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Sand, Surf and Secrecy

In June I joined Charlotte Atkins, Labour Member of Parliament for Staffordshire Moorlands in the United Kingdom, for lunch in Panama. A steady stream of Europeans, like herself, are discovering a country that has been more used to visitors with American accents in the past. The Labour MP was a member of the first UK parliamentary group to visit Panama and besides a declared commitment to developing relations between the two countries, she could see that Panama, like Egypt, was more than a canal.

One of the country's industries which has grown steadily over the years, with a quickening pace in recent times, has been offshore financial services. It's not as if Latin America has a plentiful supply of centres providing such services and in fact the only other centre is located in Belize. Just offshore, of course, are the Caribbean financial services centres, some with an international appeal which has endured for several decades and the collective reserve of talent and knowledge there is daunting, serving as a magnet for those seeking guidance. It was Winston Churchill who felt that the empires of the future would be those of the mind and there is no doubt that some business empires owe much of their success to a powerhouse of professionals located offshore who, by astute analysis and planning, have enabled their clients to succeed financially.

But should Panama strive to rival such premier offshore centres in the Caribbean – or elsewhere for that matter? The lower profile that Panama still enjoys should, perhaps, if at all possible, be maintained. The UK parliamentarian was right to say that Panama is not just about shipping, but I suggest that the country focuses more on widening the canal than broadening its appeal as an offshore centre. For those who consider this a negative viewpoint, I would repeat that old Chinese chestnut that cautions us to be careful about getting what we wish for.

China, in fact, is a case in point. It is now making a comprehensive review of its tax laws after serious fiscal abuses have come to light. Presently, foreign businesses operating in China can benefit from generous relief that can mean tax savings of up to 20%. The problem (and the evidence is compelling) is that many of these foreign businesses are not really foreign; they are disguised, domestic operations doing business through offshore companies owned by Chinese nationals who are circumventing the domestic corporate tax rate of 33%.

In 2005 the UN Conference on Trade and Development produced statistics on the stock of outward foreign direct investment from emerging countries which showed that Hong Kong topped the list (\$470.5bn) with the Caribbean offshore centres of the British Virgin Islands and the Cayman Islands recording, respectively, \$123.2bn and \$33.7bn. In Central and South America only Brazil (\$71.6bn) surpassed the Cayman Islands – but not the BVI – followed by Mexico (\$28bn), Argentina (\$22.6bn) and Chile (\$21.3bn). What this illustrates is the considerable proxy role played by these two Caribbean offshore centres in the international financial arena – especially when compared with nearby Belize and Panama.

The BVI and China connection has been referred to previously in the Offshore Pilot Quarterly (June 2005 and June 2007) and the Chinese government recently announced that it is looking into the matter of offshore tax avoidance after releasing figures that record most of the investment by Chinese-based companies is heading to offshore centres. Apparently, data released by the Chinese Ministry of Commerce has shown that between January and May, 2007, Hong Kong was at the top of the capital investment table, followed by the BVI, Japan, South Korea, Singapore, the United States of America and then, in seventh place, the Cayman Islands. The

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actual amounts of foreign capital invested in the various jurisdictions by Chinese enterprises accounted for 86.16% of China's total foreign capital. "What you cannot avoid, welcome", says an old Chinese proverb. When the tax man knocks on the door, I hope those Chinese businessmen agree.

The Dark Side of Success

China's bosom trading partner, the US, has similar concerns about its citizens and its Senate Finance Committee has put the spotlight on another phenomenal offshore success, the Cayman Islands. Worried that tax payers are escaping taxes through offshore structures, the Committee has asked its Government Accountability Office to look into offshore operations which it believes have been deliberately established to escape payment of US taxes. The Committee's Chairman, Senator Max Baucus, was strong in his condemnation of US companies who register in the Cayman Islands because they were "setting up shop at the beach just to avoid their tax obligations".

Beijing is a long way from the beaches of the BVI whereas Washington is much closer to the waves lapping the shores of the Cayman Islands, so the Committee, which has jurisdiction over tax legislation, wants an investigation team to visit "one of the most likely shady places tax transactions could be sheltered". But does Max have the facts? Ringing in my ears are Benjamin Disraeli's words: "It is easier to be critical than correct".

