

Globalisation and the continuing appeal of offshore finance

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Abstract

Since the late 1990s Offshore Finance Centres (OFCs) have been engaged in ongoing dialogue with multilateral organisations and supranational institutions such as the EU and OECD. This is directed at improving transparency and implementing exchange of information agreements with countries that believe their tax revenues are undermined by offshore products and services. International pressure was initially perceived as a threat to OFC viability. However, in the more significant financial jurisdictions or those with niche products and services, business continues to grow and key OFCs remain prosperous. There is also a gravitation of funds to centres that are not listed by any multilateral or supranational agency. This paper is based on interviews with regulators, accountants, lawyers, fund managers, fiduciaries and related financial service providers in Australia, France, Samoa, Andorra, Guernsey and Singapore. It surveys the self-reported effects of these multilateral and supranational initiatives on OFCs.

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Introduction: Globalisation of Financial Jurisdictionality

Globalisation involves the compression of time and space, generating increased and accelerated flows of goods, services, money, people and images across borders, demanding their simultaneous liberalisation and regulation (Appadurai 1990, 1991, Harvey 1989). People and their commodities are increasingly enmeshed and intertwined almost regardless of the barriers imposed by geography. Globalisation involves the mobilisation of “people and their things”, of products and services, on a worldwide scale.

Debates about globalisation tend towards two views. The first is that the nation state is declining or withering away given the pressures of a globalising economy, society and the internationalisation of governance over key areas of administration (Darian-Smith 2000, Arnold & Sikka 2001). The second is that while the nation-state is being substantially re-constituted through global processes, the acceleration of cross-border movements is nevertheless strengthening or at least changing the form of the nation-state (Bourdieu 1998, Picciotto 1999, Palan 1999). The legal anthropologist, Eve Darian-Smith (2000, p.811) argues that with globalisation, law has become an instrument of the nation-state and a tool for “shaping new arenas of transnational legal activity that best serve the increasing demands of a global political economy”. She argues that globalisation:

...intrinsically relies upon the continuing enforcement of law through the nation-state and its international agencies and capacities...State sovereignty and state law *have* been important in sustaining, servicing, and enforcing global economic operations, and *will remain so* in the foreseeable future (Darian-Smith 2000, p.811).

For Darian-Smith “nation-states are crucial in modifying and negotiating the outer limits and substantive content” of globalisation. Offshore Finance Centres (OFCs) have been able to position themselves in a worldwide market of globally mobile funds

that seek new offshore states with the capacity and right to draft and enforce their own company laws, financial regulations and tax codes; and to choose whether to tax or not to (or at what level); and to author all manner of financial products that complement these extremely attractive fiscal environments for today's managers of global portfolios. This is particularly evident in the laws that regulate offshore finance and facilitate the flows of funds "in" and "out" of the world's OFCs and core financial hubs. As one accountant in Western Australia says of Vanuatu:

...history has now set the course of the legal framework of Vanuatu and that framework is the central point around which the 'tax haven' system works... As no taxes other than VAT and Import Duty exist in Vanuatu, professionals are free to exploit the law of trusts to an unimagined extent (Fullarton, 2001)

Globalisation and jurisdictionality are thus intertwined. Jurisdictionality refers to the sovereign ability of countries and self-governing territories to craft laws without undue external interference. Such laws have a spatial or extra-territorial dimension because although they are "local" they have a global marketplace (Hudson 1998, Arnold & Sikka 2001, Maurer 1997, Palan 1999, Picciotto 1999). Ronen Palan (1999, p.19) suggests that the offshore involves the separation of regulation into discrete but mutually related sovereign realms of differential activity, dispersing and fragmenting the contradictions and tensions of globalisation.

The jurisdictional right of states to draft and enforce their own tax laws brought 35 OFCs into disagreement with the Organisation for Economic Cooperation and Development (OECD) during the late 1990s. In a 1998 report the OECD argued that globalisation was opening up massive opportunities for tax avoidance and evasion through OFCs in the Pacific, Caribbean and Europe. The OECD urged jurisdictions to abolish bank secrecy and non-disclosure laws in the interests of international tax compliance, cooperation and information sharing. Of the 35 jurisdictions that met the OECD's tax haven criteria in 2000, 30 have agreed to cooperate with the OECD, and work towards eliminating "harmful tax practices" by 2006 (OECD 1998, 2000, 2002 & 2003). However, this paper argues that the offshore sector is not going to suddenly disappear, because it is far too important to the workings of contemporary capital to simply vanish. What is occurring, rather, is contestation between institutions of international governance and portfolio managers, and practitioners and tax

compliance regulators, to define what the offshore actually is and what it should become.

