the UK quite literally created more of the world’s tax havens than any other state, it being the deliberate policy of the Foreign & Commonwealth Office over many years to encourage small island states to develop as tax havens. It is not chance that so many of the world’s tax havens are small states closely allied to the UK or its Commonwealth.

There can also be no doubt that the UK is responsible for perpetuating this situation. As the National Audit Office report on the British Overseas Territories published in November 2007 noted<sup>116</sup>:

The Territories are a UK Government-wide responsibility. The Foreign and Commonwealth Office, (“the Department”), leads overall policy and maintains the main UK presence in Territory, with other Government departments helping to discharge specific aspects of the UK responsibilities.

[A]reas, such as the regulation of offshore financial services, clearly pose important and growing risks, though these have not yet resulted in direct costs to the UK.

The implication is clear though: the UK has the responsibility and the risk. As such it can and should manage these havens better than it does.

### **The Euromarket**

The decision of the Bank of England to open an unregulated space for the trading of dollars located outside the UK had the consequence of creating the Euromarket. This remains focussed on London, and continues to avoid most banking regulation.

So significant is this market believed to be that the economic policies of the UK have been heavily influenced by its existence in London. In particular, it has contributed to the notion that London is lightly regulated. More important still, it has been the reason for the UK’s commitment to refusing any suggestion of tax withholding on the payment of interest to person’s not resident in the state in which payment arises. This has been to the enormous benefit of other tax havens, both by allowing the flow of tax free funds to them and by ensuring that they can defend their known refusal to apply withholding taxes by saying they are only emulating best practice in the UK. The flow of illicit funds around the world has benefited enormously as a result. There can be little doubt that the UK would have

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<sup>116</sup> [http://www.nao.org.uk/publications/nao\\_reports/07-08/07084.pdf](http://www.nao.org.uk/publications/nao_reports/07-08/07084.pdf) accessed 4-6-08

acceded to general European desire for withholding taxes but for this reason. The refusal marks it out as a state dedicated to tax haven policies.

### **The Domicile rule**

The domicile rule is the quintessential evidence that UK is a tax haven. Albeit now modified and reduced in scope from April 2008 its impact is in practice little reduced for it has always been of greatest benefit to the very wealthy migrant person, and they still have easy access to the benefits it provides.

Those benefits remain a considerable cost to the UK economy. The rule has two other considerable adverse consequences. The first is that other tax havens say that it is the domicile rule that makes the UK a tax haven. This is frequently heard in the Channel Islands, for example.

Secondly, and regrettably, they are right because this rule means that the UK deliberately maintains a “ring fence” within its tax laws to benefit those who are only temporarily resident in the country (even if the definition of temporary in this case somewhat stretches normal usage of this term). Ring fences have been identified as harmful tax practices by the OECD<sup>117</sup>. They were right to do so. In addition they’ve also been identified as harmful by a UK Treasury minister - Dawn Primarolo to be precise. She chaired the committee that gave rise to the EU Code of Conduct on Business Taxation. It said<sup>118</sup>:

When assessing whether such measures are harmful account should be taken of, inter alia: ... (b) whether advantages are ring fenced from the domestic market so they do not affect that national tax base.

That is precisely what the domicile rules do. As a result it is clear that if this definition applied to personal tax as well as business tax, for which it was designed, the domicile rule would be considered a harmful tax practice by the EU. In consequence it is just chance that the domicile rules survive as legal under EU rules. Or maybe it was not chance. It is widely believed in Brussels that Dawn Primarolo was the main obstacle to extending the rules in the EU Code of Conduct on Business Taxation to the individual, behaviour also indicative of the UK’s status as a tax haven state.

### **Ease of company administration in the UK**

One of the characteristics of a tax haven is the ease with which entities may be incorporated and the ease with which anonymity can be secured when doing so, and subsequently with regard to the operation of the resulting limited company. It is regrettable to note that the UK is very lax in these matters. Some of the considerable

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<sup>117</sup> <http://www.oecd.org/dataoecd/33/0/1904176.pdf> accessed 4-6-08

<sup>118</sup> [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/harmful\\_tax\\_practices/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm) accessed 4-6-08

weaknesses in UK company administration that make it a favoured location for residents of other countries to incorporate their companies are as follows:

1. Ease of incorporation. It is possible to form a company within hours in the UK. No proof of identity of any sort is requested by the UK state agency responsible; Companies House. This omission is quite extraordinary.
2. Companies can be bought 'off the shelf' from registration agents. When this is done although the agent will ensure they have forms to ensure that their agents are removed as company director and secretary they are under no obligation to make sure that the form is properly completed by a person whose identity they have proven. As such it is very easy to establish a company using false names and information.
3. It is possible to issue bearer shares in UK companies even though this practice is heavily frowned upon in tax havens since it facilitates money laundering. This cannot be by accident: the right to issue bearer shares survived into section 779 of the Companies Act 2006. As one formation agent<sup>119</sup> who seems to specialise in the more esoteric end of the market has noted, UK companies with bearer shares are 'our most popular package with UK residents'. It's not hard to see why: this option allows the names of the real owners of the shares in a company to not just be hidden: they simply aren't recorded anywhere. As one source notes<sup>120</sup>:

A **bearer instrument** is a document that indicates that the bearer of the document has title to property, such as shares or bonds. Bearer instruments differ from normal registered instruments, in that no records are kept of who owns the underlying property, or of the transactions involving transfer of ownership. Whoever physically holds the bearer bond papers owns the property. This is useful for investors and corporate officers who wish to retain anonymity, but ownership is extremely difficult to recover in event of loss or theft.

This means that not only can the ownership of a company be hidden, it can be transferred at will without this being known, stamp duty or capital gains being paid, and without any organisation dealing with the company being any the wiser. Money laundering regulation becomes virtually impossible in that circumstance.

4. UK companies can also use nominees as directors, company secretary and shareholders, all of whom can be recorded as being located at an accommodation

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<sup>119</sup> <http://www.coddan.co.uk/s-9-uk-bearer-shares-company-formation.html> accessed 4-6-08

<sup>120</sup> [http://en.wikipedia.org/wiki/Bearer\\_instrument](http://en.wikipedia.org/wiki/Bearer_instrument) accessed 4-6-08

address. So significant is this activity that one well respected company formation agent advertises that <sup>121</sup>:

In addition, we can administer many of the business operations of a UK company, including the opening and operation of company bank accounts; raising and despatch of invoices; payment of suppliers etc..

What this means is that, in effect that you can set up and run a company in the UK without Companies House or the public having any idea at all who is behind the activities it is pursuing. It may even be quite hard for HM Revenue & Customs to find out. The chance of a tax authority in any other country doing so is remote indeed. And that company might really have no substance in the UK at all, which is a classic feature of a tax haven exercise. After all, unless there is no one here in the UK why would you need someone to invoice on your behalf from the UK, as Jordans offers to do?

5. One of the chief characteristics of a tax haven is that it provides a secrecy space - an opportunity for something to happen about which it is almost impossible for anyone, including tax authorities, to ask questions. The UK makes this possible because any company trading in the UK need never file a set of accounts. The reality is that a UK company can be incorporated by a formation agent, run by nominees and then after it has been in operation for a period of 21 months or so be due to file its first accounts. However it can instead simply file form 652(a) with the Registrar of Companies to ask to be struck off instead. Being struck off means that the company is dissolved without the need for a formal liquidation. As if by magic the company simply disappears instead. All that the directors have to state in making this application is:

I/We as DIRECTOR(S) apply for this company to be struck off the register.

In the past three months the company has not:

- traded or otherwise carried on business, or changed its name;
- disposed of for value any property or rights which it would have disposed of for value in the normal course of trading or carrying on business; or
- engaged in any other activity except for the purpose of making this application, settling its affairs or meeting a statutory requirement.

Note that there's nothing there that requires them to say if they have ever traded, if they have paid their tax, or of they have settled all their obligations to file accounts.

In that case a director of a company that wants to disclose no information can cease trading after 18 months and they can then honestly sign this form after 21 months

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<sup>121</sup> <http://www.jordans.co.uk/jordans3.nsf/Main/UK+company+administration+for+non-UK+shareholders>

when the accounts are due to be filed with the Registrar. It costs £10 to file and the company is usually dissolved within a few months. Companies House never asks for the accounts in that case.

HM Revenue & Customs can object. But in practice they almost never do, especially if they know nothing about the company (and the director in question will have ensured that is the case).

As a result anyone can run a limited company in the UK behind a charade of nominees and quite simply no-one will ever know what it does because it will never file accounts. And no one seems to care.

More than 100,000 companies are dissolved in the UK each year using this method of dissolution.

6. Even if it is decided to file accounts with the Registrar of Companies if the company is deemed in law to be a 'small entity' (and about 97% of all companies are) then the information filed is very limited in scope, being restricted to the balance sheet and some notes to the accounts. No profit or loss account data has to be filed. This makes the information put on record almost meaningless. There is no commitment to transparency in this process.
7. These small companies also enjoy low tax rates. Now charged to tax at 20%, this rate is lower than those charged in many other European countries, and is a benefit provided to small companies alone. It might be seen as a tax haven inducement by other states. For example, information supplied to the authors of this report suggests that more than 15,000 Norwegian enterprises are run through UK based limited companies.
8. One other form of UK entity, the Limited Liability Partnership is 'tax transparent'. This means that the entity itself, although incorporated with limited liability under UK law is not taxable. Instead its profit is apportioned to its members who are then taxable if resident in the UK. This provides opportunity for such entities to have income arising in the UK on which they can seek to avoid UK tax liability, providing them with an unfair competitive advantage. This situation needs to be changed since it creates a ring fence in favour of those not normally resident in the UK operating in the UK domestic economy.

### **The trust regime**

The UK trust regime, already noted in this report is the other characteristic of the UK that makes it a tax haven. There is no register of trusts in the UK: worse it is apparent that HM Revenue & Customs' data on trusts is seriously deficient and is likely to result in their

incomplete taxation<sup>122</sup>. This looks dangerously like tax haven behaviour, especially when trusts can, in combination with nominee companies be used to create banking secrecy.

### **Inflated financial services sector**

Lastly, and importantly, the UK is host to an OFC, as the IMF have shown in work by Ahmed Zoromé<sup>123</sup>. Put simply, the UK's financial services activity is excessive for domestic market needs. As such it is clearly set up to service offshore clients, some of whom will undoubtedly use the other tax haven characteristics of the UK noted above.

### **Conclusion**

The UK is a tax haven and hosts a massive OFC. It is therefore part of the tax haven problem for the rest of the world.

At the same time the UK suffers from tax haven activity.

It is within this dual context that the answers that follow to the questions raised by the Treasury Committee are offered.

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<sup>122</sup> <http://www.hmrc.gov.uk/research/report25.pdf> page 19 accessed 4-6-08

<sup>123</sup> [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=986815](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=986815) accessed 3-6-08

## Section 2 - The Treasury Committee Questions

### 8. To what extent, and why, are Offshore Financial Centres important to worldwide financial markets?

As has been noted in the introductory section of this report, tax havens and the OFCs they host have been critical to the development of the global financial system because they have provided the unregulated spaces in which the financial markets have developed.

Worldwide financial markets have been critically dependent upon offshore activity since the UK effectively created the unregulated, offshore Euromarket in October 1957 (see introduction for details). It is now fair to say that many of the most significant instruments in the financial markets are heavily dependent upon the OFCs located within tax havens to operate. These include:

1. **Hedge funds.** In 2003, offshore locations accounted for 40% of the number of funds and 49% of assets under management <sup>124</sup>. By January 2006, 55% of registered hedge funds were located from offshore. The most popular offshore location was the Cayman Islands (63% of offshore funds), followed by British Virgin Islands (13%) and Bermuda (11%). The US was also a popular location (with funds mostly registered in the tax haven of Delaware) as was Ireland<sup>125</sup>. The absolute value of funds had also risen by this date from US\$800 billion to about \$1.5 trillion, meaning that by 2006 there were more offshore hedge fund assets than there were total hedge fund assets in 2003. In true offshore style the actual management of the hedge funds located offshore generally happens in the major financial centres. In 2006 it was estimated that around 36% of global hedge fund assets were managed in New York in 2006, down from 45% in 2002. London is the second largest global centre for hedge funds managers after New York. Its share of the global hedge fund industry more than doubled between 2002 and 2006 to 21%<sup>126</sup>.
2. **Private equity.** A substantial part of the private equity sector is located offshore. The *Observer* newspaper has estimated that 80% of the main UK private equity earners are domiciled outside the UK. Private equity funds they are linked to will all be located offshore to ensure that they do not pay UK capital gains tax<sup>127</sup>. Jersey based lawyers advertise their private equity client base on their web site as including CVC Capital Partners, Alpha Group, AXA Private Equity, Terra Firma,

<sup>124</sup> [http://www.ifsl.org.uk/upload/CBS\\_Hedge\\_Funds\\_2004.pdf](http://www.ifsl.org.uk/upload/CBS_Hedge_Funds_2004.pdf) accessed 9-6-08

<sup>125</sup> [http://www.ifsl.org.uk/upload/CBS\\_Hedge\\_Funds\\_2007.pdf](http://www.ifsl.org.uk/upload/CBS_Hedge_Funds_2007.pdf) accessed 9-6-08

<sup>126</sup> *ibid*

<sup>127</sup> <http://www.guardian.co.uk/business/2007/jun/17/privateequity.observerfocus>

Carlyle Group, Investindustrial and Mercapital<sup>128</sup>. Major private equity groups, such as Permira, owners of the AA are based wholly offshore. The first company quoted on the London Stock Exchange's Specialist Fund Market on 29th May 2008 was The Da Vinci CIS Private Sector Growth Fund Limited, based in Guernsey. The Specialist Fund Market was launched by the London Stock Exchange in November 2007 as a regulated market for highly specialised investment entities. Its lighter regulations are aimed at attracting hedge funds and private equity funds.<sup>129</sup>

3. **Accountancy.** As has been previously noted, the major accountant firms operate in all the world's major tax havens, however small they are. This can only be because of the international role of the OFCs located in these territories. There is little or no local demand for their services in these places.
4. **Collateralisation and securitisation** are undertaken almost exclusively offshore. Northern Rock's Granite entity was partly based offshore<sup>130</sup>. HBOS has a €40 billion securitised fund in Jersey called Grampian Funding Limited<sup>131</sup>. That's £28 billion, near enough. A figure just a little less than the UK spends on public order and safety a year.
5. **Private wealth management** is almost entirely located offshore. The sector is dominated by Switzerland and London, although funds may be in any satellite location. As previously noted, the Tax Justice Network has estimated that in 2004 \$11.5 trillion of funds were held offshore by private wealthy individuals<sup>132</sup>, basing this finding in turn on reports from Merrill Lynch, Cap Gemini and Boston Consulting Group. CapGemini estimated in 1998<sup>133</sup> that one third of these assets were held offshore, and in 2002/03 refined that to 31%. They have not commented since. There is no reason to think the ratio has changed: indeed, funds on deposit offshore have continued to grow markedly, as data earlier in this report on funds in Jersey shows. A recent survey of dividend payments showed Cayman to be the fifth largest recipient<sup>134</sup>.
6. Various estimates suggest that 50% of **world trade** passes through a tax haven. Proving this is hard: what is clear is that more than 60% of world trade is intra-group (i.e. between companies under common ownership)<sup>135</sup> and it is much more likely

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<sup>128</sup> <http://www.mourant.com/section/54/index.aspx> accessed 9-6-08

<sup>129</sup> [http://www.ogier.com/Deals/Pages/Ogier\\_Guernsey\\_involved\\_in\\_landmark\\_London\\_listing.aspx](http://www.ogier.com/Deals/Pages/Ogier_Guernsey_involved_in_landmark_London_listing.aspx) accessed 9-6-08

<sup>130</sup> <http://www.timesonline.co.uk/tol/news/politics/article3406368.ece> accessed 9-6-08.

<sup>131</sup> <http://www.reuters.com/article/bondsNews/idUSL1121127120070911> accessed 9-6-08

<sup>132</sup> [http://www.taxjustice.net/cms/upload/pdf/Price\\_of\\_Offshore.pdf](http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf) accessed 9-6-08

<sup>133</sup> <http://www.capgemini.com/m/en/doc/WWR98.pdf> accessed 9-6-08

<sup>134</sup> <http://www.taxresearch.org.uk/Blog/2008/06/04/cayman-5th-largest/> accessed 9-6-08

<sup>135</sup> OECD Observer April 2002 OECD

that this trade will involve a tax haven step than trade which does not have that linkage in it. An example of how this might happen was published in the Guardian newspaper in November 2007, using a case study on banana trading which showed the extent to which offshore re-pricing was used to ensure that the profits from this trade ended up offshore<sup>136</sup>.

The evidence is unambiguous: tax havens and OFCs are central to the world financial system.

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<sup>136</sup> <http://www.guardian.co.uk/business/2007/nov/06/12> accessed 9-6-08

## 9: To what extent does the use of Offshore Financial Centres threaten financial stability?

The threats arising from the use of tax havens and the OFCs that together make up the offshore world are substantial. They also extend beyond financial markets. They can be summarised under the following headings:

### Corruption undermines stability

As the Tax Justice Network has persistently argued, corrupt activities that fall into the category of grand corruption cannot happen without the existence of tax havens and the OFC companies that operate from them<sup>137</sup>. And yet tax havens are considered some of the least corrupt countries in the world by Transparency International, as this table shows<sup>138</sup>:

Table 1: Tax havens economies ranked amongst the 'least corrupt' countries in Transparency International's 2006 Corruption Perceptions Index.

Country rank	Tax haven jurisdictions*	CPI score
	Iceland / New Zealand	9.6
1	Zealand	9.6
5	Singapore	9.4
7	Switzerland	9.1
9	Netherlands	8.7
	Luxembourg /	
11	United Kingdom	8.6
15	Hong Kong	8.3
16	Germany	8.0
18	Ireland	7.4
20	Belgium / USA	7.3
24	Barbados	6.7
26	Macao	6.6
28	Malta / Uruguay	6.4
31	UAE	6.2

\* source: Christensen, J. & Hampton M.P. (2005) tax us if you can, TJN-IS

As one former Nigerian politician commented about protracted negotiations to secure the repatriation of assets stolen by former Nigerian President Sani Abacha:

<sup>137</sup> [http://www.taxjustice.net/cms/upload/pdf/0701\\_Mirror\\_Mirror\\_corruption.pdf](http://www.taxjustice.net/cms/upload/pdf/0701_Mirror_Mirror_corruption.pdf) accessed 9-6-08

<sup>138</sup> *ibid*

“It is rather ironical that the European based Transparency International does not think it proper to list Switzerland as the first or second most corrupt nation in the world for harbouring, encouraging and enticing all robbers of public treasuries around the world to bring their loot for safe-keeping in their dirty vaults”.<sup>139</sup>

Tax havens undermine global stability by enabling most of the corruption that takes place in many developing countries.

The capital flight they enable is even more harmful. As has been noted in the introduction, Raymond Baker<sup>140</sup> estimates that tax driven illicit cash flows amount to 60-65% of all illicit flows. This suggests that flows motivated for this purpose have a value of between US\$600 billion and US\$1 trillion a year. Half of this might come from developing countries.

The Tax Justice Network has estimated that US\$11.5 trillion of funds are held offshore by individuals, based on data published by major banks and financial services institutions in 2004<sup>141</sup>. They estimate that US\$255 billion of tax is lost to the countries of the world as a result.

The OECD estimates a lower level of funds held offshore, at between US\$5 - US\$7 trillion, but their estimate excluded non-financial assets, which the Tax Justice Network estimate included.

Christian Aid has estimated that the cost of lost corporate taxes to the developing world is currently running at US\$160bn a year (£80bn). That is more than one-and-a-half times the combined aid budgets of the whole rich world - US\$103.7bn in 2007. As a result of transfer pricing abuse alone they estimate that lost revenue contributes to the death of 350,000 children a year<sup>142</sup>.

These flows undermine more than financial stability: they threaten lives.

### **Tax havens undermine corporate governance**

Tax havens undermine good corporate governance. This arises because they provide the facilitating infrastructure for corrupt and illegal payments. Recent examples include Samsung and Siemens. In the former over 1,200 accounts were secretly operated for the benefit of senior executives<sup>143</sup>. In the latter case<sup>144</sup> it is stated that:

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<sup>139</sup> Former Education Minister Professor Aliya Babs Fafunwa quoted in *This Day*, 6th June 2005

<sup>140</sup> [http://www.gfip.org/index.php?option=com\\_content&task=view&id=109&Itemid=74](http://www.gfip.org/index.php?option=com_content&task=view&id=109&Itemid=74) accessed 2-6-08

<sup>141</sup> [http://www.taxjustice.net/cms/upload/pdf/Price\\_of\\_Offshore.pdf](http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf) accessed 2-6-08

<sup>142</sup> <http://www.christianaid.org.uk/images/deathandtaxes.pdf> accessed 2-6-08

<sup>143</sup> <http://www.ft.com/cms/s/0/e0c68cd4-0c3e-11dd-86df-0000779fd2ac.html> accessed 9-6-08

<sup>144</sup> <http://ap.google.com/article/ALeqM5h1FI0GhdKYET8xBkitwnzl-odYkwD90TCHVG0> accessed 9-6-08

Siekaczek, 57, is charged with 58 counts of breach of trust. Prosecutors allege that he set up a complex network of shell corporations that he used to siphon off company money over several years. The money allegedly was used as bribes to help secure contracts abroad by paying off would-be suppliers, government officials, potential customers. Testifying as the trial opened, Siekaczek acknowledged having set up slush funds. "The whole sectoral management was naturally informed that this function was carried out by me," he told the Munich state court.