Ugland House, home to an international law firm with deep roots in the Cayman Islands (and not located on the beach) has become the target. Thousands of companies have their registered office there (according to the Senate Committee, they number 12,748). Chuck Grassley, the Committee's ranking member, is adamant: "It's time the Finance Committee found out what's really going on there" so that it can be understood "what sorts of transactions are being conducted in that building".

In a wonderful example of understatement, worthy of Mark Twain suggesting that the report of his death was exaggeration, the US Government Accountability Office, charged with launching the investigation, has already accepted that it "may be limited in its ability to obtain information in the Cayman Islands". Perhaps the only real discovery will be whether or not the law firm in Ugland House makes good coffee – if it's offered. How ugly will it get at Ugland House? Not very, I suspect, despite

Milton Friedman, drawing on Shakespeare for inspiration, once commenting that "Hell hath no fury like a bureaucrat scorned".

The problems go beyond the Caribbean and, again, prominence can have its dark side. In the June issue of the OPQ I wrote about two onshore financial centres, London and New York, which, of course, are offshore centres for non-US taxpayers and plans are in hand to review the possible role played in tax haven abuses by some bankers, accountants and lawyers in London. Perhaps New York will be next.

The Norwegian government is forming a global coalition to look into the issue of illicit assets held in offshore centres. Recently the International Monetary Fund classified the UK as an offshore financial centre and the UK Treasury has said that whilst it works with the Organisation for Economic Co-operation and Development in such matters, it has not been approached to join the Norwegian-inspired taskforce that will be looking, inter alia, into the role played by the UK in facilitating tax evasion and money laundering. It is thought that about \$1 trillion of illicit funds flowing to offshore centres are managed by financiers based in London, New York (don't tell Senator Max Baucus) and Dubai. It will be interesting to see how this Nordic nudge towards transparency square's off against London's Square Mile, the centre of Europe's financial prowess.

In tandem with the perennial push to emasculate offshore centres, come the predictable counter-claims, especially from island offshore centres with palm-fringed beaches. Representatives of Overseas Territories (dependencies of a European state) have rallied together and at a conference a few months ago in BVI they stressed that in recognising the importance of discussion and understanding with all countries concerned, it was equally important to tackle the fact that some developed countries are not practising what they preach. Surely not.

Some recent reports which address offshore regulation are telling. One undertaken by Camille Stoll-Davey of Oxford University found that in important areas (such as identifying the owners of entities and exchange of tax information) there were OECD member countries whose own standards were hardly glowing. This is supported by an April report that was issued by the Commonwealth Secretariat which works on behalf of the Commonwealth (comprising 53 countries that are all formerly part of the British Empire). The report had been commissioned on behalf of the International Trade



and Investment Organisation, a group of small countries with international finance centres, and referred, in part, to legal and administrative barriers “to the effective exchange of information in the UK... [with] the availability of bearer shares and the lack of requirements for companies to have beneficial ownership information”.

In the case of the US, many states do not insist on companies providing beneficial ownership information and it has been said that some need to provide more information to register a web address. Switzerland limits exchange of tax information to cases of fraud whereas both Hong Kong and Singapore restrict information exchange to matters where there is a domestic interest involved.

So there’s no clear pathway to the off-quoted ubiquitous level playing field when it comes to taxation while such contradictions (not to mention self-interest) hold sway. This, however, will not deter the onward (albeit slow) drive of such bodies as the OECD in what I have described before as this war of the (onshore and offshore) worlds and in which John Maynard Keynes’s question goes unanswered: “When the facts change, I change my mind – what do you do, sir?”

Ostriches and Swallows

A raucous Senator Baucus during his protestations at a May US Senate Finance Committee hearing into tax havens brandished a photograph of the already mentioned Uglund House, and since then the Cayman deputy financial secretary, Deborah Drummond, has said that her government “should be delighted to assist any interested persons in quitting the ostrich position as it relates to the Cayman Islands.”