In a series of research were been carried out with 48 accountants, lawyers, regulators, fund managers, insurers, bankers, CEOs, legislators and fiduciaries in Andorra, Australia, Guernsey, France, Samoa and Singapore. Interviews covered the effects of multilateral efforts to regulate OFCs (particularly the OECD's Harmful Tax Practices Project and the European Union's Savings Tax Directive), changes in client response/profile as a result of these initiatives, the current market for offshore services, the motivations for using OFCs, the current state of tax planning techniques and future prospects for offshore finance. This paper draws on interviews with 37 research participants and explores their self-reported commentaries on multilateral and supranational initiatives in the offshore financial services sector.

One of the characteristics of multilateral initiatives is that they tend to conflate the distinctive characteristics of different countries and territories. Similarly the research results discussed here draw from information gathered in diverse countries, each with their own specialisations, statuses and markets. Some interviewees in Guernsey, for example, emphasised that it should not be defined as an OFC, but rather as a finance centre in the same league as Luxembourg, Switzerland, Singapore and Hong Kong. The different jurisdictions are grouped together because of public and official perceptions of offshore finance in major OECD countries, even if those representations are unfounded and unwarranted. "Onshore" medias tend to misleadingly group these very different countries and territories together as recalcitrant "tax havens" (McLennan 2004, p.3, Lewis & Macfarlane 2003, p. 1&4, Gilchrist 2004, p. 1, Wade 2003, p. 9). By comparing and contrasting them, however, this paper aims to show that they are diverse and dynamic participants in the international community. Their OFC facilities are just as much a reflection of the globalisation of capital as they are of divergent tax regimes and financial secrecy. Onshore states and the differences between national regulatory systems produced OFCs in the first place. Small states crafted their laws and regulations accordingly.

Methodology

The research results in this paper are based on open-ended semi-structured interviews. A series of themes was covered and participants were asked to talk around them. Research was carried out in jurisdictions where people were willing to be interviewed. Of the 37 interviews incorporated into this paper, Guernsey was the most rewarding, with 22 people interviewed over two trips in December 2003 and January 2004 totalling three weeks. The remaining 15 are split between France, Singapore, Andorra, Australia and Samoa.

The interviews were not normally taped. Instead, extensive notes were taken during and immediately after the interview. Detailed note taking is standard practice in anthropology (the author's disciplinary background) and proves valuable in many forms of qualitative, investigative social science research including sociology, criminology, law and international relations.

For ethical reasons the research followed strict confidentiality guidelines, and nothing is attributed to any specified person, firm or institution. In terms of recruiting research participants, snow-balling techniques were employed, whereby interlocutors were asked to give names of others who might be interested in one or more interviews. On Guernsey, the authorities also had an extensive publicly available database of hundreds of offshore firms that was consulted along with the local phone book to recruit interviewees. Almost everyone that was contacted agreed to an interview.

Multilateral Initiatives: A Review

In the last 5-10 years OFCs have come under pressure to abolish excessive bank secrecy and develop information exchange protocols with countries that believe their tax revenues are being undermined by offshore products and services. In its 1998 report the OECD argued that OFCs encourage tax evasion, facilitate questionable aggressive tax planning strategies, undermine revenue raising systems in member and non-member countries alike and distort global investment decisions. The OECD identified 12 key features of "harmful preferential tax regimes" (1998, p.33). The report noted that the existence of bank secrecy "may constitute one of the most

harmful characteristics of a regime. The availability of protection from enquiries by tax authorities is one of the biggest attractions of many harmful regimes” (OECD 1998, p.33). The OECD urged jurisdictions to abolish such laws in the interests of international tax cooperation and information sharing. In 2000 a subsequent OECD report identified 35 countries and fiscally sovereign jurisdictions that met the tax haven criteria of the 1998 report (OECD 2000, p. 17). In this and a following report published in 2001, the OECD stated that while this list did not automatically mean that these countries and territories would automatically face “defensive measures”, they were urged to end their “harmful tax practices”. If they did not commit to ending harmful tax practices then a further list would be made and these countries and territories would face “defensive measures”.