The defendant's case makes it clear that this was company policy. There can be little doubt that this remains commonplace: corrupt funds do not arrive in tax havens without someone being complicit in paying them.

There is another, more insidious way in which tax haven-based structures undermine corporate governance. It is commonplace for the special purpose vehicles that issue many of the complex financial instruments associated with tax havens to be owned by charitable trusts. This arrangement it adopted to ensure that the entity promoting the special purpose vehicle can claim that it neither owns nor controls the resulting company and as such can keep it 'off balance sheet'. The objective is clear: the company creating the structure wants to hide the true nature of its financial position. The charitable trust is supposedly controlled by professional trustees. In practice the whole arrangement consists of smoke and mirrors, managed and controlled in practice by the entity whose debt the SPV issues.

This creates an enormous ethical issue, which poses a significant challenge to good corporate governance. In fact the structure of the SPV is a charade: it is not what it appears to be. It is neither independent, nor charitable (as was noted during the Northern Rock / Granite debacle, the charity supposed to benefit from the trust owning Granite had never received a penny from it<sup>145</sup>). In that case the management who promote such schemes know that they are, in effect, promoting a fraudulent structure. The language is correct: fraud does not need to imply criminality, it actually means "deceit, trickery, sharp practice, or breach of confidence, perpetrated for profit or to gain some unfair or dishonest advantage<sup>146</sup>." This is exactly what was achieved through the use of the SPV: as Northern Rock again proved, its SPV called Granite enjoyed a higher credit rating and therefore a lower cost of borrowing than the bank that sponsored it did. That was the financial advantage it secured as a result of this trickery that misrepresents the true nature of the economic transactions that are taking place.

When the use of such deception is commonplace a fine line has been crossed: deception is accepted as a normal part of corporate practice. Good corporate practice is bound to be undermined as a result. Since offshore has facilitated many of these structures it has played a key role in creating the financial instability that has resulted from the creation of

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<sup>145</sup> <http://www.guardian.co.uk/money/2007/dec/05/banks.northernrock> accessed 10-6-08

<sup>146</sup> <http://dictionary.reference.com/browse/fraud> accessed 10-6-08

mechanisms that have now been seen to undermine the credibility of financial market regulation, not least in the UK.

### **Tax havens destabilise governments**

There can be no better indication of this than the BAE affair: Tony Blair's government was under threat from the disclosures that might have taken place as a result of the BAE affair, most of which occurred offshore<sup>147</sup>, without which, no doubt it would not have happened. Whatever happens, the debacle will remain as a stain on his record and that of the UK, which because of transactions like this has a poor international standing on corruption issues.

This affair did not bring down a government: on another occasion it might have done. The use of offshore arrangements has the power to undermine the instruments of government itself in the developed world.

### **Tax havens can destroy OFC operators**

The fifth largest firm of accountants in the world in 2000, Arthur Andersen was destroyed as a result to the damage to its reputation arising from the offshore trading of its client Enron<sup>148</sup>. KPMG agreed to pay US\$465 million in settlement of a federal investigation into tax shelters it had marketed to its clients in the US.<sup>149</sup>

The same debacle has also resulted in Barclays, Merrill Lynch, Credit Suisse and other banks have all had their reputations harmed by involvement with Enron<sup>150</sup>.

### **Tax havens facilitate crime**

Extensive reference has been made in the introduction to the ways in which tax havens facilitate crime. These flows amount to hundreds of billions of dollars a year<sup>151</sup>.

### **Tax havens create Financial instability**

Tax havens significantly increase the risk of financial instability in the world. Fundamentally they do this by ensuring that information is not available. Markets are always inefficient when there is less than perfect information available to them. Tax havens set out to create asymmetric access to information. As a result risk is increased because:

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<sup>147</sup> <http://www.guardian.co.uk/world/2007/jan/17/bae.saudi-arabia> accessed 9-6-08

<sup>148</sup> [http://en.wikipedia.org/wiki/Arthur\\_Andersen](http://en.wikipedia.org/wiki/Arthur_Andersen) accessed 9-6-08

<sup>149</sup> <http://law.taragana.net/archive/tax-shelter-suit/> accessed 12-6-08

<sup>150</sup> <http://www.guardian.co.uk/business/2006/nov/03/corporatefraud.enron> accessed 9-6-08

<sup>151</sup> [http://www.gfip.org/index.php?option=com\\_content&task=view&id=109&Itemid=74](http://www.gfip.org/index.php?option=com_content&task=view&id=109&Itemid=74) accessed 2-6-08

1. In many cases a person will have no way of knowing the true identity of who is being dealt with;
2. Counterparty risk in many financial transactions will increase as a result;
3. Default risk increases as a result, whatever the trade;
4. There is increased risk of moral hazard as it is easier to allow a company to fail in a tax haven where there is little or no chance of the true nature of its ownership being established than there is in a mainstream economy where such information is more likely to be disclosed for public record. A perfect example is to be found in the case of Carlyle Capital Corporation (CCC), a unit of the private equity firm Carlyle Group, which said on 13 March 2008 that it would not be able to meet lenders' demands for money<sup>152</sup>. Astonishingly, as reported by Prof Prem Sikka of Essex University<sup>153</sup>:

On February 27 2008, Carlyle Capital Corporation published its annual accounts for the year to December 31 2007. These accounts were audited by the Guernsey office of PricewaterhouseCoopers, the world's biggest accounting firm, which boasts revenues of \$25bn.

Amid one of the biggest credit crises, the accounts claimed on page five), that the directors were "satisfied that the Group has adequate resources to continue to operate as a going concern for the foreseeable future". The auditors were satisfied, too, and on 27 February 2008 gave the company a clean bill of health (page 6).

Less than two weeks later, on March 9 2008, Carlyle announced that it was discussing its precarious financial position with its lenders. And on March 12, the company announced that it "has not been able to reach a mutually beneficial agreement to stabilize its financing".

The company collapsed with debts of £11 billion<sup>154</sup>. If evidence were needed of the difficulty in assessing stability in the offshore world, and the risk it poses, then this must be a prime example. If PricewaterhouseCoopers can be caught out within 11 days on the basis of having had full access to the books of this company no-one else has a chance of assessing the risk in such companies.

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<sup>152</sup> <http://news.bbc.co.uk/1/hi/business/7293663.stm> accessed 9-6-08

<sup>153</sup> <http://www.guardian.co.uk/commentisfree/2008/mar/14/watchingthedetectives> accessed 9-6-08

<sup>154</sup> *ibid*

5. The offshore economy deliberately exacerbates risk with the structures it creates. For example protected cell companies (see chapter 3, above) create what are, in effect, ring fenced limited liability companies with what are already almost opaque offshore entities. These are used within the insurance sector, in particular, when party to legitimate activity but will, inevitably make it difficult to determine what, if any assets are available to creditors. This is particularly disturbing in a sector where the insurer is meant to act as payer of last resort.
6. Offshore is prone to the creation of what might best be called Ponzi style risk. As was argued by Anastasia Nesvetailova<sup>155</sup> in her book *Fragile Finance, Debt, Speculation and Crisis in the Age of Global Credit*<sup>156</sup>, written before the credit crunch began, derivatives, securitised debt, the Collateralised Debt Obligations<sup>157</sup> that guarantee them and the hedge funds that trade them all form a part of Ponzi scheme. As Dr Nesvetailova notes<sup>158</sup> there are three models of finance according to Hyman Minsky; hedged, speculative and Ponzi:

An advanced financial system goes, he says, through three stages: it begins with hedged finance, whereby borrowers raise money against collateralised assets. But as the period of growth continues, borrowers over-estimate the potential for growth, and borrow against future asset growth: in short, they speculate. Eventually, the bubble of speculative finance develops into what Minsky called Ponzi finance. The term comes from Carlo Ponzi, the most famous, though clearly not the only one, architect of a pyramid scheme. Ponzi's pyramids, involving 'investment' in real estate and land, ripped off more than forty million Americans during the US property boom of the 1920s.

By the time the model has reached the Ponzi stage the only way it works is for more and more people to join the scheme. When for any reason that stops the scheme collapses. This stage has not yet been reached in the credit crunch. It has obviously been approached with regard to the collapse in the collateralised sub-prime mortgage sell off through securitised debt. If this risk reaches the market for collateralised debt obligations, almost all of which is denominated offshore, crystallises into falling confidence in the value of CDOs then the next stage of the credit crunch would arise. The market is hard to value. One estimate suggests it is worth \$4 trillion<sup>159</sup>. Others suggest more. Many think this melt-down could happen. Dow Jones was discussing the risk on the day this report was written<sup>160</sup>. If monoline

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<sup>155</sup> <http://www.city.ac.uk/intpol/Staff/Nesvetailova.html> accessed 9-6-08

<sup>156</sup> <http://www.palgrave.com/products/title.aspx?is=0230006906> accessed 9-6-08

<sup>157</sup> See [http://en.wikipedia.org/wiki/Collateralized\\_debt\\_obligation](http://en.wikipedia.org/wiki/Collateralized_debt_obligation) accessed 9-6-08

<sup>158</sup>

[http://www.city.ac.uk/intpol/dps/WorkingPapers/A\\_Nesvetailova%20Ponzi%20Finance%20and%20Global%20Liquidity%20Melt-down.pdf](http://www.city.ac.uk/intpol/dps/WorkingPapers/A_Nesvetailova%20Ponzi%20Finance%20and%20Global%20Liquidity%20Melt-down.pdf) accessed 9-6-08

<sup>159</sup> <http://www.moneyweek.com/file/29060/how-to-stay-safe-in-the-credit-bubble.html> accessed 9-6-08

<sup>160</sup> <http://www.efinancialnews.com/assetmanagement/index/content/2450890667> accessed 9-6-08

insurers<sup>161</sup> fail to cover the risk then melt-down is likely. Their capacity to do so is also in doubt at the time of writing<sup>162</sup>.

7. In this situation accounting becomes unstable. Under both US and international accounting rules assets of major corporations have to be stated at their market worth on the balance sheets of major corporations. This is called 'mark to market' accounting and is part of the model of accounting adopted since the 1990s called 'fair value accounting' which replaced the previously accepted 'historical cost accounting'. The impact in the credit crunch has been enormous. Historical cost accounting leaves assets stated as having a value equivalent to the price paid for them unless that value materially declines. This creates stable balance sheet accounting. Fair value accounting replaces historical cost with current value, thus creating volatile balance sheet values. This suits companies, and especially financial corporations very well if asset values are rising: they can book that increase in value as profit even if they have not sold the assets in question. There can be no doubt that this simple fact motivated enthusiasm for this form of accounting.

In a downturn the reverse happens. Losses have to be booked. This is why such substantial provisions have had to be made on the accounts of so many banks during the first half of 2008. But the situation in a credit crisis has the capacity to deteriorate fast: if the market for an asset fails (and there is always the potential for this in a downturn when buyers for some forms of asset evaporate) then balance sheet values collapse in an inverse Ponzi related accounting crisis that can spiral out of control with insolvency resulting.

This risk exists at present. It has not all been created by offshore. It could not have happened without offshore allowing the creation and sale of the assets that have precipitated the crisis of confidence in asset value due to the limited information available on them (not least to credit rating agencies).

The evidence is clear: using a wide variety of indicators the capacity of offshore to both create and contribute to instability is enormous. Within the financial sector it would have been impossible for the current credit crunch to have happened if offshore had not existed.

Things may still get much worse yet.

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<sup>161</sup> [http://en.wikipedia.org/wiki/Monoline\\_insurance](http://en.wikipedia.org/wiki/Monoline_insurance) accessed 9-6-08

<sup>162</sup> <http://www.reuters.com/article/reutersEdge/idUSN0637505720080606> accessed 9-6-08

## 10: How transparent are Offshore Financial Centres and the transactions that pass through them to the United Kingdom's tax authorities and financial regulators?

Secrecy is at the core of tax haven activity, even more than tax is. They exist to create secrecy spaces, as explained in chapter 4.

As a matter of fact the vast majority of tax havens do not have information sharing agreements of any sort with the UK. In addition, double taxation agreements are discouraged as they provide benefits to the havens, e.g. allowing some form of income to be received there without tax being deducted at source in the UK. This is resisted because that would increase the tax loss to countries like the UK from tax havens.

Some tax havens, such as Jersey, are resisting even entering into limited information sharing agreement with the UK called Tax Information Exchange Agreements (TIEAs) because they claim they do not get enough benefit from them<sup>163 164</sup>. At present the UK only has the following TIEAs with tax havens, all relating to the EU Savings Tax D Directive alone<sup>165</sup>:

### Tax Information Exchange Agreements (TIEAs) - in force

Reciprocal Agreements relating to the EU Directive on taxation of savings income in the form of interest payments.

- Jersey (PDF 187K)
- Gibraltar (PDF 280K)
- Guernsey (PDF 187K)
- Isle of Man (PDF 189K)
- Montserrat (PDF 149K)
- British Virgin Islands (PDF 250K)
- Netherlands Antilles (PDF 124K)
- Aruba (PDF 107K)

Non-reciprocal Agreements relating to the EU Directive on taxation of savings income in the form of interest payments.

- Anguilla (PDF 117K)
- Cayman Islands (PDF 217K)
- Turks and Caicos Islands (PDF 219K)

An agreement with Bermuda is in negotiation.

<sup>163</sup> <http://www.taxresearch.org.uk/Blog/2007/12/09/no-no-no/> accessed 9-6-08

<sup>164</sup> <http://www.taxresearch.org.uk/Blog/2007/11/27/jersey-wants-to-renege-on-tax-information-exchange-agreements/> accessed 9-6-08

<sup>165</sup> [http://www.hmrc.gov.uk/international/tiea\\_inforce.htm](http://www.hmrc.gov.uk/international/tiea_inforce.htm) accessed 9-6-08

The reality is, therefore, that under the terms of tax treaties the tax havens of the world are largely closed to enquiry from HM Revenue & Customs, and the systems of public enquiry available in such places is also decidedly limited, as has been noted in the introductory chapters. This is in marked contrast with most countries in the world, where the UK has one of the strongest networks of double tax treaties that exists. These provide for relatively straightforward information exchange<sup>166</sup>.

That said, all is not lost in some criminal cases, where request for information can be made using what are called Mutual Legal Assistance requests for specific information known to be held by specific persons. The difficulty with these is, however, that in some cases even this is not possible: for example, when there is no local equivalent offence to that being investigated in the UK, as can happen in tax related issues when there is no equivalent tax in the tax haven then the request for assistance can be denied. Second, the pace of cooperation can be slow. Third, the system is exceptionally bureaucratic and often fails for this reason. Fourth, it is not always known precisely what information is needed and so specific requests cannot be made.

This means that in its most successful attacks on offshore arrangements, HM Revenue & Customs is still dependent on more conventional sources of obtaining information. It was, for example, by means of accessing bank data held in the UK that the data to undertake the UK's 2007 tax amnesty took place. Data on Liechtenstein has been purchased. Informants and tax investigation methods still provide a lot of the data used to break these arrangements. Cooperation from the tax havens remains decidedly limited and it looks as though they intend that it should stay that way.

This is unsurprising. Many tax professionals worldwide think that it might be their duty to comply with the law of the state in which they are resident. Few think they have duty to comply with the law elsewhere: most have little or no knowledge of whether they might be doing so and an indifference to finding out if that is the case. The already quoted statement of the chairman of the Swiss Bankers Association who said his members do not feel responsible for their client's actions, and that they do not consider themselves to be a tax authority is typical of most tax 'professionals' around the world. As such there is indifference to tax evasion as an offence requiring reporting under money laundering rules. This is why so few money laundering reports are generated or come out of those locations. It is not that the offences do not happen. Those arranging them are complicit in the process of fraud that takes place, and HM Revenue & Customs is largely powerless to obtain information from those territories about what is happening there.

As such it is reasonable to conclude that the world's tax havens and the transactions that pass through them are opaque to the United Kingdom's tax authorities and financial regulators.

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<sup>166</sup> See <http://www.hmrc.gov.uk/si/double.htm> accessed 10-6-08

## 11: To what extent does the growth in complex financial instruments rely on Offshore Financial Centres?

It is appropriate to note that complex financial instruments can and do exist without the involvement of OFCs. However, complexity comes at a price. Offshore has been used to reduce that price. It does so in a number of ways.

First of all it provides what many OFC operators like to call a ‘tax neutral’ environment. Actually, this means that no tax is charged. That is not tax neutral, of course.

Second, and as importantly, it provides a ‘light touch’ regulatory environment. There are two aspects to this. This first is that almost without exception regulation is undertaken reluctantly and under duress in tax havens. As a result minimum compliance is accepted. In addition, this is encouraged wherever possible. For example, in September 2007, just as the current global financial crisis began to develop Jersey announced that it was to offer a “zero regulation regime for funds where investors have put in a minimum of at least \$1 million”. As the *Wall Street Journal* said of this development<sup>167</sup>:

The small English Channel island of Jersey -- a haven for funds thanks to its light regulatory touch and low taxes -- is relaxing its rules even further.

It described the issues this raised as follows:

- The Issue: Jersey, an offshore center for hedge funds and other alternative asset managers, will offer a "zero regulation" regime for certain funds. Will rival centers follow, to attract business with the lightest regulation?
- Why It Matters: Some politicians and regulators want more, not less, oversight of hedge funds.
- Bottom Line: Offshore financial centers are outside the purview of U.S. and European regulators, placing oversight of the funds out of reach, even if fund managers are based in financial centers like London and New York.

As the *Wall Street Journal* noted, “It is a shift that could trigger a race to the bottom amongst offshore financial centers”. This comment is almost certainly correct: it may be that Jersey was simply responding to Guernsey, which has had a system since 2004 that allows a new hedge fund to be registered in 72 hours, largely by streamlining regulatory checks.

Third, this light touch regulation extends to other activities. If no tax return has to be submitted (as is becoming increasingly common in locations where there is no corporate income tax) and if accounts do not need to be prepared or audited, consideration of how to

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<sup>167</sup> [http://online.wsj.com/article/SB119102308704743294.html?mod=googlenews\\_wsj](http://online.wsj.com/article/SB119102308704743294.html?mod=googlenews_wsj) accessed 10-6-08

comply with these requirements and the technical issues they might raise in other locations, such as how a tax regime might apply to an instrument or how it might be disclosed under relevant accounting rules, can simply be ignored.

Fourth, many tax havens have very lax attitudes towards the regulation of charitable activity. As noted in chapter 9, charitable trusts administered by professional trustees in offshore jurisdictions are often used to own the structures that create complex financial instruments. Without such structures being readily and cheaply available offshore many of those instruments would not be available or viable. Lax regulation in this area has, therefore, significantly contributed to this problem.

Fifth, there is another way in which offshore facilitates complexity: because so many of the complex financial instruments that are issued are structured offshore the expertise to create these instruments is now concentrated there. In saying this it is stressed, most structures will be designed in locations such as London. The expertise that offshore provides is in wrapping those structures within SPVs, trusts and other vehicles and in supplying the administrative services that ensure that the resulting SPVs comply with local regulation. This task may not be onerous: the transactions undertaken by most SPVs are of decidedly limited extent, but someone needs to make sure they are properly recorded and centres such as Cayman and Jersey that focus on this market provide that expertise through a relatively limited number of law firms. This concentration also provides cost effectiveness, which was arguably the original incentive for producing the protected cell company since this structure allowed easy repetition of complex structures for similar deals between different entities.

Finally, throughout all this, of course, non disclosure is the norm. If a structure is fraudulent (as defined above) then this is of considerable importance because it means that the 'off balance sheet' liabilities of the entities promoting complex financial structures can literally hide what is within them and so complete the process of deception that they are undertaking. Offshore is an essential element of this deception since the key service provided by tax havens is the 'secrecy space', without which all their other supposed advantages would be worthless.

## 12: How important have the levels of transparency and taxation in Offshore Financial Centres been in explaining their current position in worldwide financial markets?

As was noted in the previous chapter, and has been discussed in more detail in chapter 4, the lack of transparency is vital to the offshore economy. That world is one of deliberately constructed ‘secrecy spaces’ that are usually, in a legal sense, neither in the locations that provide the legislative structure they use or anywhere else come to that. Sometimes these creations comply with the law of the other jurisdictions on which they impact, wittingly or unwittingly. As often they do not.

Without secrecy almost nothing would happen in tax havens. Low tax rates are of no benefit to the tax evader if it is obvious to their domestic tax authority that they are availing themselves of them. That is why information exchange is so heavily resisted by the providers of offshore services.

Non-disclosure of accounting information is vital to the corporate abuse of these locations, whether for legitimate or illegitimate purposes. The ‘legitimate’ reason has been noted in the previous chapter: secrecy enables corporations to make use of complex financial instruments without being held accountable for doing so, not least because if such structures are used for intra-group transactions they disappear from view again when included in consolidated financial statements as issued to shareholders which only reflect transactions with genuine third parties.