Senator Baucus had previously remonstrated that “we can’t keep our heads in the sand,” but whether they are or not is of little consequence once a perception takes hold, as illustrated when the French diplomat Talleyrand died. His Austrian rival, Prince Metternich, is said to have asked, “I wonder what he meant by that?” Something beyond natural events, surely, had to be in play in the case of this deceased, cunning prince of diplomats. So it is for those who share the conviction that offshore financial arrangements will always mean tainted trusts and fraudulent foundations. I prefer, however, to apply Aristotle’s rationale: just as one swallow does not make a summer, neither should corrupt cases condemn an entire industry.

One needs neither the hapless *Struthio camelus* that cannot fly (despite being the largest bird), nor the diminutive swallow that can, to find a plentiful supply of common misconceptions. The legend of the Holy Grail, which itself is enveloped by mystery and intrigue, is a fine example. It was close to the end of the 12th century when the pursuit of the Holy Grail was first chronicled in France by Chretien de Troyes (appropriately, a virtually unknown individual). Many more writers with active imaginations were to follow in succeeding centuries propagating a growing number of legends that were, to say the least, continually embellished.

Not just the stories, but the Grail itself has undergone transformation, having been described variously as a dish, a stone and a vessel. In fact, as far as it can be ascertained, the original source surrounds the celebration of the Christian Mass; the usual and romantic association with knights, castles, kings and fair maidens came later. It is said to possess healing powers and has been associated with both Christ’s Last Supper and crucifixion. This, in turn, has led to its link with the celebration of the Eucharist and the belief that the chalice used during Mass represents it. Today the Grail is still with us, actively used by artists, writers and advertising copywriters. A service or product, when given the Holy Grail tag, can conjure up, for example, perfection, excellence and reliability – far removed from the distortions of chroniclers in centuries past upon which this edifice of falsehood stands.

According to the late University of Chicago philosopher, Leo Strauss, elites in liberal societies are sometimes required to create “myths” to bind those societies for fear of them collapsing because of self-interest and individualism. This may have had something to do with the creation of the Holy Grail in the 12th century when conflicts were redefining the relationship between secular society and religious belief; perhaps a light sprinkling of imaginative religious stardust was needed.

The view expressed by Leo Strauss goes back to Plato who was the originator of what is known as the noble lie. Plato used the term for the first time 2000 years ago when he wrote “*Republic*” in which the hypothetical, ideal city is created and he poses questions about, firstly, whether it can ever be permissible for a ruler to lie to the citizens and, secondly, what sort of person should rule: should the *hoi polloi*, in other words, be allowed to govern themselves?



This slippery slope, mixed with hubris, can lead, as history has shown, to governments telling noble lies when they feel that it would be in the best interest. But whose? Certainly, today's governments in developed nations might find it in their best interest to castigate tax-lite financial transactions consummated offshore.

Perhaps Wally, a boat building business, has a solution for some tax refugees with its Wallyisland, a vessel that is like a luxurious boat island with fuel tanks large enough to allow for five years of cruising. Its design presents multiple options and means that

there is ample space, for example, to include a tennis court, a garden or a very large swimming pool. The possibilities (the forward deck area is 1,000 sq. metres) are endless. It seems that the only thing missing is a passport.

I suspect that Wally has its own taxes carefully managed (it is based in Monaco) but perhaps those living on their Wallyisland could encourage the captain to keep the vessel permanently outside selected territorial waters? The idea, at least, was worth floating, and one which Plato might have appreciated.

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Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice before making offshore commitments.

Bankers

HSBC Bank (Panama), S.A

Banco Panameño de la Vivienda, S.A.

Auditors

Deloitte.

Physical Address: Suite 522, Balboa Plaza, Avenida Balboa, Panama, Republic of Panama.

Mailing Address: Apartado 0832-1630, WTC, Panama, Republic of Panama.

Telephone: +507 263-5252 or +507 269-2438 – Telefax: +507 269-4922/9138

E-mail: fiduciary@trustserv.com Website: www.trustservices.net

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