Authorities in the listed jurisdictions expressed concern that this would lock them out of the world’s financial system by placing restrictions on inward/outward bound payments and transactions. They argued that the OECD’s initiatives were an infringement of sovereignty, took advantage of their relative vulnerability as small states, undermined their economies and offered no alternative development strategies or financial compensation in the wake of lost revenue. The leaders of the 35 jurisdictions, along with regulators and fund managers located in these territories, also argued that the OECD’s initiatives unfairly restricted competition in financial services to the advantage of OECD members, particularly those with active “on-shore off-shores” located in the UK, USA, Japan and Ireland. A number of jurisdictions initially refused to comply with the OECD’s requests on the grounds that the same standards were not being applied to at least three of its members – Luxembourg, Switzerland and Austria – not to mention the UK and the USA, where states such as Delaware and Montana offer tax haven facilities for non-residents.

Despite the initial opposition to its initiatives, the OECD and 30 of the listed tax havens (excluding three that were not initially listed because they gave advanced commitment letters to the OECD) entered into dialogue, resulting in a series of global and regional forums and meetings with OECD officials and offshore regulators that began in 2000. They are now engaged in on-going talks with the OECD to establish common standards for exchange of information, though there are debates concerning the idea of a level playing field, largely due to the reluctance of Switzerland and Luxembourg to adopt the same standards that are being asked of the listed OFCs.

In 2001 the EU announced plans to standardise the cross-border taxation of non-resident interest payments to individuals with bank accounts and other interest bearing investments within the EU (EC 2001, p.1). In 2003 the European Commission issued the EU Savings Tax Directive (EC 2003). This will be applied within the EU from 1 January 2005. However, Austria, Belgium and Luxembourg objected to its exchange of information requirements and succeeded in modifying the directive. They have been permitted to levy the withholding tax on non-resident accounts in lieu of releasing client information and/or will offer account holders the option of withholding tax or exchanging information (PriceWaterhouseCoopers, Luxembourg 2003). This option of exchanging information with EU member states or levelling a withholding tax on interest income was then extended to non-EU member states (Switzerland, Liechtenstein, Andorra, Monaco, San Marino, the British Overseas Territories and the Crown Dependencies of Guernsey, Jersey and the Isle of Man) in an effort to encourage their cooperation with the directive. These non member states (with the possible exception of the British Overseas Territories) are under no obligation to implement EU directives. The Savings Tax Directive is limited in its efficacy if confined to EU member states, as residents of the EU could shift their money outside of the Union. It has thus been necessary for the EU to negotiate with non-member states that fall inside Europe's geographical borders. Tallberg's (2002) argument that compliance within the EU involves both management and enforcement is relevant to relations with non-member border states as well. However, the EU has limited its negotiations to only a small number of non-member jurisdictions. It does not apply to independent Caribbean, Pacific or South East Asian OFCs. The Prime Minister of Andorra, Marc Forne, observed that: "The whole thing does not end with Andorra, Monaco or Liechtenstein. I would like to know what other countries like the United States, Singapore and Taiwan think about the fiscal directive on saving, because money is volatile and if in the end Europe applies the directive it will see capital flee to these other countries" (Forme 2003, cited in Lomas 2003). When these initiatives were first announced, particularly the OECD's project, many observers, commentators, government's and scholars predicted that they would bring about the demise of the OFC. One scholar, Mark Hampton (2002, p.1667), noted that: "The fundamental attractions of OFCs – low or no taxation, banking secrecy, minimal financial regulation and political stability – face significant threat of erosion". What this research has aimed to find out is: are these initiatives having an effect on the

offshore sector and if so how and why? How has business been affected by these initiatives? Secondly, what kind of impacts have these programs had on local economies and societies? Do they face significant threat of erosion?