Illegitimate corporate abuse of tax havens involves transfer pricing abuse and capital flight: the resistance of corporations to country-by-country reporting is based in no small part on the fear that such tax abuse would be exposed if the veneer of consolidated accounts when used in combination with tax havens was shattered using this method of reporting.

For the fraudster using such arrangements as sham trusts and nominee companies secrecy is vital, and the tax haven jurisdictions and the offshore financial centre operators based there fight tooth and nail to preserve it. This includes major UK institutions. The five UK banks whose records were disclosed to form the basis of the 2007 UK ‘tax amnesty’ by HM Revenue & Customs fought hard in the UK’s tax commissioner system to prevent disclosure of the information they had in their system even though the evidence that doing so would assist tax evasion was overwhelming. The culture of secrecy runs deep, and at very high level.

Corruption could not take place in transparent tax havens. Crime would be harder.

Compared with secrecy low tax rates are simply the bait that attracts the customer and keeps them present once hooked. Secrecy is the essential component that makes tax haven activity possible. Without it the whole offshore charade would be shattered.

### 13: How do the taxation policies of Offshore Financial Centres impact on UK tax revenue and policy?

If those who defend tax havens are to be believed tax havens exist to impact on UK tax and revenue policy. In the libertarian view government is an oppressor of liberty and tax havens exist to limit the role of government by placing competitive pressure on them to reduce the scope of their activity and the charge they make for it, called tax.

This is the core philosophy of the Center for Freedom and Prosperity, set up to defend tax havens against challenge from the OECD. Dan Mitchell of that organisation has said<sup>168</sup>:

Tax competition occurs when individuals can choose among jurisdictions with different levels of taxation when deciding where to work, save, and invest. This ability to avoid high-tax nations makes it more difficult for governments to enforce confiscatory tax burdens. In effect, tax competition pressures politicians to be fiscally responsible in order to attract economic activity (or to keep economic activity from fleeing to a lower-tax environment).

Tax competition promotes responsible tax policies. Lower tax rates reduce the burden of government on businesses and create an environment more conducive to entrepreneurship and economic growth. Without competition, politicians can act like monopolists, free to impose excessive tax rates without fear of consequences.

Competition between jurisdictions creates a check on this behavior. Whether this is desirable, of course, depends on one's perspective. Those who want lower tax rates and tax reform favor competition between countries. Those who want more power for the government and higher tax rates do not like such competition.

The Tax Justice Network disagrees with the logic of these claims: indeed, TJN argues that they cannot be supported either by political economic theory or ethics. This is not least because even if the claims were right as a matter of fact most people do not have choice about where they can live: immigration policy usually restricts this for all but the most wealthy in the world and citizens of the EU. That means tax competition can only, as a matter of fact benefit the wealthiest and the capital they own. We believe it inappropriate that any policy be promoted from which this group in isolation can benefit.

As important, the economics is simply wrong. The micro-economic theory of the firm (itself open to serious questioning as to applicability in that sector) certainly cannot be extrapolated to explain the behaviour of states. The capacity to fail is integral within the micro-economics of the firm. It is the sanction for getting decisions wrong. The world cannot afford failed states. The economics cannot as such work.

<sup>168</sup> <http://www.heritage.org/Research/Taxes/BG1460.cfm> accessed 10-6-08

Politically we also disagree: tax competition is not the appropriate constraint on government, the ballot box is. The policy promoted by the Center for Freedom and Prosperity is fundamentally anti-democratic as a result since it ignores the right of electorates to choose the tax policies they wish without external interference undermining their right.

Since tax havens are the main low tax states of the world those who promote the idea of tax competition, including the Institute of Economic Affairs in the UK<sup>169</sup>, believe that they are at the forefront of the initiative to constrain what they see as the unwelcome tax policies of the UK and other OECD nations. In doing so they come remarkably close to endorsing tax evasion. Richard Teather, a chartered accountant and lecturer at Bournemouth University has written, when discussing the advantages of a person placing their savings offshore (emphasis added)<sup>170</sup>:

In practice, however, if the investor does not report his income, then the home country can have great difficulties in discovering and taxing it, particularly if the haven country has strong banking secrecy laws.

While I am not seeking to condone dishonesty or criminal activity, from an economic perspective this is merely another example of tax competition: *indeed, it is often necessary behaviour in order to take advantage of tax havens. Without the willingness of some to engage in this sort of activity, tax competition would be much less effective and therefore reduce the benefits that flow from it for the rest of us.*

It is a curious benefit that can in some cases only be secured by breaking the law. Other commentators have been even more overt: Konrad Hummler, a partner of the Swiss bank Wegelin & Co., commented to Der Spiegel in May 2008 that tax evasion by his German citizens was a legitimate defence “to partially escape the current grasp of the administrators of a disastrous social welfare state and its fiscal policies. Swiss-style saving outside the system” is something that both wealthy people and small and medium sized businesses are entitled, he added, saying “These people must be protected.”<sup>171</sup>

The reality is that in practice decades of what has been described as tax competition has not resulted in a cut in overall tax rate changes in the OECD from 1998 to 2005, as the following graph shows<sup>172</sup>:

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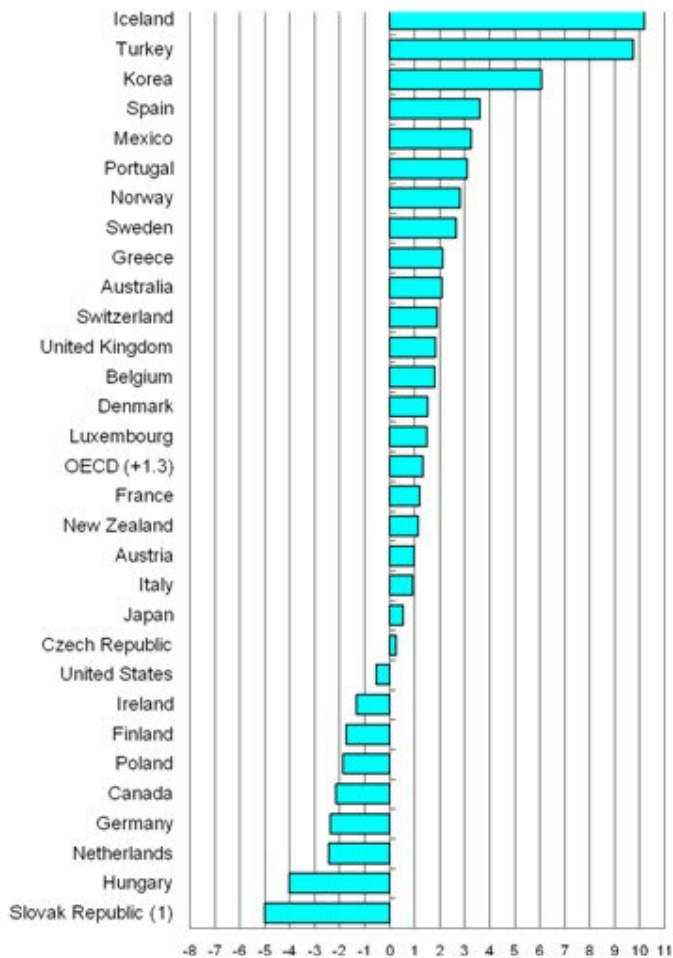
<sup>169</sup> <http://www.iea.org.uk/record.jsp?type=book&ID=303> accessed 10-6-08

<sup>170</sup> <http://www.iea.org.uk/files/upld-book303pdf?.pdf> page 81 accessed 10-6-08

<sup>171</sup> <http://www.spiegel.de/international/business/0,1518,554284,00.html> accessed 17-06-08

<sup>172</sup> Source [http://www.oecd.org/document/58/0,3343,en\\_2649\\_201185\\_39498298\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/58/0,3343,en_2649_201185_39498298_1_1_1_1,00.html) accessed 10-6-08

Chart E. Changes in tax to GDP ratio (in percentage points) (page 43)  
1995-2005



It will be noted that the UK had seen modest growth; that overall more countries saw growth than did not, and that the OECD as a whole saw growth of tax as a proportion of GDP of 1.3 per cent. It might be concluded that the evidence for tax competition working does not exist.

Even if that is true, and we suggest it is, this does not however end discussion of this issue. This is because whilst it is true that the overall level of tax in the UK has been under the control of the UK parliament, and the burden has risen as a result of government policy over the last decade or so, this does not represent the totality of the argument.

The reality is that the tax policy of the UK since New Labour came into office has been a carefully plotted two strand strategy<sup>173</sup>. Proportionately over the ten years Gordon Brown was Chancellor he raised exactly the same level of tax as proportion of GDP, to the second decimal place (38.56%), as his Conservative predecessors did in the previous decade<sup>174</sup>. Gordon Brown succeeded in raising tax when many doubted his ability to do so. He balanced his 'golden rules'. Time and again he has confounded the City and economic pundits by finding tax revenues to balance his books. And he did so whilst apparently cutting tax rates. The corporation tax rate was 33% when he came to power. It's been 30% throughout much of his tenure. Now it is 28%. The top rate of income tax might have been constant at 40% throughout his decade in office but the basic rate has fallen from 23% to what is now 20%. Capital gains tax fell from what was typically 40% to rates as low as 10%, although that has now increased to 18%. Through all this New Labour succeeded in raising substantial amounts of tax. In absolute terms that sum amounted to £316 billion in 1997-98, increasing to over £500 billion now.

Despite this, the UK's commitment to supporting tax havens survived under his tenure to such extent that at the close of his time in office the UK has become the most populous tax haven in the world according to an IMF study<sup>175</sup>. It has been enough for some to say that his contribution has been to make the UK the billionaire's first choice of residence despite the recent changes in the domicile rule. Only three of the top ten in the Sunday Times rich list<sup>176</sup> for 2007 were actually born in the UK. The rest were likely to be non-domiciled in the UK. It is no coincidence that those featured on that list saw their wealth increase by an average of 260% over the previous ten years in contrast with an average 120% wealth increase for the population as a whole.

The dichotomy in approach is obvious. New Labour has on the one hand been prudent and careful Chancellor, whilst being accused of running 'tax haven Britain'. The position is, however, entirely reconcilable using the definition of a tax haven and OFCs offered in the introduction to this report. The dichotomy can also be explained: New Labour has not had one tax strategy for the UK. It has had two. There has been a domestic strategy and an international one, and the policies used for each have been fundamentally different. It is the domestic strategy to which New Labour has wished to draw attention: it is the international strategy that has attracted the attention of the wealthy.

The domestic strategy has been consistent. Gordon Brown, whether as Chancellor of Prime Minister, has been unambiguously political in pursuing his agenda whilst seeking to secure the revenues he needed. The early tax cuts were designed with this objective in mind. They won political favour. They were matched however, and have been matched time and

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<sup>173</sup> The commentary that forms the basis of the argument to be found here can be found in an essay by Richard Murphy at <http://www.taxresearch.org.uk/Blog/2007/06/14/brown%E2%80%99s-decade-was-it-taxing/> accessed 10-6-08

<sup>174</sup> <http://www.taxresearch.org.uk/Blog/2007/06/05/3856-is-apparently-a-magical-number/> accessed 10-6-08

<sup>175</sup> [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=986815](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=986815) accessed 3-6-08

<sup>176</sup> <http://www.timesonline.co.uk/tol/news/uk/article1719880.ece> accessed 10-6-08

again by moves to raise revenue elsewhere. That is a process that has not, despite the name attributed to it been one of stealth taxation: it's been too explicit for any such attribution. So in early budgets there were the notorious moves to abolish advance corporation tax, which simultaneously prevented tax credit repayments to pension funds. Single windfall taxes on previously privatised utilities raised about £5 billion. Innovative financing, such as the sale of digital phone licences raised much more. Moves to raise council tax have been increasingly regressive. Later moves involved a reversal of early policy on cutting national insurance: it's now at rates well above those he inherited. Additional national insurance charges on benefits in kind have hit employers, whilst the self employed have seen politically popular moves to encourage them to incorporate their businesses, followed by expressions of surprise that they took opportunity to do so, and subsequent reversal of the policy.

And all the while the tax planning industry sought to mitigate tax due by those whom they serve, who are clients that can afford to pay their bills. A prevailing theme of Brown's period in office has been his attempt to beat this industry. He has scored hits despite the claim of one accountant in 2004 that<sup>177</sup>:

No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken.

In December 2004 he effectively closed all tax avoidance schemes that had become a feature of City bonus payments as more and more esoteric planning arrangements involving payments in such things as fine wines, carpets, currency futures and platinum sponge. Despite claims that this law was retrospective it has survived challenge. The national insurance and tax avoidance industry that featured so heavily in this sector has had to look elsewhere for business.

This action was matched by the introduction of rules requiring the disclosure of tax avoidance schemes within days of their being marketed. The scheme has worked despite continuing abuse from what the Revenue estimates<sup>178</sup> to be less than one hundred 'spivvy' tax planning boutiques. As soon as it was introduced the Revenue learned of large numbers of schemes that would have otherwise been unknown to them for years hence. The result was that over a relatively limited period the Tax Justice Network estimated that at least 40% of all new tax legislation was aimed at tackling tax avoidance<sup>179</sup>. This makes clear with whom much of the responsibility for complex legislation lies: the tax avoidance industry generates the need for the bulk of it.

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<sup>177</sup> <http://www.guardian.co.uk/business/2004/mar/18/budget2004.budget2004> accessed 10-6-08

<sup>178</sup> <http://www.accountancyage.com/accountancyage/news/2173419/hmrc-director-general-bashes> accessed 10-6-08

<sup>179</sup> <http://www.taxresearch.org.uk/Blog/2006/12/06/41-of-all-uk-tax-legislation-tackles-tax-avoidance/> accessed 10-6-08

The disclosure scheme was updated and extended in 2006. The number of disclosures has fallen. It is generally assumed this means that the level of abusive planning, which rode the crest of a wave in the heady dot.com days and arrived in the UK from the USA, has fallen. The measures to contain it, which represent so much of Gordon Brown's legislative legacy may lie unused on the statute book for decades to come as a result. This strategy has worked, even if it's been the cause of considerable complaint. Falling tax rates have been matched by sustained revenue for HM Treasury.

The profile of the tax paid has changed however. Between 2001 and 2007 (for which period comparable statistics are available) the proportion of income tax as a part of total tax revenue fell slightly, national insurance contributed more than 1% more of the total, the VAT contribution fell by the same amount (almost certainly as a result of fraud) whilst corporation tax revenues rose by just over 1% to a little over 11% of total tax revenues<sup>180</sup>. This reflects the buoyancy of the economy in that period. As the proportion of profits in GDP has risen during Brown's tenure the actual proportion of corporation tax paid as part of GDP was constant over the period<sup>181</sup>. This can only be explained by a fall in the effective rate of corporation tax actually paid on profits as shown by the TUC report 'The Missing Billions'<sup>182</sup>. Capital gains tax receipts showed the same constancy.

The net change resulting from this activity has, however, been small. It is possible that the wealthiest 5% in society increased the tax they paid as a proportion of the total by about 1% to 24.3% over the period for which data is available whilst the bottom 25% of income earners might have seen their share of tax paid fall by 0.6% to 8.3%. Tax credits probably explain the benefit for those on the lower end of the scale. The fact is that New Labour has maintained the status quo in its domestic tax strategy. Against the challenge of the combined tax avoidance industries over a period of a decade tax has basically been consistently collected from the same people.

Remarkably, and more surprisingly given all the challenges that have arisen in the offshore economy, consistency has also been New Labour's parallel achievement with its international tax strategy. Throughout this period the UK has stood remarkably firm. As much as New Labour has been the tax avoider's foe in the UK it has been their friend offshore. Lip service has, of course, been paid to all these initiatives, but on occasion little more than that. The EU Code of Conduct on Business Taxation is an example. Despite holding the chair of the committee responsible for its oversight there is a widespread feeling amongst EC officials that the UK did all it could to delay implementation of this Code in the tax havens for which is responsible, persistently helped by Dawn Primarolo's insistence on behalf of the UK Treasury that the Code related solely to business tax and would never be extended to personal tax. It was on the basis of this assurance that the Isle of Man introduced its now failed scheme to company with the Code. And, of course, the UK

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<sup>180</sup> [http://www.hmrc.gov.uk/stats/tax\\_receipts/table1-2.xls](http://www.hmrc.gov.uk/stats/tax_receipts/table1-2.xls) accessed June 2007.

<sup>181</sup> <http://www.taxresearch.org.uk/Blog/2006/10/17/tax-paid-by-uk-companies/> accessed 10-6-08

<sup>182</sup> <http://www.tuc.org.uk/publications/viewPub.cfm?frmPubID=535> accessed 10-6-08

was aware that it was subsidising the Isle of Man to allow its abusive zero / ten tax strategy. Without having a policy to promote tax haven activity it is very hard to explain why the UK has continued to sustain this arrangement, or to allow its renegotiation in 2007 without imposing any significant change, by which time average GDP per head was higher in the Isle of Man than in the UK as a whole.

Explanations can be found for why the UK government has supported its dependent tax havens. First, it was and remains vital to the UK that the EU Code of Conduct is restricted to business taxation. If it were extended to personal taxation then the UK's domicile rules would undoubtedly fall foul of that Code. Second, the domicile rules are of little use to the UK unless there are convenient nearby offshore locations in which the wealth of those persons who wish to utilise them can be recorded as being located whilst they live virtually tax free in London. As such for Labour's policy to work the havens had to stay, and New Labour's promise to reform their activities, made when they came into office<sup>183</sup> have been quietly forgotten.

In combination these factors suggest that, for example, the retention of the domicile laws is symptomatic of the UK having a fundamental economic problem that can only be plugged by using tax competition to attract portfolio capital to the UK. This problem is a legacy of the Thatcher years. First the UK has given up on many of its former industries, including manufacturing. As a result it runs a perpetual trade deficit. This has to be financed and financial services do that. Second, despite the trade and current account deficits UK politicians have desired a strong independent currency to keep inflation at bay. Large inflows of external savings keep sterling buoyant, but it only stays on a tax free basis.

The dilemma this has created explains the UK's quite deliberate obstruction to the second major EU initiative on tax, the EU Savings Directive. This was introduced to tackle the problem of tax evasion by those who seek to place their funds outside their country of residence with the intention of not declaring the income for tax in the place where they live. This is, obviously, most effective when the state in which the funds are relocated does not tax them when the interest is paid. Europe's desire was twofold. First it was to ensure that all funds held (bar those of companies) could be attributed to the individuals who might own them, even if managed through a trust arrangement. Second, they hoped to arrange for a withholding tax when interest was paid and an information exchange arrangement between the countries in which the funds were located and the country in which the owner resided to make sure all such investment income was subjected to appropriate tax, split between the states involved.

The UK undermined this process in two ways. Firstly it led the opposition to tax withholding because of its commitment to the Euromarket, which is dependent upon interest not being deducted at source on the payments made. Second, it allowed the Directive to be negotiated with the European Commission believing that it would require information

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<sup>183</sup> <http://www.archive.official-documents.co.uk/document/cm41/4109/a-cntnts.htm> accessed 11-6-08

exchange on funds held in trusts. Trust law is only found in Common Law countries and as such is mainly a matter for UK concern and expertise in Europe. We have been reliably informed that only after the Directive was signed did the UK make clear that it could not apply to trusts as drafted. This both supported the significant trust business in many UK dependent territories, and especially Jersey, and created a significant loophole for those seeking not to comply with the Directive's requirements. This is one of the defects that the EU now wishes to remedy in the Directive following the Liechtenstein revelations of 2008.

The result of this policy of supporting tax haven activity whilst maintaining the domicile rules and by itself operating as tax haven to support the over-blown presence of the City in the UK economy has meant that the UK has attracted substantial numbers of wealthy foreigners to live in the country. In its commentary on the Blair legacy the BBC noted<sup>184</sup> that 'The wealthiest Britons have become far wealthier in the past ten years, something which critics attribute to non-domicile tax concessions favouring the rich.' This policy has not been benign as the domicile debate of 2007 made all too evident.

The conclusions are clear. Gordon Brown has achieved his objectives. He has raised the tax he has needed, but in doing so he has had to be tough. He would not have needed to be so tough on tax avoidance if he was not simultaneously promoting tax avoidance: the obvious folly of which was shown by the 2007 'tax amnesty' for those UK tax residents who had not declared income on their offshore bank accounts; accounts on which they may well have had no tax liability if they had been living in the UK as a non-domiciled person. The credit crisis, the crisis of the domicile rule, the private equity crisis, the capital gains crisis and most of the other tax problems of the last year can be laid at the door of this policy.

So too can the crisis in corporation tax taking place in 2008. The UK pursued a policy of having an open door to all comers who wished to use its generous corporation tax regime. When it became apparent as the economic down-turn began that those used to not paying UK tax (and as research has shown, most of those protesting have not been used to paying UK tax<sup>185</sup>) might leave the government panicked and set up a committee to investigate the competitiveness of the UK tax environment. When doing so it only invited big business to take part<sup>186</sup>. The inference was clear: competitiveness within the UK economy did not matter; the creation of a level playing field on which all UK business could fairly compete one with another did not matter, all that was of concern was the UK's status as a tax haven.

It is against the background of this policy, set in the political philosophy of tax competition that the Prime Minister appears to have embraced, that the comments that follow on the impact of tax haven policies on the UK are made.

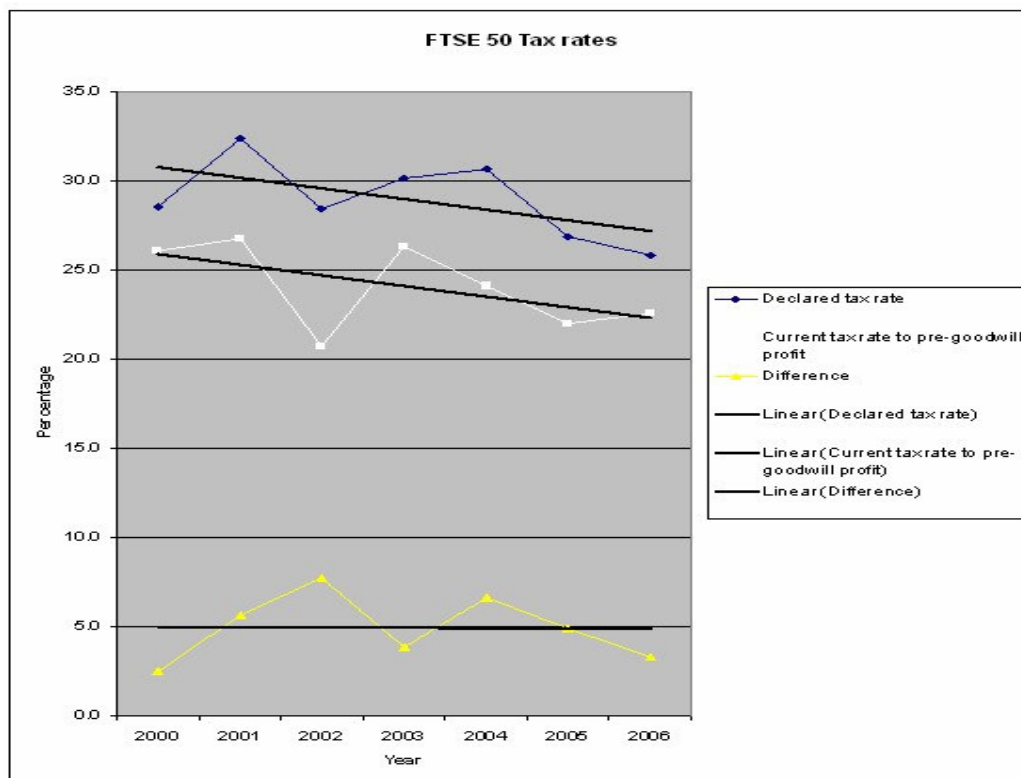
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<sup>184</sup> <http://news.bbc.co.uk/1/hi/business/6641759.stm> accessed 11-6-08

<sup>185</sup> <http://www.taxresearch.org.uk/Blog/2008/05/20/britains-big-companies-arent-paying-tax/> accessed 12-6-08

<sup>186</sup> <http://business.timesonline.co.uk/tol/business/money/tax/article3842529.ece> accessed 12-6-08

The UK operates a policy that makes it very much easier for UK based publicly owned companies to operate offshore than it is for UK privately owned companies and individuals. For example, recently disclosed tax haven operations by Tesco<sup>187</sup> were legal when created. They would almost certainly not have been if created by either a private limited company in the UK or a UK resident and domiciled person. The impact of tax havens has in this way created a two tier economy in the UK made up of some companies who may use a wider range of tax avoidance techniques than others. There can be no doubt that the increasing willingness of large companies in the UK to use these schemes has contributed to the five per cent fall in the effective tax rates of the largest fifty companies quoted on the UK stock exchange over the period 2000 to 2006 as shown here<sup>188</sup>:



The difficulty of controlling this trend has been all too apparent. The EU's rules on capital mobility were, in particular, used for a long period to undermine any attempt by national governments within the EU to control the haemorrhaging of their own tax base. This issue has now been addressed by the European Court of Justice which has reversed this trend in

<sup>187</sup> <http://www.taxresearch.org.uk/Blog/2008/06/01/tescos-the-zug-deal-is-tax-avoidance/> accessed 16-6-08 and <http://www.taxresearch.org.uk/Blog/2008/06/11/tesco-tax-avoiding-again-this-time-its-luxembourg/> accessed 16-6-08

<sup>188</sup> <http://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf> accessed 16-6-08

its own decision making, but the test case on the UK's controlled foreign company (CFC) rules brought by Cadbury Schweppes has left the situation ambiguous.<sup>189</sup>

The EU has ruled that these rules cannot be used if it can be shown by objective factors, which are ascertainable by third parties, that the subsidiary company established outside the UK is actually established in the overseas jurisdiction (which means it really is managed there) and carries on genuine economic activities there. In the latter case even if there is a tax motive in setting up the CFC company overseas this should not, of itself, be sufficient to bring it within the UK's CFC regime. The difficulty that remains lies, however, with proving what are genuine economic activities, and the issues relating to this have given rise to the current problems for HM Revenue & Customs in determining just how to tax foreign profits. In effect this issue resolves around the question 'when is a company in a tax haven for the sole purpose of avoiding tax, or not?' The impact of the issue is so significant that some companies (albeit ones that pay little or no tax at present in the UK) have threatened to leave for Ireland.<sup>190</sup>

Despite the evidence of both abuse, tax lost, attempts being made to mitigate this and high profile dissent to such behaviour, the thing that is remarkably absent from this debate is evidence. Except for the TUC data, noted above, which suggests that major UK corporations seriously underpay tax when compared with the rate at which they are expected to pay, amounting to approximately £12 billion a year, or approximately a quarter of the actual total corporation tax yield, it is almost impossible to say what the cost of tax haven practice is to the UK for the corporate sector. There is one reason for this. Companies do not publish the information in their accounts to allow this data to be compiled.

Although companies are required to reconcile their declared tax liabilities with those that might be due at the UK's statutory tax rate almost none declare any impact of tax haven activity when doing so (GlaxoSmithKline being an exception). Few acknowledge differing tax rates as even having any impact, and those that do on average, and paradoxically, note that this has the consequence of increasing, and not reducing their tax rate. And yet it is abundantly clear that companies do use tax havens and do so, at least in part, to reduce their tax rate. What is obvious as a result is that the reporting of companies in this area is wholly insufficient to enable their shareholders, stakeholders or governments to determine what is happening, and we recommend changes in accounting disclosure in this report so that this defect can be remedied.

In the area of personal taxation it is easier to measure the impact. It has been argued that the domicile rule costs the UK at last £4 billion a year<sup>191</sup>. Since the changes made in 2008

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<sup>189</sup> <http://www.icaew.com/index.cfm?route=142022> accessed 16-6-08

<sup>190</sup> <http://business.timesonline.co.uk/tol/business/money/tax/article4045464.ece> accessed 16-6-08

<sup>191</sup> [http://www.taxjustice.net/cms/upload/pdf/Domicile\\_UK\\_0709\\_submission.pdf](http://www.taxjustice.net/cms/upload/pdf/Domicile_UK_0709_submission.pdf) accessed 17-6-08

are expected to raise less than £1 billion it is reasonable to presume that there is a remaining cost of at least £3 billion.

The Tax Justice Network has argued that in total the cost to the government's of the world from private wealth held offshore is not less than US\$255 billion per annum (£130 billion)<sup>192</sup>. Since this is based on data now five years out of date this is likely to be higher now. It is not possible to say with certainty how much of this is attributable to the UK. However, in 2005 some 448,000 UK residents were considered high net-worth individuals (HNWI) by the World Wealth Report<sup>193</sup>, some 5.1% of the world total. Assuming equal distribution of HNWI wealth and income then the loss to the UK might be about £6.7 billion a year from this group alone. This probably seriously understates the loss from this group because London has attracted a very large population of ultra-HNWIs, being those with considerable wealth plus the means to avoid tax legally.

Both this figure and that for the domicile rule (with which it will partly overlap) suggest that tax avoidance using offshore imposes a substantial cost for the UK amounting to many billions a year.

Tax evasion imposes a much bigger cost to the UK. The Missing Billions, published by the TUC, suggested the cost of personal tax avoidance in the UK amounted to at least £13 billion a year. Our current estimate of tax evaded is not less than £70 billion a year. Of this a significant part happens through offshore as a result of:

- Hidden investment income, of which the 2007 'tax amnesty' only scratched the surface for a number of reasons;
- Undeclared earnings invoiced from shell companies in tax havens, the value of which is very hard to estimate but is considered substantial;
- Corruption, where bribes and the proceeds of fraud are hidden offshore, often disguised as 'consulting income';
- Tax fraud, such as carousel fraud;
- Transfer pricing abuse and re-invoicing fraud, to which the UK as a major trading nation will undoubtedly be vulnerable;
- Insider dealing and other City based frauds operated through offshore accounts, to whom many in financial institutions have easy access;
- VAT abuse, for example from such activity as yacht registration in tax havens.

The list could be continued. We believe that if the cost of tax evasion is more than five times that of tax avoidance in the UK then it is likely that the cost of offshore tax evasion is likely to exceed £20 billion per annum.

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<sup>192</sup> [http://www.taxjustice.net/cms/upload/pdf/Price\\_of\\_Offshore.pdf](http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf) accessed 17-6-08

<sup>193</sup> <http://www.ml.com/media/67216.pdf> accessed 17-6-08

We cannot prove this. What is surprising is that HM Treasury has not sought to do so. We would urge the Select Committee to ask them to do so. An informed basis for this work seems essential if this problem is to be tackled, and resources are to be appropriately allocated to dealing with it.

If it were appropriately tackled then we believe that there could be a substantial change in the direction of UK domestic tax policy, as noted above. It is the pressure to broaden the tax base that has led to accusations of ‘stealth taxation’, which, whilst not accurately described is indicative of what has happened. It is the consequence of seeking to give apparent tax concessions within a limited palette of opportunity because of the constraint of both being a tax haven and refusing to tackle tax haven abuse that has led to such poor policy choices as introducing and then abolishing the 10p tax rate, and introducing and then abolishing the zero per cent tax rate for small companies. Both of these measures have spectacularly backfired and given rise to significant additional complication in the tax system.

Only by accepting, and changing the UK’s role as a tax haven, and its policy towards tax havens can a domestic focus be reintroduced to tax policy for the benefit of the people of the UK. That is currently the major challenge for UK tax policy.

## 14: Are British Overseas Territories and Crown Dependencies well regarded as Offshore Financial Centres, both in comparison to their peers and international standards?

It is apparent from the report of the National Audit Office on the British Overseas Territories in November 2007 that those territories and the Crown Dependencies cannot be treated as a homogenous unit when answering the question.

Anguilla and Montserrat are at the very lowest level of the tax haven hierarchy. They have almost non-functioning regulation. The quality of the OFCs operating from them is very low. It is the lowest quality of offshore transaction that uses places with high reputational risk. The Turks & Caicos are probably in the same league, being closely associated by many with high risk transactions, as is noted elsewhere in this report. These places are treated in low regard.

The British Virgin Islands are probably treated only a little better. It is true that the quality of the OFC operating from the BVI may be slightly higher than in the first three mentioned places, but that is almost certainly due to volume of demand due to lax regulation. So low is that regulation that when officials in the BVI were interviewed by the author of this report in April 2008 concerning the extraordinary number of private companies that it is claimed are registered in those islands<sup>194</sup> it was admitted that the published statistic is itself of doubtful quality. It represents the total number of registrations in the last decade. The BVI has no real idea of how many of these are actually really in operation still, giving some indication of the quality of its own administration, and further indication of its limited capacity to regulate anyone else.

What is known, and is recognised by those in the BVI, is that much of their business relates to China and there can be little doubt that much of this is ‘round tripping’, involving the reinvestment of capital flight funds illegally exported from that country as if it were foreign direct investment. Since this, by definition, involves evasion of regulation there can be little doubt that the quality of regulation and reporting within the BVI is low. This might be part of its attraction, joining it with those territories already mentioned.

Bermuda and the Cayman Islands have higher standards of regulatory compliance than the first four territories mentioned, and the NAO found evidence of this. Both are widely used by the American financial markets to which they primarily sell their services. For this reason their banking compliance is believed by the NAO to be good. Both have lapses elsewhere in their regulatory regimes and it is apparent from other matters reported on by the NAO that the standard of civil administration in Bermuda is very poor, many of its own accounts, for example, being several years out of date. There is little or no chance of a

<sup>194</sup> <http://www.bvifsc.vg/Default.aspx?tabid=200> suggests there are 823,502 at 30 September 2007.

territory unable to keep its own accounts in order being able to regulate a financial market.

The consequence has been graphically shown of late. In May 2008 the EU issued a list of territories deemed to have equivalent regulatory standards to the UK with regard to client identification and other procedures meant to tackle money laundering activities<sup>195</sup>. Inclusion on the list meant a territory has been deemed to have satisfactory controls against money-laundering. As the Daily Telegraph noted<sup>196</sup>, Jersey, Guernsey and the Isle of Man plus Gibraltar were in effect placed by the EU on an 'intermediate' list of financial centres which 'may' meet compliance regulations whilst the British Overseas Territories including the Cayman Islands and British Virgin Islands have been excluded altogether, meaning they are effectively blacklisted.

The ranking appears appropriate based on the available evidence, and that supplied by the NAO. The Crown Dependencies do have better apparent compliance with regulation than do Bermuda and Cayman. In part this is because of support provided to them by the UK, including the loan of significant numbers of staff (it is believed at least 8 members of staff were loaned by the UK to Jersey in 2007 to deal with money laundering related issues). However, despite the protests of such places it is impossible to believe that their standards are as good as those in the UK and some of the other countries listed, even if that list does include Russia. That is because of the nature of small island life. As the NAO reports, reporting of suspicious activity is at the heart of anti-money laundering arrangements but at least in the smaller financial centres, the number of reports is so low as to indicate that some financial institutions either do not know or monitor their customers sufficiently or are unaware of their obligations to report<sup>197</sup>. But this need not necessarily be the explanation in small islands where the civil servant regulator is relatively lowly paid, is regarded as coming from a lower social order than those they regulate, and has much less influence in the local community than the much richer financial services operators who will have the ear of government more readily than the civil servant will. This is true of all the territories being considered here, it is just most exaggerated in places like Montserrat. The reality is that in very small communities elites are virtually ungovernable and all these locations suffer badly from the existence of both financial elites and political elites, many of whom will overlap, at least in social circles. Nowhere has the impact of such elites been more graphically demonstrated in the last year than in Jersey. The latest crisis to hit the Island, during early June caused one opposition senator on the island to say<sup>198</sup> that there was an entrenched ruling clique who were 'out of control, deficient and undisciplined'. There may

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<sup>195</sup> Available on [http://www.hm-treasury.gov.uk/documents/financial\\_services/money/fin\\_crime\\_equivalence.cfm](http://www.hm-treasury.gov.uk/documents/financial_services/money/fin_crime_equivalence.cfm) accessed 16-6-08

<sup>196</sup> <http://www.telegraph.co.uk/news/uknews/2070094/Channel-Islands-left-off-EU's-money-laundering-'white-list'.html> accessed 16-6-08

<sup>197</sup> [http://www.nao.org.uk/publications/nao\\_reports/07-08/07084.pdf](http://www.nao.org.uk/publications/nao_reports/07-08/07084.pdf) page 23

<sup>198</sup> <http://www.thisisjersey.com/2008/06/14/out-of-control-deficient-and-undisciplined/> accessed 16-6-08

be political hyperbole in his claim, but the evidence is on his side, as it is on the side of commentators in Cayman who make the same sort of observation<sup>199</sup>.

The conclusions reached are clear: some of the locations are little better than out of control. Regulation in Cayman and Bermuda is wholly deficient for the volume of business they handle, Cayman being considered the fifth largest banking centre in the world, a fact that evidence published in the last month suggests plausible<sup>200</sup>. Gibraltar is widely perceived as remaining inadequately regulated and liable to attract low end business. Whilst things are perceived as being better in the Crown Dependencies the standards of regulation in these places are low, and the quality of reporting of suspicious transactions is indicative of serious deficiency in both standards and attitudes. This being the case, the NAO was justified in saying in its own report that:

*Contingent liabilities [for the UK] are not a hypothetical risk in financial services. Regulators worldwide are open to legal challenge for their actions or inaction, if such actions can be shown to be in bad faith. The victims of a crime or a financial collapse that can, in part, be attributable to weak oversight may seek financial compensation on the grounds that the authorities in the Overseas Territories knew about the weaknesses and failed to address them. The costs of such actions could be high, and would fall directly to the UK in jurisdictions such as Anguilla, Montserrat and the Turks and Caicos Island, where the Governor retains direct responsibility for regulation of international finance. In the wealthier Territories, responsibility for the financial services sector lies with the Territory government but the UK could still face reputational impacts, and, in a worst case scenario, be called to provide aid should the sector collapse. To date, no regulator in a UK Overseas Territory has been successfully sued, and currently their regulators express confidence of being able to defend any known disputes with complainants which might reach the courts.*

So far short of international standards are all these places that this risk is real, and is likely to grow in an economic downturn. The UK has to accept its responsibility for a situation that it has allowed to develop by taking action to remedy the defects. In most cases this will mean that the financial services activity in these locations will have to stop. Effective regulation is almost impossible in small island communities which are liable to political capture by dominant industries and their local cheerleaders.

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<sup>199</sup> <http://www.caymannetnews.com/news-7947--8-8---.html> accessed 16-6-08

<sup>200</sup> <http://english.etnews.co.kr/news/detail.html?id=200806020010> accessed 16-6-08

Perhaps a word should go to a pro-tax haven commentator. Bob Bauman was once a Republican Congressman in the USA and now writes for the Sovereign Society that staunchly defends tax havens. He said in his blog dated 6 May 2008<sup>201</sup> that:

*Because these islands are under ultimate control of the United Kingdom, they lack the greater privacy and freedom to act that independent tax havens, such as Panama, Singapore, Hong Kong or even Switzerland, enjoy.*

*Five years ago I wrote: "As long as the British Labour government continues in power, you can expect it will continue its unrelenting efforts to curb tax and asset havens, including those under its colonial domination."#*

*So this latest announcement from the House of Commons Committee is just another skirmish in a decade-long war against British financial privacy and freedom.*

*And if you are interested in using these jurisdictions as a base of offshore activity, you may be wise to wait for the outcome of the British parliamentary elections due within the next two years. In the meantime, if you're shopping for a place to set up your business, or invest globally, I would look outside the United Kingdom's rule.*

All of which suggests that these places are neither one thing or another: neither bad enough to attract rogue business or good enough to compete in a global market where only the highest standards of transparency and regulation will eventually be allowed. It is why they will, almost inevitably, fail in the foreseeable future. But in that case an editorial in the Cayman NetNews of June 11 2008 is most telling. It said<sup>202</sup>:

*Joel Slemrod, a tax economist at the University of Michigan Business School, sees tax havens as "clearly a bad thing." They enable many small island nations to "commercialise" their sovereignty at the expense of mostly industrial nations, he says. Tax havens have given tiny nations a lucrative job-creating business and, once again, the Cayman Islands is referred to as having 5,400 financial-services employees.*

*This is an issue that we regularly raise for debate but very few people in either public or private sectors seem to acknowledge that the writing is on the wall (and has been for some time) as to the direction that Cayman's traditional offshore industry seems to be heading.*

*One local attorney, Stephen Hall-Jones, did take up the issue recently in a letter to the editor and he made some very valid observations, including the telling point*

<sup>201</sup> <http://baumanblog.sovereignsociety.com/2008/05/the-brit-haven.html> accessed 16-6-08

<sup>202</sup> <http://www.caymannetnews.com/news-7947--8-8---.html> accessed 16-6-08

*that he used to believe that there was no moral obligation on the part of any country to impose direct taxation of any kind, which largely coincides with the view expressed as recently as this year by the Chairman of the Cayman Islands Monetary Authority, Tim Ridley, that paying tax is not a moral obligation.*

*However, Mr Hall-Jones now believes that an independent democratic country may owe a moral obligation to the wider international democracy that goes “beyond simply applying its own domestic choice in its internal fiscal philosophy.”*

*It seems to us that Mr Hall-Jones’ conversion on this issue may reflect a growing global consensus and one that is not especially favourable to our financial sector. He echoed a message long promoted by us that a “head-in-the-sand” approach is not the solution, and expressed the hope that “someone is prepared to give us an honest answer.”*

*Thus far, that hope remains unfulfilled so far as we are aware and, in our experience of arguing for the same thing, is unlikely to be addressed any time soon in the typically reactive environment of public sector management and administration in the Cayman Islands.*

*However, it still seems to us that the looming problems in this respect are not going away but getting potentially weightier with each new media report and official or political murmurings in the more highly-taxed jurisdictions.*

*It would be nice to think that there might be a contingency plan should our financial services industry suffer a devastating blow, but there is no evidence that one exists. Of course, each financial institution that transacts offshore business of any kind here has their own such contingency plan, but that will involve them bailing out of Cayman rather than sticking around to offer or be part of any solution.*

*The problems that appear to be looming for the financial sector are just some of the severe economic pressures that the county is facing. We hope that more voices of comprehension and reason will soon be heard in order to stimulate a real and effective national debate on these issues.*

When some in the tax havens doubt their own credibility or place in the world, let alone the quality of the regulation they impose there is sign of real change coming. The UK has a duty to participate in that debate.