Impacts

A majority of research participants said that these international initiatives were having an effect on the offshore sector. Sixty percent of interviewees reported that the initiatives had an impact on their firms, 11% said that they had not had any effect on business, 5% said that it was too early to tell and 24% said not yet but they will if fully implemented. The main impacts were increased compliance costs for offshore firms and regulators associated with the implementation of due diligence and Know Your Customer (KYC) standards. They have “put up the cost of regulation”, as one official said. This interviewee maintained that regulatory bodies and firms were now having to spend a lot of time proving to international organisations that their systems were up to standard. Another research participant said that the main effect had been the “tightening of regulation” and firms had to review their clients and the kinds of services they provided to determine whether or not they could continue working for them. Sometimes the cost of compliance for some clients was too high and therefore firms had to terminate their relationships with them, particularly in the fiduciary area. Some clients relocated to other jurisdictions while others decided that it was not profitable to maintain a trust structure. They would “call it in” and “repatriate their money back onshore”. This placed pressure on the profitability of trust firms, and had a “slowing down effect”. Another trust officer said that trustees had only been regulated in the past three years. “Before that trustees were not regulated”, and then continued “an awful lot has changed, an awful lot has changed”. When it came to due diligence and KYC procedures there was “now a training session every week” (Interviews, Guernsey, December 2003-January 2004).

On Guernsey the trust sector is one of four financial sectors, the others being private banking, funds management and insurance. There was some variation in responses between these sectors. While trusts and fiduciaries that catered to High Wealth Individual (HWI) clients reported increased compliance costs, the funds industry, insurance, and private banking emphasised that firms in these sectors were resilient and could absorb these costs. One respondent reported that these initiatives had “put

up the cost of doing business”, but they were only “a minor irritation”. Another said “to be honest they [the OECD and EU] are a real pain but you just have to swallow hard and rise above it...you can always rise above it” (Interview, Guernsey, January 2004).

In Samoa the effects were more pronounced, with one interviewee saying “there’s been a 15-20% drop in the number of renewals in the last year. It’s been slow; new business is slow. Confidence out there with international clients is down” (Interview, Samoa, December, 2002).

Eleven per cent of businesses reported no adverse effects on their firms what so ever. These tended to be companies with institutional clients (for example, large corporations and multinationals), but also a number of trust companies catering to HWIs. One trustee said that there had been “no effect on our business” and this interviewee did not think that there had been an “effect generally” on the industry.

Other interviews suggested that it was too early to determine whether or not these initiatives were having any effect. One interviewee said, “It’s too early to tell, because they’re not clearly in force yet”. This interviewee noted that that offshore authorities had insisted through out their negotiations that they were not prepared to implement changes that larger countries themselves will not agree to, adding that “any country is entitled to tax its own citizens to enjoy the benefits of society...we are not here to help people evade tax” The interviewee emphasised that there was a difference between avoidance and evasion and people were free to establish structures that minimised their tax liabilities in perfectly legal ways (Interview, Guernsey, January 2004).

A number of interviewees in Guernsey said that the effects of the island’s decision to negotiate with multilateral organisations had been positive because it helped reinforce its reputation as a well-regulated, cooperative and responsible jurisdiction. One interviewee said that the effects, in terms of standardising and regulating due diligence and KYC procedures, were “terrific” adding that “anything that makes us clean as a record” has to be good (Interview, Guernsey, January 2004). Another official said of clients who may have left Guernsey in response to these enhanced regulatory standards that “it’s probably business that should not have been here in the first place” (Interview, Guernsey, December 2003). People also reported that the

industry had already weathered a number of the effects of these international initiatives. The publication of black-lists and the media publicity surrounding OFCs caused initial alarm and damaged client confidence at the very outset. However, on Guernsey authorities reacted very quickly and constructively by agreeing to negotiate with the OECD and other organisations, reassuring clients that Guernsey was a safe and reliable place for business.

This was independently confirmed by an IMF assessment of financial regulation in Guernsey. It stated: “The detailed assessments of compliance show that the financial regulatory system of Guernsey complies well with the international standards” (IMF 2003, p.13). Similarly, the IMF’s assessment of Andorra indicated “that financial supervision is generally sound with respect to material activities of the financial system” (IMF 2002, p.4).