## 15: To what extent have Offshore Financial Centres ensured that they cannot be used in terrorist financing?

There is only one realistic answer to this question, and that is that no one knows.

There can be no doubt that the world's tax havens have been doing what has been asked of them by the Financial Action Task Force to put in place legislation that is supposed to assist the tracing of terrorist funds.

There can equally be no doubt that in some cases this implementation has not, at least as yet, resulted in an effective regulatory regime existing on paper. Evidence from the National Audit office report on the British Overseas Territories, noted in the introductory chapters and published in November 2007 shows this to be the case.

That data on weaknesses of the sort they catalogue is widely available meaning that the whereabouts of ineffective regimes is also known means that anyone seriously seeking to launder funds of any sort can easily find locations where this is relatively easy to undertake because of the weakness of effective regulatory regimes.

This fact is facilitated by two further factors. The first is that terrorist financing is probably by far the smallest component of all international money laundering, and so exceptionally difficult to differentiate from any other flows.

The second is that it is believed that the 9/11 attacks cost somewhere between \$400,000 and \$500,000 to execute<sup>203</sup>. This sum is so small it could have been laundered using credit cards. As has been noted in the introductory chapters, both the major credit card networks (Visa and MasterCard) supply anonymous credit cards from operations based in some of the least regulated tax havens (such as the Turks & Caicos Islands), the ownership of which is almost impossible to track. Whilst commercial organisations of this sort, both quoted on the US stock exchange show such indifference to the risk of money laundering by licensing the use of their products in this way it is very difficult to see how any effective measures against terrorist financing can be launched anywhere.

As a result it can be reasonably concluded that there are no effective mechanisms for dealing with the regulation of terrorist finance in tax havens or amongst the OFCs that operate from them, and that some operating in the latter sector would appear to show indifference to this issue because the mechanisms they supply for their own commercial benefit can easily be exploited for money laundering of the sums required to launch serious terrorist attacks.

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<sup>203</sup> [http://govinfo.library.unt.edu/911/report/911Report\\_Exec.htm](http://govinfo.library.unt.edu/911/report/911Report_Exec.htm) accessed 13-6-08

## 16: What are the implications for the policies of HM Treasury arising from Offshore Financial Centres?

Treasury policy is massively influenced by two things. The first is that London is a tax haven and the biggest OFC in the world, which has arisen as a result of deliberate policy decisions taken by the UK. The second is that the UK is responsible for some of the biggest tax havens in the world, and as we have also shown this is also the consequence of UK government policy.

The Treasury is constrained by these two factors when considering (as we have also shown) taxation policy, regulation policy, relationships with the EU, international relations in general and the relationship between the UK taxpayer and their government.

The need for our government to raise funds through tax havens to fund UK trade deficits has created an open economy from which capital can leave as easily as it can arrive.

The problem for the UK now is to resolve the dilemma that this policy has left us with. In particular, we have to decide whether to compete on tax rates, or tax base. If we do not decide on one or the other then we will, inevitably lose tax sovereignty. Anyone who fights on two fronts at once, with a policy of gradual withdrawal on both, inevitably ends up losing. And yet that is the policy we are pursuing. This must change or the principle of sovereignty will be one not worth maintaining: there will be no tax revenue to collect from those with the capacity to remove income from the UK.

The same is true of regulation. It is apparent that there is a current need to re-regulate the financial markets. But being a tax haven the UK has maintained a 'light touch' regulation regime. The consequence has been obvious. The sub-prime crisis might be a US phenomenon but the impact is being more heavily felt in London than New York. The US has supposedly lost from its tighter regulation environment introduced after the offshore abuse of Enron, and yet it has proved relatively effective. It is British banks that have the CDOs and SPV on their balance sheets that have led to massive banking losses. These 'assets' were created offshore, often in British jurisdictions, and we are paying the price for that.

We pay a similar price for losses in the domestic economy from the abuse of company law; law that allows hundreds of thousands of companies to be struck off the register of companies each year without ever paying tax, without ever filing accounts and in many cases leaving creditors in their wake with no chance of making a claim for the money they are owed. This is the real cost of the race to the bottom in company regulation, in which the UK plays a part, even having a ministry dedicated to the role at present<sup>204</sup>. This reflects the impact of tax havens but the cost is borne by each and every person who loses from the

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<sup>204</sup> Department for Business, Enterprise and Regulatory Reform

abuse of incorporated status that follows from it. We do not promote regulation for its own sake; we do to protect the vulnerable. When companies are deregulated it is always the vulnerable who suffer: limited liability is a privilege that is always open to abuse. The UK has turned this into an art form at a cost to our own population and to the people of the developing world.

This is also the case with regard to our policy on corruption. We have stood by as tax havens are used to facilitate corruption<sup>205</sup> and have not taken action to stop the problem at source. Our international standing has suffered as a result. The standing of government has suffered as a result. This is a tax haven issue, and we have not addressed it.

Most of all this is an issue for development. We have shown in this report that tax havens impose massive cost and cause deaths in the developing world. Others have done the same<sup>206</sup>. The duality of this approach when we are also strong supporters of development makes the stand even more perverse, and utterly illogical. Facilitating one of the means from which it is accepted that developing countries are suffering badly when lending them support makes no sense.

In fact, none of these policies make sense now, if they ever did. The only welcome thing to note is that the mood of many is now changing, and that the opportunity for change exists. To quote from two commentators hardly noted for their radical positions, both writing in the *Financial Times* in May:

*Financial regulation is only one example of where the mantra of needing to be “internationally competitive” has been invoked too often as a reason to cut back on regulation. There has not been enough serious consideration of the alternative - global co-operation to raise standards.*<sup>207</sup>

and:

*regulation will need to be radically reconsidered, unless, as Mr Volker<sup>208</sup> points out, we are comfortable with a substantial financial crisis every five years or so. However great the lobbying power of the financial sector, it will surely be unable to preserve a licence to commit havoc on such a scale, particularly when, as he also remarks, “it is hard to argue that the new system has brought exceptional benefits to the economy generally”.*<sup>209</sup>

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<sup>205</sup> For example, <http://www.guardian.co.uk/world/2007/jun/11/bae> accessed 17-6-08

<sup>206</sup> <http://www.christianaid.org.uk/getinvolved/christianaidweek/cawreport/index.aspx> accessed 17-6-08

<sup>207</sup> Larry Summers writing in the FT 5.5.08 <http://www.ft.com/cms/s/0/999160e6-1a03-11dd-ba02-0000779fd2ac.html> accessed 17-6-08

<sup>208</sup> [http://en.wikipedia.org/wiki/Paul\\_Volcker](http://en.wikipedia.org/wiki/Paul_Volcker) accessed 17-6-08

<sup>209</sup> Martin Wolf writing in the FT 6.5.08 <http://www.ft.com/cms/s/0/52bf0f4a-1b8b-11dd-9e58-0000779fd2ac.html> accessed 17-6-08

We believe both these true: we believe as a result that the current incoherent policies of the Treasury arising from the UK's role as a tax haven need to be reformed. We believe substantial harm could be remedied as a result. We have laid out what we think needs to be done in our recommendations in chapter 19 of this report.

But we also find ourselves in agreement with this comment from Martin Wolf, made on 26 May 2008:

*I agree that the present ability of corporations to shift income into tax havens is intolerable. But tax competition among countries must still be allowed. If Ireland wants lower taxes on its residents than the UK does, that is a sovereign choice. If some British residents move to Ireland in response, so be it.*<sup>210</sup>

Sovereign choice must exist in the world of tax. What must end is the choice of sovereign states and related microstates to use that power to undermine the right of other states to exercise their national sovereignty in the area of tax and regulation, which is the only *raison d'être* for tax havens.

This the new direction in which the Treasury needs to travel. It means rejection of the tax haven and OFC model it helped create and which it has embraced since 1957, at least. But there has never been a better time for that change to happen, there has never been more evidence of the benefits that will arise from doing so, and there has never been a greater need for it to happen.

We happen to believe it is possible as well, which helps.

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<sup>210</sup> <http://blogs.ft.com/wolfforum/2008/05/preserving-the-open-economy-at-times-of-stress/#comment-12762>  
accessed 17-6-08

## 17: What has been and is the extent and effect of double taxation treaty abuse within Offshore Financial Centres?

It is important to note that most places conventionally thought of as tax havens are not party to Double Tax Treaties (DTAs). This particularly applies to micro-states such as the British Overseas Territories and Crown Dependencies. They have Tax Information Exchange Agreements, at best.

There are, however, some tax havens where the abuse of DTAs forms a major part of their activity. These include some micro-states. For example, the Netherlands Antilles based much of its economic development strategy on its DTA with the USA, for which it acted as a conduit for a number of years until such time as the benefits of this treaty were largely negated as result of changes in US legislation.

The ‘conduit’ role is very important and is a major role of the havens involved, which include:

- The Netherlands
- Switzerland
- Belgium
- The UK
- Cyprus
- Malta
- Luxembourg
- Mauritius
- Netherlands Antilles
- Barbados

This list is meant to be indicative, and is not complete.

The role of the conduit is almost always dependent upon the existence of favourable DTAs and tax arrangements that are very often specially constructed by the tax haven to exploit those treaties.

Some conduits are used to access trading markets. An example from outside the UK might be found in the Canada - Barbados DTA. If a Canadian parent company opens a Barbados company to undertake its global sales operation outside of Canada then the Barbados company only pays 2.5% taxes on profits recorded there and can return 97.5% of its income to Canada as a dividend, tax free. The Canadian company can then pay the resulting income it receives on to its shareholders without incurring any additional tax charge because of the foreign dividend exemption that applies in Canada for ‘active income’ of this sort, so reducing its tax on this profit from this activity to 2.5% in total in Canada for an activity which may well be only very notionally located in Barbados. This sort of abuse is

of the type the UK has sought to avoid when considering anti-avoidance measures when planning to exempt foreign dividends from tax in the UK. If it does not do so similar abuses will occur in the UK.

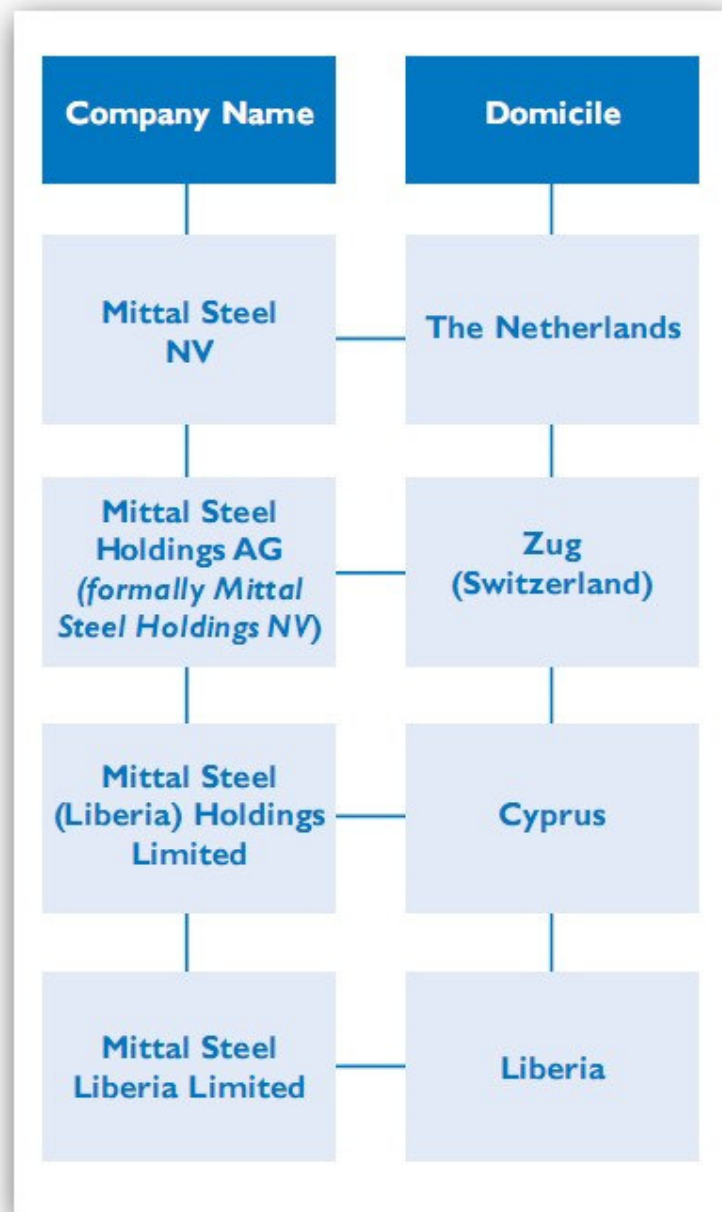
Other conduits are used for the purposes of investment. An example in this case might be the India - Mauritius DTA. This DTA has caused considerable controversy and is currently under renegotiation because Mauritius has been widely used by foreign investors to route their investments into India. Mauritius does not tax capital gains on the resulting investments recorded as arising in that country, while the corporate tax liability does not usually exceed four per cent. About 40% of the \$45-50 billion Foreign Direct Investment that came into India from 1991 to 2006 was routed through Mauritius<sup>211</sup>. A similar percentage of Foreign Institutional Investment inflows into India are also from Mauritius, but most worrying of all is the incidence of 'round tripping' and 'treaty shopping' by investors. In round tripping, Indians bring their tax evaded money back into the country via Mauritian shell companies whilst in treaty shopping, foreign investors route their investment into India via Mauritius to save tax. The Indian government had estimated a revenue loss of over Rs50 billion (£600mn) caused by treaty shopping. It has offered Mauritius aid of Rs 5 billion (£60mn) to persuade it to remove clauses in the agreement giving rise to this loss. This gives some indication of the value of these arrangements, and the cost they impose. It also suggests a direct and quite possibly appropriate course of action for ending this abuse.

There are other examples of the impact of tax havens on development. For example, when Global Witness investigated the investment Mittal Steel made in Liberia it found that it had used this structure<sup>212</sup>:

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<sup>211</sup> <http://timesofindia.indiatimes.com/articleshow/msid-1322646,prtpage-1.cms> accessed 13-6-08

<sup>212</sup> Based on Heavy Mittal by Global Witness  
[http://www.globalwitness.org/media\\_library\\_detail.php/156/en/heavy\\_mittal](http://www.globalwitness.org/media_library_detail.php/156/en/heavy_mittal) accessed 13-6-08



A Netherlands subsidiary of the holding company invested in turn through another holding company in Switzerland which in turn owned a holding company in Cyprus that owned the licence to operate in Liberia but which in turn licenced it to an operating company based in Liberia.

The structure was tax driven. The Liberian company enjoyed considerable tax advantages in that state, including a considerable tax holiday. This meant that it would have normally given rise to a full tax charge in the Netherlands if it had remitted profits straight to that country, because the usual treaty arrangement with the Netherlands which exempts dividends received in that country from tax does not apply if the profits giving rise to the

income were not taxed in accordance with the usual tax regime of the country in which they arose, as would have been the case here.

Routing them through Cyprus and Zug overcame this problem even though both were passive and entirely nominal participants in the arrangement. Cyprus would charge all income from Liberia to tax on any dividend received, but at a maximum rate of tax of 10%, the lowest in the EU, which makes it an ideal conduit for receiving income from such locations into the EU environment. Zug might have charged an income stream from Cyprus to tax except for the fact that its tax rate would have been lower, at between six and eight per cent, so it was neutral in this deal, but had a better double tax treaty with the Netherlands for ensuring that the income stream was not tracked back to a source not properly taxed. Because of its own 'participation exemption'<sup>213</sup> the Netherlands would then treat the dividend as passive income in that country and so tax it at, at most 5%, except because it had already suffered tax in the EU at 10% in Cyprus even this might be waived. The result was that the tax holiday granted by Liberia was translated by the structure used into an effective overall very low rate of tax for Mittal Steel. The use of these arrangements does, therefore, contribute significantly to the fiscal degradation of developing countries.

That treaty shopping is rampant is obvious from other evidence. UNCTAD's Inward FDI Performance Index for 2004-2006 shows the following<sup>214</sup>:

Rank	Economy	Score
1	Luxembourg	17.476
2	Hong Kong, China	9.630
3	Suriname	9.454
4	Iceland	7.715
5	Singapore	7.622
6	Malta	7.401
7	Bulgaria	7.000
8	Jordan	6.357
9	Estonia	6.288
10	Belgium	6.122

It is obvious that Luxembourg is not the biggest recipient of FDI in the world. It has only 486,000 people<sup>215</sup>. It is being sued as a conduit. The same is almost certainly also true of Hong Kong, Iceland, Singapore, Malta, Estonia and Belgium in this list. Each offers mechanisms to encourage investment through them, not in them, and tax treaty shopping is part of this.

<sup>213</sup> For an explanation see [http://www.somo.nl/html/paginas/pdf/netherlands\\_tax\\_haven\\_2006\\_NL.pdf](http://www.somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf) accessed 13-6-08

<sup>214</sup> <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2471&lang=1> accessed 13-6-08

<sup>215</sup> <https://www.cia.gov/library/publications/the-world-factbook/print/lu.html> accessed 13-6-08

The evidence from this limited range of case studies is clear: DTA shopping is rampant and has significant impact on the way in which world trade is structured. This imposes real costs on governments, and most especially on those of the developing countries of the world.

## 18: To what extent do Offshore Financial Centres investigate businesses and individuals that appear to be evading UK taxation?

The tax havens that do most business with the UK are, without doubt, those over which it has greatest influence, including in particular those in the Crown Dependencies and the British Overseas Territories.

As is noted in the introductory chapters of this report, the National Audit Office of the UK reported in November 2007 with regard to the British Overseas Territories that<sup>216</sup>:

Progress has been made in developing the Regulation of Offshore Financial Services, though the four larger offshore financial centres are leaving in their wake the weaker regulatory capability of the three smaller centres where the UK retains most direct responsibility. The main challenge across all Territories is to respond adequately to growing pressures to reinforce defences against money laundering and terrorist financing.

As the evidence, also noted in the introductory chapters shows, they are in practice struggling to comply with legislative requirements in most territories, do not have the resources to investigate the suspicious transaction reports they receive, which are pitiful in number, and concentrate solely (as the above paragraph does) on money laundering and terrorist financing. It is very unlikely that any assistance is provided to the UK in tackling either evasion or avoidance from these locations.

The situation in the Crown Dependencies is supposedly a little better. However, this may in no small part be because significant numbers of their investigating officers are on secondment to them from UK authorities. Nonetheless the emphasis remains on drugs money laundering and terrorist financing: awareness that tax evasion is defined as money laundering appears very low either due to ignorance (despite the money laundering manuals of Jersey, for example stating that is the case) or because of a wilful desire to turn a blind eye to the issue: largely because those who should be reporting on tax evasion are largely dependent on fee income from this activity.

The revelation that more than 60,000 people held bank accounts with just the five main UK high street banks in the Crown Dependencies on which they had evaded tax makes this amply clear. These were declared under the term of the ‘tax amnesty’ offered by HM Revenue & Customs in 2007. More than 45,000 of these people made tax settlements and more than £400 million in tax was paid<sup>217</sup>.

<sup>216</sup> [http://www.nao.org.uk/publications/nao\\_reports/07-08/07084.pdf](http://www.nao.org.uk/publications/nao_reports/07-08/07084.pdf) accessed 13-6-08

<sup>217</sup> <http://business.timesonline.co.uk/tol/business/money/tax/article3008168.ece> accessed 13-6-08

The banks in question, all of which are household names claimed that this was not their responsibility. They relied upon the argument, also recently used by the Swiss Bankers Association to defend its actions, that what their customers did with their bank accounts was not the banks concern.

In this case that was not true. Prior to the introduction of the EU Savings Tax Directive in July 2005 the banks in question would have been required to write to every one of these customers to ask them if they wished for tax to be withheld on interest paid to their account of for information exchange to take place. Presumably, and because these account holders had to make declaration under the 'tax amnesty' they all opted for tax to be withheld.

The moment the banks in question received a request for the withholding tax option they should have reported their suspicion that the account in question might have contained funds that had been money laundered to the relevant financial services authority in each of the jurisdictions in question. This is because any reasonable person knowing that a person receiving income in the UK on which it was likely that they had a tax liability but who did not wish it to be declared to the UK tax authorities must have had suspicion that this was because tax evasion was taking place. The only requirement for making a report is that there is suspicion that money laundering (in this case in the form of tax evasion) is taking place. There is no duty to report that it is: that is not the banker's job, they must merely report suspicion.

What we know without doubt is that in 2006 such suspicions were not reported. Tax evasion would be criminal money laundering. Not a single report of criminal money laundering was made to authorities in Jersey in 2006, as noted in the introductory chapters. This means that all these banks ignored their duty to report. They also fought to prevent disclosure of the data they held in the UK.

The conclusion is simple: tax havens and the OFC operators based in them do not appear to investigate businesses and individuals that appear to be evading UK taxation. Worse, they deny that it is their duty to do so even though it is abundantly clear that under all money laundering regulation the contrary is the case.

There would appear to be wilful and deliberate neglect of this obligation in OFCs based on the evidence noted here.

## 19: Conclusions and recommendations

*“There is a strong economic and social case for strong co-operation and exchange of information between Governments and tax authorities around the globe, and particularly within the EU, in order to meet the challenges being posed by globalisation, not just for economies as a whole, but also specifically for national tax systems.”*

James Roberston, HM Treasury, Speaking in Warsaw on The Challenge Of Globalisation For Tax Policy In The EU at The Polish Lisbon Strategy Forum, May 2008

This report has sought to achieve four objectives:

1. To explain what tax havens and offshore financial centres are;
2. To explain how these places work, and what their impact is;
3. To relate the findings in these first two sections to the questions raised by the Treasury Committee in its call for evidence dated 30 April 2008<sup>218</sup>;
4. To offer recommendation on how the UK might tackle the issues that have been referred to.

This chapter deals with the last of these four objectives.

We do not consider tax havens and OFCs to be the same thing. Indeed, whilst it is clear that the two are related one to the other they have entirely different characteristics. Tax havens are places with the capacity to create legislation designed to assist a person to avoid the regulatory obligations imposed upon them in the place where they undertake the substance of their economic transactions. In other words, tax havens deliberately create legal structures, whether they be companies, trusts or other arrangements that have little or no benefit for those resident within their own domains (and might even be denied to those so resident) but which can be exploited by those resident elsewhere, legally or illegally, to avoid obligations placed upon them by the law of the places where they live or undertake their economic activities.

Offshore Financial Centres are the commercial communities hosted by tax havens which exploit the structures that can be created using that tax haven’s legislation for the benefit of those resident elsewhere. In other words, the offshore financial centre is made up of the accountants, lawyers, bankers and their associated trust companies who sell services to those wishing to exploit the mechanisms the tax haven has created.

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<sup>218</sup> [http://www.parliament.uk/parliamentary\\_committees/treasury\\_committee/tc0708pn42.cfm](http://www.parliament.uk/parliamentary_committees/treasury_committee/tc0708pn42.cfm) accessed 12-6-08

It is immediately obvious that these are not the same thing. The tax haven is fixed geographically and has loyalty to a place. The OFC community is highly mobile, often works in many tax havens simultaneously, and serves a mobile client base who can relocate globally. As we have shown, the last thing that this community has is a commitment to a geographic space: indeed, developments in its activities over the last decade have shown that its commitment is to securing for its clients the ultimate goal of the tax avoider, which is to be 'nowhere' for regulatory purposes and therefore beyond the scope of the law, whether that law relates to tax or other matters.

As we have shown, this is possible. The result is that it is possible to create 'secrecy spaces' in which transactions take place that are effectively unregulated by the global financial system. This possibility poses a fundamental threat to the stability of that system. It also challenges the ability of governments to collect the tax due to them. Most seriously, in our opinion, these structures permit the capital flight that is fundamentally undermining development efforts in the poorer nations. This capital flight represents the biggest flow of funds from the poorest people in the world to the richest people in the world and from the poorest nations in the world to the richest nations in the world since time began. This capital flight is estimated to be at least US\$600 billion a year at present, and might be as high as US\$1 trillion<sup>219</sup>. Sixty or more percent of this might arise as the result of commercial exploitation of developing countries and their tax systems by multinational corporations: thirty per cent might relate to criminal activity. As little as three per cent might relate to corruption, but in all these areas the impact is pernicious and harmful to universal well being.

None of these activities can take place without the veil of secrecy that tax havens provide, and which the OFC operators exploit. It is wrong to think of tax as the major selling-point of these locations. Secrecy is their major selling-point and the central component of all activity that takes place there. Low or no taxes is best seen as bait that either attracts the business to them or that keeps it within their domains once captured: once the secrecy that the havens supply has been exploited in the course of a commercial transaction it might well be that tax law has been violated in another state. The unwillingness of the tax haven users to admit the tax evasion to which they have been a party keeps their funds locked into the tax haven and the OFC operators who exploit this to provide themselves with a long term income stream.

In assessing this issue the UK has a particular problem to address. As we show, it is a tax haven in its own right. It also hosts what is almost certainly the largest OFC in the world in the City of London. All objective observers agree that this is so. Indeed, many would argue that the UK is at the epicentre of the tax haven phenomenon, having created many of the instruments that tax havens now utilise, and still being in the market for their supply at this time. As we also show, whether this happened by either accident or the circumstance of chance is now irrelevant: the UK's economic policy and the Treasury's taxation policy is

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<sup>219</sup> [http://www.gfip.org/index.php?option=com\\_content&task=view&id=109&Itemid=74](http://www.gfip.org/index.php?option=com_content&task=view&id=109&Itemid=74) accessed 2-6-08

explicitly based on maintaining the UK's role as a haven. This might not be advertised, but it is a fact. The evidence is impossible to interpret otherwise, and the impact is being seen in many of the taxation issues that have caused recent embarrassment to the government.

In addition, the UK also has international responsibility for many of the largest tax havens in the world, including Cayman, Jersey, Guernsey, the Isle of Man, Bermuda and the British Virgin Islands, a fact that recent government reports have acknowledged.

This being the case, the UK has a range of issues to address when considering both tax havens and OFCs. In particular it has to:

1. Resolve and make explicit its own policies as a tax haven;
2. Determine how best to regulate its own OFC in the City of London;
3. Consider how it can mitigate the risk arising from the actions of the tax havens for which it is responsible both to itself and others, and how best to regulate the OFCs that operate from those locations;
4. Create a coherent strategic policy for progress on tax haven and OFC issues that addresses all the issues they pose with regard to transparency, taxation, financial stability, corruption criminality and, most importantly, development.

In our opinion this strategy does not exist at present. Its absence has contributed to many recent economic and political concerns in the UK as well as being an issue of major concern to many of our trading partners and international allies, both within and beyond the EU.

In this section we touch on the issues that the UK will need to address if this coherent strategy is to be created and suggest some of the benefits that will result.

### **1) Extend regulation to OFCs**

The entire focus of regulation of the offshore economy has to date focussed on the role of the tax haven. The reason is obvious: in world where regulators come from nation states their mind set has been to use the power of the nation state to regulate activity that they believe is located within it.

As is becoming increasingly obvious, this does not work in the offshore economy. Some have claimed that the role of that economy is to undermine the power of the nation state to regulate. Whilst there is little evidence, as yet, that this has impacted on the major nation states of the world, there can be no doubt that any power that the micro states that are host to most of the world's tax havens has been foregone by them as a result of hosting OFCs. The reason is simply stated: those OFCs are dominated by major international banks, firms of accountants and lawyers. As has been increasingly obvious over the last decade, the global and mobile OFC operators of the world can hold any micro-state tax haven to ransom when demanding legislation that they desire to facilitate their trade.

As a result there has been widespread introduction of laws that, for example, facilitate the relocation at will of corporate entities through the process known as redomiciliation: these laws effectively undermine any power the fixed location tax haven might have over entities that are now, at most nominally incorporated using its laws, but which might at any time move elsewhere. Legislatures that have, in effect, sold their right to regulate in this way have little or no power to exercise control over the OFCs that are located within their domains.

The consequence has been plain to see. Whilst enormous effort has been put into creating legislation and regulation to comply with the requirements of organisations such as the Financial Action Task Force, that regulation has been treated with contempt by the OFC operators located within tax havens who have little or no incentive to offer more than token compliance with its requirements for two, very obvious reasons. The first is that those who staff the senior ranks of the companies that make up the OFCs rarely come from the tax havens in which they operate, and as such have no tie with that location bar a temporary commercial one. They therefore know that in the event of problem arising they can usually flee back to the state from whence they came. Second, their clients have even less allegiance to a place which they may never have visited. In that case they are indifferent to its regulation, especially when, as far as they are concerned the entity they have created is not located in that tax haven, but offshore from it, in what we have termed a ‘secrecy space’.

What this means is that the entire focus of offshore regulation has been focussed at the wrong target. Whilst there can be no doubt that regulation of financial services activity within an economy is essential, to presume that it might be effective in a global economy where much if not most financial activity is at least notionally based in micro-states has been an act of misplaced faith.

### ***Recommendation 1***

***There is only one alternative option to regulating the tax haven though, and that is to regulate the OFC.*** There is obvious difficulty in doing so. These are made up of commercial entities, many of which are multinational and some of which have global extent. The Big 4 firms of accountants are in all major and many of the world’s minor tax havens, for example. But it is the OFCs that must be regulated if we are to ensure that the risks that the offshore economy poses to the world at large, now and in the future, is to be minimised.

We recognise the difficulty of regulating commercial organisations who operate multinationally. We also believe that the need to address this issue is one of the consequences of globalisation and that it cannot be avoided. Equally, and obviously, the task requires a different approach to regulation from that adopted to date, which has to a large extent failed. It is for that reason that we next turn to individual issues of regulation, but in all cases set our comments against this background requirement that it is the OFCs

that now need regulating before returning later in this chapter to the theme of how that task might be fulfilled based on our other recommendations.

## 2) Extend transparency

We have already noted that it is secrecy that underpins the offshore economy. Without it most of the other abuses that emanate from there would be curtailed, or be significantly limited in extent. It is therefore apparent that transparency is key to regulation. Without it what happens in OFCs will not be known and regulation of their activities will not be possible.

The UK needs to lead the way in regulatory reform to promote transparency: both as a tax haven and OFC in its own right it has a duty to do so. Its own practices falls far short of the level that might be considered desirable. The UK should ensure that transparent recording of the structure of all entities is available on public record and that the accounts of all material entities are available on public record<sup>220</sup>.

### *Recommendation 2*

*The UK government should make clear its own commitment to creating and rigorously enforcing operation of the registers noted here, and lead the call for other countries around the world, and especially those tax havens for which it is responsible, to do the same:*

#### **A. Create a public register of companies and to record on it:**

- a. A list of all incorporated companies;
- b. Detailed information for each company concerning:
  - i. Its registered office at which official contact can be made with it;
  - ii. Its constitution;
  - iii. Its membership and their identifiable addresses at which they can be contacted, updated at least annually, and if those members are nominees or corporations the names of the persons for whom they ultimately act shall be given;
  - iv. The details of the person or persons (whether individuals or a corporation charity trust or other entity) that controls the corporation shall be stated and if there are 5 or fewer connected persons<sup>221</sup> who ultimately control the corporation then the means of

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<sup>220</sup> This section is based on section 2 of the Exposure Draft of a Code of Conduct for Taxation published jointly by the Tax Justice Network and the Association for Accountancy and Business Affairs in October 2007, available at [http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code\\_long.pdf](http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code_long.pdf) accessed 12-6-08

<sup>221</sup> A connected person is generally considered to be a person's parent, step-parent, sibling, step-sibling, child, step child or greater issue or step-issue, aunt or uncle, first cousin, spouse and former spouses for a period of five years from the time of divorce having taken place and those spouses' connected persons and all corporations, trusts, charities or other entities owned or controlled by such persons, all business partners and those of connected persons and all trustees, nominees and agents appointed to undertake business on behalf of

establishing control shall be shown and the country of location for each individual, corporation, charity, trust or other entity involved in that process of control shall be disclosed, in each case with an identifiable contact address being given;

- v. Its directors or other officers and if such persons are nominees the identities of those on whose instructions they are required or are accustomed to act, including the country in which such persons are located and the reasons by which they obtain their authority to issue instruction, in each case with an identifiable contact address being given;
- vi. The holders of any debt or other financial instruments that it has issued which does, or might foreseeably, afford control of the company, including full details of beneficial ownership if nominees are used.
- c. A list of all companies, charities, trusts or other entities controlled directly or indirectly by the company, in each case with sufficient identification details and an address being given so that the entity can be identified in its country of incorporation or registration.
- d. Its annual financial statements.

**B. Create a register of charities containing all that information required of companies, with in this case provisions with regard to directors and other officers extending to trustees and other such officials and with the addition that in this case:**

- a. The names of those promoting the charity should be disclosed;
- b. The names and identifiable addresses of any individual, corporation, charity, trust or other entity who, with their connected parties, provides more than 10% of the income of the charity in a year should be disclosed;
- c. The names of the beneficiaries receiving more than 5% of the income of the charity in any year should be disclosed;
- d. The reason why the income of the charity has not been distributed shall be disclosed annually if less than 75% of its income has been applied to its stated charitable purpose.

**C. A register of trusts should be created containing all that information required of companies, with in this case provisions with regard to directors and other officers extending to trustees and other such officials and with the addition that in this case:**

- a. The name of the settlor or settlors of the trust should be disclosed and all those contributing a sum more than 10% of previously gifted trust property shall

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any such connected party, whether the person in question be a natural person or a corporation, charity, trust or other entity created under legislative powers anywhere in the world.

likewise be disclosed together with their identifiable addresses, at least annually;

- b. The trust deed should be disclosed as should all side letters, letters of wishes and other communications of any form (including written summaries of verbal instructions or communications issued in non-reproducible electronic format) that give indication to the trustees or those who instruct the trustees as to the way in which the funds under their care should be used;
- c. In the event that the trust is of a discretionary nature then a list of all those who have benefited from more than 5% of the income of the trust in any year in the previous ten years should be supplied with identifiable addresses.

**D. A register of other entities created under statute should be created containing all that information required of companies, and with such other information as is shall be appropriate to ensure that information of the type required for charities and trusts is also available, if appropriate.**

Each of these registers should be available for free public searching, on the internet and at public buildings at any time.

Such a commitment would require an extension of disclosure rules in the UK and for almost every government in the world. The advantages would be:

- 1. A reduction in secrecy;
- 2. An increase in the efficiency of identifying assets under the control of any person or other entity;
- 3. An increase in the tax yield;
- 4. Greater openness and transparency in commercial transactions leading to benefits for all stakeholder groups including enforcement agencies of all sorts, employees, those with environmental concern, commercial creditors of organisations, banks and other suppliers of capital, consumers, and civil society at large.

It should also be noted that in practice the requirements are not onerous. Under the 'know your client rules' that are an integral part of FATF based financial services regulation such information has to be secured as a matter of course by those providing service to these entities. The information must therefore be known, as is the additional information noted as to proof of ultimate beneficial ownership and the means by which such connections can be established. As such the public disclosure of this information would not impose an onerous administrative burden on any business which is in possession of a bank account anywhere in the world since it has to have it available already, no matter where located.

### 3) An end to banking secrecy

Everyone has the right to reasonable privacy. No one has the right to break the law. Banking secrecy was created by Switzerland to enable foreign person's using its bank accounts to break the law of their countries of residence, and that has remained the prime purpose of banking secrecy ever since. This has to end, and the UK should lead the way in demanding this change in banking regulation, which is something it could do if the registers noted in the previous section were created in the UK as the law of this country could not then be used to create what the Swiss consider banking secrecy by proxy through the combination of trusts and nominee companies.

Once banking secrecy is abolished the next obvious step is the automatic exchange of information on income earned on capital assets located by a person in one state when their main place of residence is another state. The EU Savings Tax Directive has shown that this is possible.

#### **Recommendation 3**

*The UK seek that the EU extends the EU Savings Tax Directive to all privately owned entities (whether they be companies, trusts, foundations, partnerships with limited liability or their like).*

#### **Recommendation 4**

*The UK seek that the EU extends the EU Savings Tax Directive to all forms of income derived from capital including all forms of interest, without exception, income from insurance policies and pension funds, dividends of all forms, trust distributions and the payment of royalties, licence income and similar payments derived from the ownership of intellectual property.*

#### **Recommendation 5**

*The UK seek that the EU extend the EU Savings Tax Directive to additional territories to ensure that its effectiveness is extended.*

Each of these objectives has been subject to discussion, and all are considered politically achievable.

There is of course the option of using sanctions if cooperation is not obtained: the US are considering this and Presidential candidate Senator Barack Obama has signed the Stop Tax Haven Abuse Act which incorporates that option by threatening tax withholding<sup>222</sup>. The UK also threatened this to Jersey in 2002 when it was refusing to cooperate on implementation

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<sup>222</sup> <http://levin.senate.gov/newsroom/release.cfm?id=269479> accessed 12-6-08

of the EU Savings Tax Directive and legislation to achieve this goal is as a result already sitting, unused on the UK statute book.

#### 4) Shattering the secrecy space in corporate accounts

The secrecy space that OFC operators provide when utilising tax haven entities has enabled the world's largest corporations to significantly reduce their taxation liabilities<sup>223</sup>. This opportunity would be massively reduced if the world's accounting rules did not greatly assist this process. It does by requiring that the accounts of multinational corporations be presented in what is called a consolidated format. This approach to accounting (and it is no more than an approach) requires that only the transactions between the group of companies that are within the multinational entity and third parties be included in the reported accounts. This means that all transactions within the group of companies are excluded from view. It is as if they simply did not exist.

This, of course, is not true. Multinational groups can include thousands of companies. As is noted in this report, the OECD estimates that sixty per cent of world trade takes place on an intra-group basis i.e. between companies under common ownership. None of this trade is reflected in the published consolidated accounts of multinational entities and yet it is this same trade that gives rise to the whole problem of transfer pricing abuse that facilitates so much of the capital flight out of developing countries. This means that the accounts, whilst reflecting one aspect of the transactions that a group undertakes do not by any means reflect the whole impact of that company upon the communities with which it engages.

This is of particular benefit to multinational companies seeking to use tax havens. Almost all their use of such locations will arise from intra-group trade, whether it be in physical goods, or more commonly now in services. It is through these transactions that profit is relocated to these places with the aim of saving tax<sup>224</sup>. Because of the current combination of consolidated accounting, tax haven secrecy and failure to place accounting information on public record the vast majority of this abuse stays permanently out of sight in the secrecy space that OCF operators create for their clients using tax haven legislation.

There is a mechanism to break this combination of secrecy that facilitates the biggest flow of capital flight out of the developing world, and a significant loss of taxation revenue to the developed world. This is called country-by-country reporting. Those promoting it

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<sup>223</sup> For the evidence with regard to the UK see <http://www.tuc.org.uk/publications/viewPub.cfm?frmPubID=535> accessed 12-6-08

<sup>224</sup> For an example of such a structure see <http://www.taxresearch.org.uk/Blog/2008/06/01/tescos-the-zug-deal-is-tax-avoidance/> accessed 12-6-08

suggest that accounts prepared on this basis should be published as part of the accounts of multinational corporations alongside, but not replacing, their consolidated accounts<sup>225</sup>.

Country by country reporting means that a multinational corporation would report in its accounts, without exception:

- which countries it operates in;
- what name it trades under in each country;
- its financial performance in the countries where it operates, including:
  - sales, both within the group and outside the group
  - purchases, split the same way;
  - financing costs, split the same way;
  - labour costs and employee numbers;
  - pre-tax profit;
  - tax payments to the government of the location where it is trading.

This information would be required to reconcile with the company's main published accounts.

It is important to note that Country-by-country reporting would impose little cost burden on MNCs because they already hold all the necessary data that we are asking be disclosed for internal accounting purposes.

The benefit of country-by-country reporting would be that it shows where a group of companies operates, what name it trades under, and what trading it undertakes there, both within its own group and with third party customers and suppliers. This would make new information available to a wide range of stakeholder groups. In particular it would put on record:

- Where a company is registered and operates. This would highlight those operating in politically unstable regimes, tax havens, war zones and other sensitive areas. It would also help citizens of those jurisdictions find out who really owns the companies that are trading in their countries;
- What tax is being paid where, whether that appears reasonable in relation to the tax rates in the country in question, and whether the group appears to be using tax havens for profit-shifting purposes. The use of tax havens will be highlighted both by the country listing and by data showing that intra-group trading in these places is particularly heavy. Heavy use of tax havens should trigger deeper enquiry into whether transfer mispricing is occurring.

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<sup>225</sup> For a broader discussion see [http://www.taxjustice.net/cms/upload/pdf/Country-by-country\\_reporting\\_-\\_080322.pdf](http://www.taxjustice.net/cms/upload/pdf/Country-by-country_reporting_-_080322.pdf) accessed 12-6-08

Making this information available to a wider range of stakeholders would also strengthen efforts to monitor:

- Corrupt practices, which are often disguised through the use of offshore special purpose vehicles;
- Corporate governance. There has been a remarkable coincidence between major corporate failures and groups of companies making extensive use of offshore arrangements;
- Tax payments to developing countries;
- World trade flows. Data on the 60 per cent of world trade that takes place within MNCs is scarce and hard to understand;
- Corporate responsibility. For example, employment conditions in all the countries where an MNC operates could be monitored.

#### ***Recommendation 6***

***The UK should actively promote the use of country-by-country reporting by the International Accounting Standards Board and by individual countries.***

#### **5) Corruption**

The UK has a poor record in tackling corruption, not helped by such incidents as the BAE affair.

The UK signed the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (“the OECD Convention”) in 1997 and ratified it in 1998. The UK’s ratification was extended to the Isle of Man in 2001<sup>226</sup>. It has not been extended to any of the other territories for which the UK is responsible including the Channel Islands.

#### ***Recommendation 7***

***The UK must extend ratification of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions to all territories for which it is internationally responsible and require their active participation in its implementation.***

The UK is seen to have been weak on this issue<sup>227</sup>. Its commitment is now essential if the convention is to be supported and the UK is to play its full role in the fight against corruption, much of which takes place in tax havens.