Some interviewees also reported that the OECD’s project had largely lost its way and been eclipsed by the EU Savings Tax Directive and the IMF’s favourable assessment’s of Guernsey’s enhanced regulatory standards. One interviewee said that the “OECD initiative has really run out of steam and the EU has now taken up the running”. Another reported that “the initiatives have really got diverted from their main goals”, they had “really got side-tracked”. This interviewee added that because the OECD had not taken any action against the jurisdictions (such as Liechtenstein, Andorra and Monaco) that refused to negotiate with it over exchange of information, it made a “bit of a mockery of the whole thing” (Interviews, Guernsey, December 2003-January 2004).

On Guernsey, however, authorities - both government and regulatory - were keen to continue active dialogue with all multilateral organisations, including both the EU and OECD. They were involved in negotiating a model agreement on exchange of information (along with other jurisdictions), and had already signed a Mutual Legal Assistance treaty with the United States.

In Andorra, participants indicated or implied there was a likelihood that their country would at least agree to the EU Savings Tax Directive, with one interviewee saying “this is what we are all waiting for...all of us are waiting to see what will happen. The Andorran government will make a decision next year. All of us are waiting to see; Andorra has had no taxation for all these years. It will mean a complete

restructuring of the government” (Interview, Andorra, December 2003). However, this does not mean necessarily that business is adversely affected. Arguably, government restructuring takes place and inter-government negotiations occur while enterprises continue to prosper.

Client Reaction

In Guernsey, Andorra and Singapore not one interviewee reported that the effects of these international initiatives, in terms of increased compliance costs associated with standardising due diligence and KYC procedures, had *adversely* undermined the viability or profitability of their firms. Clients by and large were not deterred from Guernsey, Andorra or Singapore . Only in Samoa did interviewees report a significant reduction in offshore clients. They suggested that this had led to a major decline in demand for the country’s offshore banks, which were undermined by both multilateral initiatives and the reach of the US Patriot Act. Compared with the major OFCs, however, Samoa is a relatively small player, supplying a niche market, largely in South East Asia, with specialised International Business Companies (IBCs).

In the other three jurisdictions interviewees reported that business had in fact increased in all four areas (fiduciary, private banking, insurance and funds management). For example, in Guernsey it was reported that the mutual fund industry was prospering, in Andorra the banking sector remained buoyant, while in Singapore there was a surge in private wealth management services. Interviewees in Singapore (a country which has not been listed by the OECD or the EU) reported that the financial services sector was at “the base of the curve” and about to “take off”, though in Europe there maybe a “chip taken out” of its share of the market due to the impacts of the Savings Tax Directive (Interview, Singapore, February 2004).

In terms of the effects of the international initiatives on client morale, there were only marginal changes. In trust and fiduciary the smaller end of the market had declined. Clients were winding-up structures and repatriating capital, often on the advice of their trustees. However, the HWI market was almost completely unaffected. One interviewee said that is was not really worthwhile for anyone who had net assets of US\$250,000 to use OFCs, but people with assets in excess of US\$1 million would invariably structure their affairs in ways that might benefit from offshore products and services. Another trustee said there were subtle changes in the firm’s client base.

There was slightly less work at the bottom end of the market, with lower volume (of manageable wealth) transactions contracting, but little change in more sophisticated arrangements. In fact, according to the interviewee, there had been increasing business from this later client group. This interviewee added that if concerns were tax motivated, then this would come from a particular client base, and these were invariably HWIs. Another trustee said: “The smaller personal tax private client has disappeared from the market”, but that the “very wealthy family market” remains important, and provided continuing work for trust and fiduciary and private banking (Interview, Guernsey, December 2003). In Samoa, the interviewee who noted a 15-20% reduction in the number of renewals remained optimistic. He emphasised that: “We have an established client base...There hasn’t been much of a change for private individuals, those with connections to established outfits. High Wealth Individuals and multinationals – families that own multinationals – they’re still the core; there hasn’t been much change with them” (Interview, Samoa, December 2002).

When it came to institutional clients, namely multinationals and large corporations, not one firm of trustees, fund managers, accountants, or insurers reported a decline in client numbers or level of assets under management, with the exception of Samoa. One interviewee whose main clientele was institutional said he had not noticed “any business leaving”. If anything institutional clients had increased, with one fund manager saying that there remained “a lot of business out there”, though they tended only to take on institutions (say hedge funds) in the £100 million range. This was sufficient, nonetheless, with another interviewee saying there were a “lot of dollars floating around” and that “hedge funds are all the rage at the moment” with new geographical markets opening-up new possibilities (Interviews, Guernsey, January 2004).