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<sup>226</sup> [http://www.oecd.org/document/1/0,3343,en\\_2649\\_37447\\_36430529\\_1\\_1\\_1\\_37447,00.html](http://www.oecd.org/document/1/0,3343,en_2649_37447_36430529_1_1_1_37447,00.html) accessed 12-6-08

<sup>227</sup> [http://www.transparency.org/news\\_room/latest\\_news/press\\_releases/2007/2007\\_06\\_13\\_uk\\_defence](http://www.transparency.org/news_room/latest_news/press_releases/2007/2007_06_13_uk_defence) accessed 12-6-08

The UK needs to take the initiative in another area of corruption. It must recognise that corruption has two sides: the demand side, which represents the person undertaking the corrupt transaction, and the supply side, which represents the supply side of those supplying the mechanisms to undertake the corrupt transaction.

#### **Recommendation 8**

*The UK should recognise the role of OFCs in supplying the mechanisms used in many corrupt transactions, and actively promote research into methods of curtailing this supply that do not rely solely upon the actions of tax haven governments who have neither the power, resources or inclination to regulate that supply.*

### **6) Tax**

### **policy**

The UK has to decide whether it has one tax policy or two: whether its tax policies are established primarily for the benefit of those living in the UK or for the benefit of those living elsewhere.

There can be no doubt that those living in the UK will benefit from the UK making a commitment to the creation of taxation policy that has as its primary goal the creation of stable domestic markets for the UK.

This requires a number of commitments to removing the UK's status as a tax haven and promoting a level playing field within the UK economy.

#### **Recommendation 9**

*The UK should scrap the domicile rule entirely. The changes announced in 2007 and implemented from April 2008 have left a massive ring-fence within the UK economy that is harmful when compared with any assessment of tax practices. As the clearest indication that can be given that the UK intends to drop its status as a tax haven this change is essential.*

#### **Recommendation 10**

*The UK currently provides a taxation environment that favours large companies over small ones, quoted companies over unquoted companies and international entities over those operating solely in the UK. This is despite the fact that at least half of all the UK workforce work for companies whose activities are located solely in the UK.*

*The UK should now commit to a tax strategy that ensures that all companies have equal access to markets, all can enjoy equivalent tax rates (there is now serious risk that smaller companies are paying taxes at higher rates than large ones) and that*

*undue regulatory burden is not placed on companies operating solely in the domestic market as a result of the action of those working multinationally.*

Active steps should be taken to promote this objective.

#### **Recommendation 11**

*The UK should work with the EU to promote adoption of a Common Consolidated Corporate Tax Base that limits the possibility for companies to arbitrage the taxation laws of one country against those used in another, and that allocates profit to country on the basis of a unitary apportionment formula taking into consideration solely where a company's employees, assets and sales are located, so limiting the possibility of profit being allocated to tax haven activity.*

#### **Recommendation 12**

*The UK is believed to have been an obstacle to implementation of some aspects of the EU Code of Conduct on Business Taxation. The UK should commit to this Code, seek to extend it to personal taxation and require that the Conduct group monitoring its implementation publish reports on its work.*

### **7) The UK's tax havens**

The UK has no clear policy for its tax havens. It does on occasion seem to treat them as a source of embarrassment. It is also aware that they are a source of risk. In the case of the Isle of Man and Montserrat it provides considerable financial assistance that assists their status as tax havens. It persistently fails to ensure that good standards of governance, financial regulation, financial reporting and local accountability are maintained. This inconsistent approach assists those who use the stability that the UK affords its tax havens as the basis for the operation of abusive OFCs.

#### **Recommendation 13**

*In 1998 the UK undertook the Edward's Review of its tax havens and then failed to require the proper implementation of the recommendations of the resulting report. The world has changed substantially since 1998 and another review is required, with Royal Commission status, to determine future policy for the tax havens.*

#### **Recommendation 14**

*The UK should require that its tax havens operate systems of accountability and transparency with regard to corporate and other disclosure equivalent to those of the UK.*

**Recommendation 15**

*The UK should now as a result of the findings of the National Audit Office published in November 2007:*

- *Improve the quality of its training for all staff seconded to Overseas Territories and the Crown Dependencies*
- *Second such staff as are needed to ensure that the financial services regulation of all territories for which the UK is responsible is operational and effective*
- *Ensure that deficiencies in current legislation for regulatory regimes are remedied with immediate effect, if necessary by way of Orders made in Council*
- *Require that contingency place be put in place for the demise of the financial services industry in each of these locations*
- *Create plans to diversify the economies of these territories so that they might have alternative sources of income available to them*
- *Make clear that funds to ensure that this development is possible are dependent upon adopting recommendations on transparency included in this report;*

**Recommendation 16**

*The Crown Dependencies are particularly vulnerable to political capture by the financial services industry. The Isle of Man can only operate because of subsidies amounting to more than £200 million a year provided to it by the UK; Jersey and Guernsey are likely to run substantial government deficits as a result of tax changes adopted to comply with the EU Code of Conduct on Business Taxation. Neither gives indication of having contingency plans available to manage those budgets given the current likely down turn in their trade as the world financial crisis develops.*

*The UK government should:*

- *Make explicit the terms of its support for the Isle of Man government and make explicit its requirement that the Isle of Man comply with both the spirit as well as the letter of the EU Code of Conduct on Business Taxation in exchange for that support;*
- *Require that each of the Crown Dependencies prepare contingency plans based on the premise that there will be no growth in their financial services sectors for the next five years;*
- *Make explicit that support will only be forthcoming for these territories if they are willing to comply with recommendations on transparency included in this report;*
- *Require that each Crown Dependency develop a plan to break its dependency upon financial services as the main source of its income and demonstrate the viability of doing so.*

## 8) Tax Havens and Development

No one suffers more comprehensively from the existence of tax havens and OFC abuse than the developing countries of the world. For them this is not a question of ensuring the effectiveness of financial regulation or the efficiency of the tax system (although both have significance in developing countries): it is also a matter of life and death, as Christian Aid has shown. This must be recognised in UK development policy, which needs also to urgently consider the lack of coherence between the UK's role as a tax haven and protector of tax havens dotted across most time zones, and its role as a leading aid donor:

### *Recommendation 17*

*The UK needs a policy on tax havens that is integrated into its work on development. This must include commitments to:*

- *Provide technical support and training to developing countries to ensure they can engage effectively with tax haven abuses, whether relating to corruption, crime or taxation abuse;*
- *Provide technical support to developing countries to ensure that they can negotiate effective contracts with significant commercial trading partners that provide them with access to adequate information to ensure that appropriate taxes are paid within their domain as required by their law;*
- *Develop models for development that break the dependence on fiscal degradation that has been the pattern of incentive used to date, so undermining the credibility of developing country tax systems and their prospect of becoming effective, self governing democracies that are not dependent upon aid;*
- *Support developing countries in creating effective information exchange agreements with other nations and with tax havens to ensure they have access to the information they need to ensure they can collect the taxes due to them;*
- *Assist developing countries in recovering stolen assets that are their rightful property, including those that have arisen as a result of tax evasion, and to create effective mechanisms for the repatriation of these assets from locations over which the UK has control (including the City of London) to those places that need these assets to fulfil their development objectives.*
- *Ensuring that international and domestic civil society is represented in the processes recommended here to ensure that governments are held accountable for the actions they take in the name of the people they govern and that where appropriate training is provided to ensure that those groups are empowered to undertake these tasks.*

## 9) Regulating the OFCs

The first recommendation of this report was that the focus of offshore regulation should now shift from the tax haven as such to OFCs. In addition to that recommendation we have made 16 further recommendations. The focus of those has been, in no small part, to break down the veil of secrecy that tax havens supply. Without that secrecy there would be no product for the OFCs of the world to supply. It is only secrecy that allows them to successfully sell products designed to abuse the regulatory obligations a person has in the place in which they normally reside or undertake their trade.

If the recommendations of this report are adopted there will be little for the OFCs to sell. Their regulation will be unnecessary. The harmful trade they pursue will have been undermined.

And there can be no doubt that it is harmful. It has as its intent the creation of secrecy from which some in society (mainly rich people and criminals) can benefit but from which the majority are excluded. The result is inevitable: the gap between rich and poor in society increases. This harms people's sense of well being. It increases absolute poverty. It increases the likelihood of crime and social discord. The resulting loss of revenue harms educational and health outcomes. The infrastructure needed for trade is not available. Essential resources to tackle some of the biggest issues we face, including global warming, will be denied when they are essential.

And all this is known to be inevitable: the most basic understanding of economic theory of the sort taught in every university in the world suggests that imperfect information results in imperfect markets, the rise of monopoly power and the need for additional regulation. Our suggestions accord perfectly with that theory. All that surprises us is that the massed ranks of the world's economists do not do so as well.

This happens through the promotion of self interest, most especially by those professions such as lawyers and accountancy that were once seen to have strong ethical motivation. Banking, once also the pillar of society, is now playing a key role in undermining it through its extensive involvement in the offshore world.

All of these sectors obtain substantial benefit from the existence of the democratic states of the world with which they are now in conflict because of their near universal presence in the world's OFCs. Society needs to present them with a choice; a choice to support society or be sanctioned by it. It would clearly be in the best interests of all that this choice was to comply. As such we come to our final recommendation:

### ***Recommendation 18***

***The UK must promote Codes of Conduct for Taxation. The first would be to support the creation of a Code of Conduct for Taxation to be adhered to by governments.***

*Progress is being made on this issue at the United Nations<sup>228</sup>, and we recommend that that the UK support the development of that Code. The second would promote a Code of Conduct for Taxation<sup>229</sup> that would uphold the highest ethical standards of conduct, including a commitment to making full disclosure of all information noted in recommendation 2 above and to desisting from the promotion of all forms of tax avoidance on the part of all engaged in the taxation profession, whether in the UK or offshore. This should be enforced by refusing to extend UK contracts for services to any company or firm that did not commit itself and all its group members and their affiliates trading under similar or associated names to that standard of conduct.*

This is possible. OFCs are a commercial response to an opportunity made available by tax haven governments. Those governments that wish to tackle tax haven abuse have the commercial right to withhold trade from those commercial firms who exploit tax havens by operating in OFCs to undermine the revenues of the governments from which those same firms want revenue. Indeed, they have more than this right, they have a duty to do so, and the USA has recently made welcome moves in this direction<sup>230</sup>.

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<sup>228</sup> [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1118805](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1118805) accessed 17-6-08

<sup>229</sup> As an example, see [http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code\\_long.pdf](http://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code_long.pdf) accessed 13-6-08

<sup>230</sup> [http://www.boston.com/news/nation/washington/articles/2008/05/23/senate\\_oks\\_bill\\_barring\\_contractors\\_from\\_avoiding\\_tax/](http://www.boston.com/news/nation/washington/articles/2008/05/23/senate_oks_bill_barring_contractors_from_avoiding_tax/) accessed 13-6-08

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## 20. The Language of Tax

Affiliate	A related company or subsidiary of a corporation.
Aggressive tax avoidance	The use of complex schemes of uncertain legality to exploit taxation loopholes for the benefit of taxpayers who can afford the fees charged by professional advisers who create such arrangements.
Arising basis	Treating income earned outside the country of residence as liable to tax in the year in which the income is earned, even if it is not remitted to the country where the tax is payable. Compare with the remittance basis.
Banking secrecy	Banking secrecy laws strengthen the normal contractual obligation of confidentiality between a bank and its customer by providing criminal penalties to prohibit banks from revealing the existence of an account or disclosing account information without the owner's consent. Can be used to block requests for information from foreign tax authorities.
BIS	Bank for International Settlements <a href="http://www.bis.org/">http://www.bis.org/</a>
Capital gains tax	A tax on the profits from the sale of capital assets such as stocks and shares, land and buildings, businesses and valuable assets such as works of art.
Capital flight	Capital flight is the deliberate and illicit disguised expatriation of money by those resident or taxable within the country of origin.
Center for Freedom and Prosperity	US based right wing think tank appearing to be closely linked to the Heritage Foundation <a href="http://www.heritage.org/">http://www.heritage.org/</a> and the Cato Institute <a href="http://www.cato.org/">http://www.cato.org/</a> . Set up to oppose the OECD harmful tax initiative launched in 1998.
Charitable trust	A trust established for purposes accepted by law as charitable.
Citizenship basis of taxation	Tax is charged on the worldwide income of all citizens of the state irrespective of whether they are resident or not in the territory during the period for which the taxes are levied. The most obvious example is the USA.
Collateralised debt obligation  CDO	Collateralized debt obligations (CDOs) are asset backed securities and structured credit products. CDOs are constructed from a portfolio of fixed-income assets. This 'construction' usually takes place offshore and the opacity with which the CDO product is thought to have had significant impact on the credit crisis that emerged in 2007.
Company or corporation	An entity treated as a separate legal person from those who set it up, established under the rules of the country in which it is registered.
Controlled foreign	A tax definition to describe a situation in which a company which

corporation (CFC)	charges tax on the profits of corporations has a subsidiary registered in a tax haven or other territory where little or no tax is charged on the profit the subsidiary makes. The subsidiary is then called a CFC and its profits can in some cases be subject to tax in the country of residence of the parent company.
Coordination centres	A special form of company with taxation advantages, often used to attract corporate headquarters to a country. Most notably found in Belgium, the Netherlands and Ireland.
Corporation tax	A tax on the profits made by limited liability companies and other similar entities in some countries, but otherwise usually being similar in application to income tax.
Currency transaction tax	A tax levied by a country that issues a currency on all the trades in that currency worldwide at very low rates e.g. 0.005 percent. Considered the most likely form of the Tobin Tax to be effective in practice.
Deferred tax	A fictional tax which only exists in company accounts and is never paid. Deferred tax does not, as such, exist. But the rules of accountancy generally require that income be matched with expenses. If an expense is recognised for tax purposes more quickly than it is for accounting purposes (which is common with much plant and equipment) this means that the tax cost for the years when this happens are understated. Conversely, when all the tax allowances have been used on the assets there might still be accounting charges to make and the tax cost would then be overstated. To balance this equation a notional tax charge called deferred tax is charged to the profit and loss account in the earlier years and put on the company's balance sheet as a liability. The liability is released as a credit to profit and loss account in the later years and supposedly over the life of the asset all should balance out.
Discretionary trusts	Most offshore trusts permit payments to be made at the discretion of the trustees, which means that the identity of beneficiaries can remain a secret. In practice, trustees normally follow a "letter of wishes", provided by the settler, instructing them whom they are to pay money to, when and how.
Domicile	The country identified as a person's natural home, even if that person has not been resident there for extensive periods of time.
Double tax relief	Tax relief given by the country in which the tax payer resides for tax paid in another country on a source of income arising in that other country.
Double tax treaty	An agreement between two sovereign states or territories to ensure, as far as possible, that income arising in one and received in the other is taxed only once. Includes rules to define Residence and Source, and limits on Withholding Taxes. Also usually includes provisions for cooperation to prevent avoidance, especially information exchange.

Effective tax rate	The percentage of tax actually paid in relation to the total income of the person paying the tax.
Elsewhere	An unknown place in which it is assumed, but not proven, that a transaction undertaken by an entity registered in a secrecy jurisdiction is regulated.
EU	European Union <a href="http://europa.eu/">http://europa.eu/</a>
EU Savings Tax Directive  EU STD	The EU Savings Tax Directive was adopted to ensure the proper operation of the internal market and tackle the problem of tax evasion. It was approved in 2003 and came into effect on July 1st, 2005. The main method is exchange of information between tax authorities. However, an alternative withholding tax arrangement has been allowed for some countries, which is intended to be provisional.
EU Code of Conduct on Business Taxation	The Code of Conduct for business taxation was set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997. The Code is not a legally binding instrument but it clearly does have political force. By adopting this Code, the Member States have undertaken to: <ul style="list-style-type: none"> <li>• roll back existing tax measures that constitute harmful tax competition and</li> <li>• refrain from introducing any such measures in the future ("standstill").</li> </ul> The code covers tax measures (legislative, regulatory and administrative) which have, or may have, a significant impact on the location of business in the Union.
Export processing zones	Artificial enclaves within states where the usual rules relating to taxation and regulation are suspended to create what are, in effect, tax havens within larger countries.
FATF  Financial Action Task Force	The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. The FATF is a "policy-making body" created in 1989 that works to generate the necessary political will to bring about legislative and regulatory reforms in these areas. The FATF has published 40 + 9 Recommendations in order to meet this objective. <a href="http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html">http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html</a>
FSF  Financial Stability Forum	The Financial Stability Forum (FSF) was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The Forum brings together on a regular basis national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. <a href="http://www.fsforum.org/home/home.html">http://www.fsforum.org/home/home.html</a>

Flags of convenience	The flag of a country with easy or lax maritime regulations and low fees and taxes, flown by ships registered in such countries, even though they have no substantial connection with the country.
Flat tax	A tax system in which as income increases above an agreed tax free sum the amount of tax paid remains constant in proportion to total income. Compare with progressive taxes.
Foreign direct investment  FDI	Foreign direct investment is defined as funds from one country being used to create a physical investment into another country. Its definition can be extended to include the purchase of a company in one country by a company located in another country so long as it is the intent to retain that ownership in the long term.
Formula apportionment	A means of allocating taxable profits generated by a multinational group of companies between the jurisdictions in which it operates using a formulaic approach. The so called Massachusetts formula affords equal weight to third party sales, labour cost and fixed tangible capital, and this formula is now commonplace in the USA.
General anti-avoidance principle	A law that seeks to prevent a tax payer from obtaining the taxation benefit arising from any transaction if they undertook it solely or mainly to obtain a tax benefit. It does so by looking at the motivation of the taxpayer at the time of entering into the transaction, for which reason the concept of tax compliance is important. If the person was seeking to be tax compliant then they should probably keep the benefit they obtained from the transaction. If they were taxation non-compliant then they should not. Compare with a general anti-avoidance rule.
General anti-avoidance rule	A general anti-avoidance rule seeks to tackle those who try to break the rules of taxation through the use of further rules. Rather than considering intention, it lays down ways of interpreting a series of events to determine whether the benefit of tax legislation can be given to the tax payer. Because rules are invariably open to interpretation a general anti-avoidance rule runs the risk of increasing the opportunity for abuse.
Gift tax	Taxes charged on gifts either during life or on death. The charges may be on the donor or on the cumulative value of gifts received by the recipient.
Harmful tax competition	A term synonymous with the OECD's report of 1998 that launched its attack on tax haven activity, entitled 'Harmful Tax Competition: An Emerging Global Issue' <a href="http://www.oecd.org/dataoecd/33/0/1904176.pdf">http://www.oecd.org/dataoecd/33/0/1904176.pdf</a> . The difficulty with the concept it created was that no explanation was given on how to differentiate harmful tax competition from that which some claimed was benign, and the project was flawed from the outset as a result.
Hedging	A strategy intended to reduce investment risk using call options, put options, short selling or futures contracts. Often refers to taking a futures position that is equal and opposite from a position in the

	cash market. A hedge can be used to lock in existing profits. It is often claimed that hedging is best done offshore, but there is no evidence to support this assertion and most hedging expertise is onshore.
Heritage Foundation	Sponsor of the Center for Freedom and Prosperity, main opponent of the OECD harmful tax competition initiative.
High net-worth individuals	Otherwise known as HNWIs (pronounced hen-wees). Generally categorised as individuals with more than US\$1 million of liquid financial assets available for investment.
Holding companies	A company that either wholly owns or owns more than 50 percent of another company, the latter being called a subsidiary. An intermediate holding company is a holding company which has one or more subsidiaries but is itself owned by another company. The term 'ultimate holding company' refers to the one that is finally not controlled by another company.
Income tax	A tax charged upon the income of individuals. It can also be extended to companies. The tax is usually charged upon both earned income from employment and self employment and unearned income e.g. from investments and property.
Inheritance tax	A form of gift tax charged upon the estates of people upon their death.
International Business Corporations (IBC)	A type of company offered by many offshore finance centres and tax havens, usually one which receives all or most of its income from abroad. IBCs usually pay an annual registration fee but are subject to minimal or zero tax rates.
International Finance Centre	A financial services centre that both provides and executes a full range of such services on behalf of clients located within the jurisdiction in which the service centre is located and, most especially, in other, identified locations to whom information is made available on the nature of the transactions undertaken, and by whom, either automatically or on request, with or without the consent of the parties for whom the transaction was undertaken.
IMF	International Monetary Fund <a href="http://www.imf.org/external/index.htm">http://www.imf.org/external/index.htm</a>
Inversion	The act of a parent company whose headquarters are located within one jurisdiction switching registration with an offshore subsidiary they own to secure location within that offshore jurisdiction in order to secure a tax advantage. Mainly occurring in the USA.
Land value taxation	A tax on the rental value of a site, assessed as if it were undeveloped and unimproved - in other words, as if it were bare land.
Licence (Licensing)	A contract for the use or property, often intellectual property such as a patent, copyright or trademark. If ownership of the property is transferred to a holding company located in a tax haven, the licence fee income paid to the licensor may be exempt from tax, as well as

	reducing the taxable profits of the operating company (often a subsidiary) which is the licensee.
Limited liability partnerships (LLP)	A partnership that provides its non-corporate members with limited liability. LLPs are frequently based offshore for tax avoidance purposes.
Loophole	A technicality that allows a person or business to avoid the scope of a law without directly violating that law.
Money-laundering	The process of ‘cleaning’ money from criminal or illicit activities to give it the appearance of originating from a legitimate source.
National insurance contributions	See social security contributions. Often called NIC.
Nominees	Persons, often being members of the legal or accountancy professions, who will lend their names to act as directors, shareholders and company secretaries of companies or as settlors and trustees of trusts with the intention of ensuring that the identity of the beneficiaries of the transactions that they undertake cannot be identified.
Nowhere	The part of the offshore economy where by design or chance the combination of unregulated entities used results in those entities and the transactions they undertake being either entirely unregulated, or being very lightly regulated.
OECD	Organisation for Economic Development and Cooperation. <a href="http://www.oecd.org/home/0,2987,en_2649_201185_1_1_1_1_1,00.html">http://www.oecd.org/home/0,2987,en_2649_201185_1_1_1_1_1,00.html</a>
Off balance sheet	The process by which an asset and / or liability is transferred out of the ownership of the company that has beneficial use of it and transferred into the ownership of an orphan company that will usually be a special purpose vehicle owned by a specially established charitable trust. The combined structure means that the accounting profession has agreed that the resulting entities need not be consolidated into the accounts of the company that nonetheless has close control of the structure through contractual or other obligations. These structures are frequently offshore where secrecy assists the companies involved to hide the true identity of the transactions they have undertaken.
Offshore	More correctly called the offshore economy in which tax havens and OFCs combine to provide their clients with the opportunity to undertake transactions without the impact of the regulation of the places in which the participants really reside being brought to bear, whether legally or illegally. In common perception the regulation avoided is tax, but in practice a much wider range of regulation is abused in the offshore economy with secrecy being the prime tool for achieving this goal, meaning that the suspicion of illegality is rarely avoided, although it will by no means necessarily occur.