Business has become tighter in the offshore sector though; it has become more competitive. There were job losses on both Guernsey and neighbouring Jersey. Some financial provider firms also relocated elsewhere. One consequence of the international initiatives is an increasing number of mergers and acquisitions, as the rising cost of doing business changed economies of scale. This did not unduly concern most participants, however, and it was reported as being an integral and important part of a dynamic business environment. Job losses were reported to be the result of out-sourcing work (often to other OFCs; for example, accounting was

outsourced to Hong Kong or the UK because it was cheaper) rather than international pressure. An interviewee put it this way: just because one firm relocates some where else does not mean that the whole industry is jeopardised. It is part and parcel of having a dynamic financial services sector. People must get used to the “ebbs and flows of finance”, this interviewee declared, adding “you hear a lot of doom and gloom”, but it was really an over-reaction (Interviews, Guernsey, December 2003-January 2004).

In commenting on the overall state of offshore finance, participants did report a polarisation between OFCs located in developed and developing jurisdictions, a view reinforced by research in Samoa. OFCs with a sophisticated range of products and services accommodated the effects of international initiatives without losing a large number of clients. These OFCs included Guernsey, Jersey, the Isle of Man, Bermuda and to a lesser extent the Cayman Islands, and the British Virgin Islands, the latter because of its market dominance in the supply IBCs. Guernsey, Singapore and Hong Kong were seen as potential competitors and were viewed as robust finance centres that had gained some competitive advantage by managing to stay off various blacklists. In Samoa, however, Singapore and Hong Kong were considered actual and potential clients, not market rivals, reflecting the diversity between jurisdictions collectively classified as OFCs. Participants in Andorra were also confident that international initiatives would not unduly damage their centre, and tended to invoke a long history of external pressure and constraints against their country (and that they always survived this). Very few interviewees in Guernsey viewed civil-law jurisdictions such as Monaco and Andorra as market rivals.

There were more severe effects in smaller so-called “third world” jurisdictions, including the loss of a substantial number of clients. One interviewee said that: “There is only so much legitimate business that can be done”. He continued that if it was not found in the top five or six jurisdictions, then clients were probably only going to other OFCs for tax evasion reasons. “When you look at the top jurisdictions, Switzerland, Luxembourg, the Isle of Man, the Channel Islands, Bermuda, maybe Cayman, and I’m not just saying this for competitive reasons, every service that any one could reasonably want would be available. Why go elsewhere?” (Interview, Guernsey, January 2004).

Interviewees with views on this suggested that the outlook for smaller jurisdictions in the Caribbean and the Pacific was bleak, and whereas there are now 35 OFCs, in ten years time there will probably only be a third of that. There are already cases of some OFCs where compliance costs alone were in excess of revenue earned by local government's, undermining their continued viability. In Tonga the government chose to close its OFC, while Niue and Nauru repealed or modified offshore banking legislation as a result of increased international standards. In its assessment of Vanuatu, the IMF reported that: "The offshore industry appears, at best, to have stagnated in recent years and has shown marked decline in some sectors" (IMF 2003, p.13). However, small well-regulated finance centres such as Samoa and Mauritius, which can tailor niche services such as IBCs or cross-border outsourced accounting, are likely to stabilise and are not in jeopardy of closing, though further growth may be relatively slow.

To summarise this section, the international initiatives had an impact on the offshore finance industry, but in the leading developed finance centres, these were limited to increased compliance costs associated with implementing due-diligence and KYC standards. There was no significant effect on client morale, with OFCs offering continued advantages to business and individuals. However, the lack of impact applies only to significant OFCs offering a sophisticated range of financial services or niche financial products. Smaller jurisdictions in the Pacific and Caribbean experienced a decline in business and their long term viability as OFCs is possibly in jeopardy. On the other hand offshore finance in places like Guernsey, Jersey and the Isle of Man is prospering. In jurisdictions with diversified economies, such as Singapore and Hong Kong, interviewees reported that they were confident that there would be continued growth in their financial services sectors.