	As a result offshore relates to any jurisdiction (regardless of whether they are islands) which provides tax and regulatory privileges or advantages, generally to companies, trusts and bank account holders on condition that they do not conduct active business affairs within that jurisdiction. The term “offshore” is very broad and normally includes “onshore” tax havens such as Andorra, Lichtenstein, etc.
Offshore financial centre  OFCs	Offshore financial centres are not the same as tax havens. OFCs are the commercial communities hosted by tax havens that exploit the structures that can be created using that tax haven’s legislation for the benefit of those resident elsewhere. In other words, the offshore financial centre is made up of the accountants, lawyers, bankers and their associated trust companies that sell services to those who wish to exploit the mechanisms the tax haven has created.
OFC operator	A company providing services from an Offshore Financial Centre. Usually a bank, trust company or firm of lawyers and accountants.
Orphan companies	Entities set up as special purpose vehicles and owned by specially established charitable trusts with the sole purpose of disguising the true nature of the transactions undertaken and keeping them off the balance sheets of the companies that promote them. Called ‘orphans’ because their parent ahs disassociated themselves from them and because the structure adopted, where a charitable trusts has nominal control means that they apparently have no parent or owner.
Partnerships	Any arrangement where two or more people agree to work together and share the resulting profits or losses.
Payroll taxes	See social security contributions.
Permanent Establishment	An office, factory, or branch of a company or other non-resident. Under Double tax treaties business profits are taxable at source if attributable to a Permanent Establishment. May include construction sites or oil platforms in place for over 6 months.
Poll tax	A tax that levies the same sum on each person irrespective of their means to make payment.
Preferential tax treatment	A situation in which individuals or companies can negotiate their tax treatment in the state in which they have a tax liability. Pioneered by Switzerland in the 1920s, the arrangement is commonplace in the offshore world.
Private company	A company not quoted on a stock exchange. Shares cannot usually be sold without the consent of the company or its owners; in many countries little or no information need be disclosed on the activities of such companies even though their members enjoy the benefit of limited liability.
Profit laundering	The process of transferring profits from a territory in which they would be taxed to another in which there is either no tax or a lower tax rate. Mechanisms for achieving this include transfer-pricing, re-invoicing, licensing, thin capitalisation, corporate restructurings and

	inversions.
Progressive taxes	A tax system in which as income rises the amount of tax paid increases in proportion to the income as well as in absolute amount i.e. the percentage tax rate increases as the income rises. Also referred to as Graduation. Compare with flat and regressive taxes.
Public company	A company whose shares are quoted on a recognised stock exchange and are available to be bought and sold by anyone who wishes without consent being required from the company itself. Generally required to be more transparent than private companies.
Quoted company	See public company.
Race to the bottom	The downwards trend of tax rates and regulatory requirements on capital arising from competition between sovereign states to attract and retain investment.
Regressive taxes	A tax system in which as a person's income from all sources increases the amount of tax they pay reduces in proportion to their income even if it increases in absolute amount i.e. their percentage tax rate falls as their income goes up. Compare with progressive taxes and flat taxes.
Reinsurance	Some large companies decide not to insure their risks with the conventional insurance markets but instead set up their own insurance companies. When insurance companies do this it is called reinsurance. By setting up a captive or reinsurance company offshore, a tax deduction for the premiums paid is available in the country where the risk is and the premium is received offshore where there is little or no tax. This can, therefore, be viewed as another form of transfer-pricing.
Re-invoicing	Re-invoicing involves invoicing a sale to an agent, typically based in a tax haven or OFC, who subsequently sells on to the final purchaser. In practice the agent pays part of their mark up to the original vendor or to the purchaser, usually to an offshore account. This is a widely used process for laundering profits to a tax haven. The process is dependent upon secrecy for its success.
Remittance basis	Concerns income earned outside the country of residence. The remittance basis says that tax is only due in the year when income is remitted to the country in which the tax payer is resident and not when it arises. Enables a person to avoid tax indefinitely in their country of residence provided it is kept and spent abroad. Compare with the arising basis. Both have relevance within the context of the residence basis of taxation.
Residence	For an individual, the person's settled or usual home; for simplicity a presumption may be applied based on a rule-of-thumb, such as presence within the country for six months or 183 days in any tax year. It may be possible to be resident in more than one country at one time (though double tax treaties aim to prevent this). Some individuals may also try to avoid being resident anywhere. For

	companies, residence is usually based on the place of incorporation but can also be where the central management and control of the company is located, if they are different. Tax haven companies formed for non resident owners are usually defined not to be resident in their country of incorporation.
Residence basis	Taxation of residents of a territory on all their worldwide income wherever it arises, usually with a credit for tax already paid overseas. The aim is to discourage residents from investing abroad in lower tax countries, by ensuring that income is taxed at the residence country rate if it is higher. Compare with source and unitary basis.
Ring-fencing	Different and preferential tax and regulatory treatment given by tax havens to companies and trusts owned by non-residents as contrasted to companies and trusts owned by residents.
Round tripping	The process by which capital flight funds leave a country only to be reinvested as if foreign direct investment having first been laundered through a tax haven entity to disguise the true ownership of the funds in question.
Sales tax	Taxes on sales can be levied in two ways. Firstly, as a general sales tax (GST) added to the value of all sales with no allowance for claiming a rebate on tax paid. Secondly, as a value added tax (VAT) charged by businesses on sales and services but which allows businesses to claim credit from the government for any tax they are charged by other businesses. The burden of VAT therefore falls almost entirely on the ultimate consumers. GST and VAT are both regressive taxes since lower income households always spend a higher proportion of their income on consumption and therefore invariably spend a greater proportion of their income on this tax than do the better off. VAT is the most widely used form of sales tax.
Secrecy jurisdiction	Another, and potentially more accurate term for a tax haven because secrecy is their primary product.
Secrecy space	The unregulated spaces that are created by OFCs using entities given legitimacy by a tax haven but which are suggested to operate outside their domain and so are treated by them as being 'elsewhere' or 'nowhere'. Both of these are domains without geographic existence in which regulation does not occur, which is the characteristic that defines the secrecy space.
Social security contributions	Payments made towards a fund maintained by government usually used to pay pension and unemployment benefits. Health benefits are sometimes covered as well. Social security contributions are generally considered to be taxes.
Somewhere	A place other than that in which a regulated entity resides in which it can undertake transactions that are regulated, with transparent interaction and communication between that place and the location

	in which the regulated entity resides taking place, at least on request.
Source basis	Taxation of income in the territory where it is earned. Compare with residence and unitary bases. Under double tax treaty rules, income attributable to a Permanent Establishment is taxable at source. Some countries tax only on a source basis, and consider income earned outside the country exempt; but some tax on the basis of both source and residence (subject to a foreign tax credit). Compare with residence and unitary bases.
Special purpose vehicles  SPV or SPV	<p>A special purpose vehicle (SPV) or special purpose entity (SPE) is a company that is created solely for a particular financial transaction or series of transactions. It may sometimes be something other than a company, such as a trust.</p> <p>SPVs/SPEs are usually located to provide the most favourable tax outcome for the transaction. As a result many are offshore. SPVs are used for transactions including securitisations and the issue of catastrophe bonds. In addition to reducing tax, SPVs can also remove assets or liabilities from balance sheets, transfer risk and (in securitisations) allow the effective sale of future cash flows.</p> <p>Many SPVs will be engineered to ensure that they are 'orphan companies' owned by charitable trusts and so not appear to be under the ownership or control of the company that has promoted them. In this way they are taken 'off balance sheet'.</p>
Structured investment vehicle  SIV	A structured investment vehicle (SIV) is a fund which borrows money by issuing short-term securities at low interest and then lends that money by buying long-term securities at higher interest, making a profit for investors from the difference. SIVs are a type of structured credit product; they are usually from \$1bn to \$30bn in size and invest in a range of asset-backed securities, as well as some financial corporate bonds. They are frequently located offshore.
Stamp duty	A tax on the value of contracts. Usually charged on contractual dealings on shares and other stocks and securities and on dealings in land and property.
Subsidiary company	A company 50% or more owned by another company which is its parent company.
Tax arbitrage	The process by which a sophisticated tax payer plays off the tax systems of two different countries to obtain a tax benefit as a result.
Tax avoidance	The term given to the practice of seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud).

	<p>The term is sometimes used to describe the practice of claiming allowances and reliefs clearly provided for in national tax law. It is, however, now generally agreed that this is not tax avoidance. If the law provides that no tax is due on a transaction then no tax can have been avoided by undertaking it. This practice is now generally seen as being tax compliance. So what the term tax avoidance now usually refers to is the practice of seeking to not pay tax contrary to the spirit of the law. This is also called aggressive tax avoidance.</p> <p>Aggressive tax avoidance is the practice of seeking to minimise a tax bill whilst attempting to comply with the letter of the law while avoiding its purpose or spirit. It usually entails setting up artificial transactions or entities to recharacterise the nature, recipient or timing of payments. Where the entity is located or the transaction routed through another country, it is international avoidance. Special, complex schemes are often created purely for this purpose. Since avoidance often entails concealment of information and it is hard to prove intention or deliberate deception, the dividing line between avoidance and evasion is often unclear, and depends on the standards of responsibility of the professionals and specialist tax advisers. An avoidance scheme which is found to be invalid entails repayment of the taxes due plus penalties for lateness.</p>
Tax base	The range of transactions that a country chooses to tax. A broad base includes a wide range of transactions. A narrow base includes relatively few transactions.
Tax competition	This is the pressure on governments to reduce taxes usually to attract investment, either by way of reduction in declared tax rates, or through the granting of special allowances and reliefs such as tax holidays or the use of export processing zones. Applies mainly to mobile activities or business, but the competition to attract investment may result in an overall decline of corporation tax rates and in the amounts of corporation tax paid, often resulting in an increased burden on individuals.
Tax compliance	A term that is acquiring a new use. It can mean payment of tax due without engaging in tax avoidance or evasion. It is also now being used in contrast to the terms tax avoidance and tax evasion. Tax compliance in this context is used as a test of a person's intention before they undertake a transaction. It asks whether the person is seeking to comply with the spirit of the legislation concerning the transaction into which they are entering. If they are, then it should be presumed their intent was to be legal. If they are seeking to comply with the letter but not the spirit of the law (and it is usually possible to determine this from the form the transaction takes) then it should be presumed their intent was to break that law, the onus of proof otherwise falling upon them. This test is then used in

	connection with a general anti avoidance principle to determine whether that principle should be applied to a transaction, or not. A person who has used an appropriate motive is “tax compliant”.
Tax efficiency	A term used by tax professionals to suggest getting away with paying as little tax as possible.
Tax evasion	The illegal non payment or under-payment of taxes, usually by making a false declaration or no declaration to tax authorities; it entails criminal or civil legal penalties.
Tax haven	<p>Tax havens are places that create legislation designed to assist a person - real or legal - to avoid the regulatory obligations imposed upon them in the place where they undertake the substance of their economic transactions. This is not by accident or chance: there is clear evidence that these places, some of them countries, some not, but all with the power to pass legislation, set out to undermine the impact of legislation passed in other jurisdictions.</p> <p>The Organisation for Economic Cooperation and Development defines tax havens as jurisdictions where:</p> <ul style="list-style-type: none"> <li>• Non-residents undertaking activities pay little or no tax;</li> <li>• There is no effective exchange of taxation information with other countries;</li> <li>• A lack of transparency is legally guaranteed to the organisations based there;</li> <li>• There is no requirement that local corporations owned by non-residents carry out any substantial domestic (local) activity. Indeed, such corporations may be prohibited from doing business in the jurisdiction in which they are incorporated.</li> </ul> <p>Not all of these criteria need to apply for a territory to be a haven, but a majority must. This definition is now considered too limited by many.</p>
Tax holidays	A period during which a company investing in a country does not have to pay tax under an agreement with its government.
Tax mitigation	A phrase used by tax professionals when describing the desire to pay as little tax as possible.
Tax non-compliant	A person who is not seeking to be tax compliant.
Tax planning	A term used in two ways. It can be used as another term for tax mitigation. When, however, tax legislation allows more than one possible treatment of a proposed transaction the term might legitimately be used for comparing various means of complying with taxation law.
Tax shelter	An arrangement protecting part or all of a person’s income from taxation. May result from pressures on government or a desire to encourage some types of behaviour or activity, or may be a commercial or legal ruse, often artificial in nature, used to assist tax

	planning.
Thin capitalisation	Financing a company with a high proportion of loans rather than shares. Used by Transnational Corporations to reduce the business profits of a subsidiary, since the interest on loans is usually allowed as a deduction, but dividends on shares are paid out of after-tax income. The interest is usually paid to another subsidiary of the transnational corporation located in a tax haven where no tax is paid upon its receipt, resulting in an overall reduction in the tax charge of the group of companies.
Tobin tax	The Tobin Tax or Currency Transaction Tax (CTT) is a proposed tax on the foreign exchange market named after the late James Tobin, the Nobel Prize winning economist, who proposed the idea.
Transfer-pricing	A transfer pricing arrangement occurs whenever two or more businesses (whether corporations or not) which are owned or controlled directly or indirectly by the same people trade with each other. The term transfer pricing is used because if the entities are owned in common they might not fix prices at a market rate but might instead fix them at a rate which achieves another purpose, such as tax saving. If a transfer price can be shown to be the same as the market price then it is always acceptable for tax. What are not acceptable for tax purposes are transfer prices which increase the cost or reduce the sales value in states which charge higher tax rates and increase the sales value or reduce the costs in states with lower tax rates. The difficulty for many corporations at a time when over 50% of world trade is within rather than between corporations is that there is no market price for many of the goods or services that they trade across national boundaries because they are never sold to third parties in the state in which they are transferred across national boundaries within the corporation. This gives rise to complex models in which attempts are made to allocate value to various stages within the supply chain within a company, which process is open to potential abuse. For this reason it is argued that such firms should be taxed on a unitary basis.
Transnational corporations (TNCs)	A corporation with subsidiaries or divisions in two or more nations. Also known as multinational corporation (MNC).
Trusts	<p>A trust is formed whenever a person (the settlor) gives legal ownership of an asset (the trust property) to another person (the trustee) on condition that they apply the income and gains arising from that asset for the benefit of a third person (the beneficiary). Trusts can be established verbally but typically take written form. Trustees are frequently professional people or firms charging fees. Trusts are usually of one of three types:</p> <ul style="list-style-type: none"> <li>• discretionary trust</li> <li>• charitable trust</li> <li>• interest in possession trust.</li> </ul>

Trustees	The people who hold the legal title to assets held in a trust and administer it.
Trust beneficiary	Anyone who may obtain a benefit from a trust. A person who has the right to a benefit has an 'interest in possession'; a discretionary beneficiary can get income or benefits only when and if the trustees decide to pay it to them.
Trust settlor	The person who establishes a trust by gifting assets to it.
Unitary basis	Treating the income of related entities within a single firm or corporate group on a combined or consolidated basis, and applying a formula to apportion it for taxation by the different countries or territories from which it derives. Each may apply the rate of tax it wishes. An alternative to the residence and source bases of taxation. It has been used in federal countries such as the USA, applying an allocation formula based on a ratio of sales, employment costs and assets employed within each state. It has been opposed by tax authorities (and TNCs) because they consider that it would be too difficult to reach international agreement especially on the formula. However, taxation of highly integrated TNCs may in practice entail a formula-based allocation of profits, due to the difficulty of finding appropriate arm's length transfer prices.
Value Added Tax	Known as VAT. See sales tax
Wealth tax	A tax on a person's declared wealth, typically imposed annually at a very low rate. Once commonplace in Europe these are now little used since they are thought to encourage people to hide assets offshore.
Withholding tax	Tax deducted from a payment made to a person outside the country. Generally applied to investment income, such as interest, dividends, royalties and licence fees.
World Bank	<a href="http://www.worldbank.org/">http://www.worldbank.org/</a> . Traditionally little involved with the offshore economy, but now engaging with it as a result of its Stolen Asset Recovery (StAR) programme.

## 21: About the Tax Justice Network

The Tax Justice Network brings together organisations, social movements and individuals working for international tax co-operation and against tax evasion and tax competition. In an era of globalisation, the TJN is committed to a socially just, democratic and progressive system of taxation. TJN campaigns from an internationalist perspective for a tax system which is favourable for poor people in developing and developed countries, and finances public goods and taxes public bads such as pollution and unacceptable inequality. TJN's objectives are detailed in the TJN declaration ([www.taxjustice.net](http://www.taxjustice.net)).

TJN is a pluralistic, diversified, non-governmental, non-party and multilingual network. Local, regional and national civil society and social movement organisations as well as tax justice campaigners, researchers, journalists, development specialists, trade unionists, concerned business people, tax professionals, politicians and public servants are members and supporters of the network.

TJN is campaigning for social change through public debate and education. Public understanding of tax matters is the precondition for international tax justice. The network makes information available through mass media as well as through conferences and seminars, the internet, newsletters, publications in print, symbolic actions, demonstrations and advocacy. We base our activities on expertise and sound research.

TJN facilitates co-operation, communication and information sharing between its members. The network organises international exchange and policy debates in order to harmonise the views and concerns of our members. This process forms the basis for powerful global campaigns in international tax policy.

TJN is run by its member organisations as well as individual supporters. The network functions on the principles of participatory democracy, empowerment, transparency, accountability and equal opportunity. TJN encourages and where necessary supports member organisations and individuals to participate in the decision making. The network supports the building of national TJN campaigns in particular in developing countries. An international secretariat coordinates the network's activities.

## 22: About the author: Richard Murphy

This report was written by Richard Murphy of Tax Research LLP on behalf of the Tax Justice Network in the UK.

Richard Murphy is a chartered accountant and graduate economist.

He trained with KPMG in London before setting up his own firm in 1985 in London. He and his partners sold the firm in 2000 when it had 800 clients, with a particular focus on media enterprises.

He is a serial entrepreneur, having helped launch or direct more than 10 companies, some of them backed by venture capital. These have included companies in the IT, toy, environmental and arts sectors.

Since 2000 Richard has increasingly been involved in taxation policy, both as an adviser and campaigner. He is director Tax Research LLP and advises the Tax Justice Network, the Publish What You Pay campaign, Christian Aid, the TUC and many other organisations on tax issues. He advises several prominent MPs and members of the Treasury Select Committee on taxation issues. He has also advised the States of Jersey on reform of its taxations systems and has addressed meetings of the UN Committee of Experts on International Cooperation in Tax Matters and of the European Commission Directorate on taxation policy. His current research work is largely funded by the Ford Foundation.

He has been a member of the Association of Chartered Certified Accountants' Academic Research Committee and is a visiting fellow at the Centre for Global Political Economy at the University of Sussex and at the Tax Research Institute at the University of Nottingham. He was formerly a visiting fellow at the University of Portsmouth Business School

Richard is a regular radio and TV commentator on tax and corporate accountability. He has participated in the making of television documentaries for Panorama, Dispatches and the Money Programme, including for the latter an analysis of Mohammed al Fayed's tax affairs. He contributes regularly to File on Four and other BBC Radio 4 documentaries. He has worked with broadcasters in a number of other countries.

His articles have appeared in a wide range of professional journals. He wrote for the Observer on taxation issues for a number of years. He writes a daily blog at [www.taxresearch.org.uk/blog](http://www.taxresearch.org.uk/blog).