Motivation, Markets and Possibilities

New markets and legitimate tax planning may well explain the continuing appeal of offshore financial services for multinational institutions and HWIs. They are also likely to guarantee the long-term viability of the offshore sector, even if the number of jurisdictions hosting OFC facilities declines. OFCs such as Guernsey and Singapore do not necessarily depend on a pool of onshore resident taxpayers, but rather attract both globally mobile capital and globally mobile people. Where resident taxpayers in

onshore OECD countries use OFCs for tax minimisation, there are also structuring possibilities through discretionary trusts that have no classified category of beneficiary. For clients who do have concerns about privacy, centres such as Singapore and Hong Kong can offer this along with more traditional jurisdictions such as Switzerland. The reluctance of Switzerland and Luxembourg to fully commit to information exchange agreements complicated moves towards a level playing field, offering continued opportunities for smaller jurisdictions. When asked what motivates people to use OFCs, 97% of respondents mentioned tax advantages. However, there was wide variation in the ranking of taxation by its relative importance. Positions on the tax advantages of using offshore structures range from not being very important to being the main factor driving the market. One firm in Andorra said the “abatement” of taxation was the main reason why investors sought their services (Interview, Andorra, December 2003). Another interviewee, whose main clients were institutions, said that investors were drawn to locating funds in Guernsey or Jersey rather than London or New York because “they won’t be taxed”. He added that if you die in England there is 40% death duty, but there are no such taxes in Guernsey. He stressed that “one of the driving reasons why people move their funds around the world is to reduce their taxes” (Interview, Guernsey, January 2004). However, another interviewee whose main clients also included institutions reported that in developed offshore jurisdictions “very little is now tax driven” (Interview, Guernsey, January 2004). Another interviewee in Samoa said “Tax is irrelevant; it is not a concern for regulatory authorities in the more established jurisdictions” (Interviews, Samoa, December 2002). Between these two positions, interviewees reported that people were attracted to OFCs for the financial products and services they offered. For example, if someone held property in a number of different countries, then it was more efficient to bring them altogether under a common trust and corporate structure in an offshore jurisdiction. This was particularly relevant for estate planning, where clients were dealing with multiple laws relating to heirship and succession. OFCs provided a convenient base for efficient and reliable estate planning. Every interviewee reported that there was a concentration of expertise in these jurisdictions that could be called upon to plan people’s world-wide financial affairs. One interviewee stated that “within one mile of this office you will get more expertise in the setting up and management of trusts than you would anywhere in the world” (Interview, Guernsey, December 2003).

All respondents reported that they serviced globally mobile capital and people. with few if any tax obligations to any one onshore country. For example, OFCs appealed to pension and superannuation funds for expatriates, payroll facilities for seafarers and oil rig workers and collective investments such as open ended and closed mutual funds. When emphasising these features, interviewees reported that there was now little difference between the “offshore” and the “onshore”. In response, participants would be asked, “if that’s the case then why not locate a fund or a pension scheme in London or New York?” The reason was that OFCs offered regulatory flexibility and diversity. For example, captive insurance companies could calculate and manage risk according to a more flexible set of criteria (for example, more accommodating reserve requirements). But it was also at this point that everyone mentioned that OFCs provided tax neutrality. Tax neutrality and regulatory flexibility usually converged. One participant mentioned that OFCs were an ideal place for large insurance firms who wished to establish subsidiaries that could manage expatriate health benefits or provide superannuation products. These were for highly mobile employees. Firms and clients were keen to establish a fund in a country that was effectively tax neutral to provide services for employees who “would move from one place to another” and then “may retire some where else” (other than their home country). Large multinationals continued to be attracted to OFCs, because a subsidiary or a fund could be established in a “benign environment” where they were not subject to “six different forms” of taxation and regulatory regimes (Interviews, Guernsey, January 2004).

Another interviewee said that offshore structures no longer worked well for anyone who is born in a country and never really leaves, “never moves beyond three or four miles from where’re they’re born” (Interview, Guernsey, December 2003). Rather they worked best for HWI “global families”. These were a growing and important part of the market. Another interviewee put it this way: “There are the wealthy in this world and they will arrange their affairs and when they become really wealthy they become itinerant” (Interview, Guernsey, January 2004). In Guernsey another important part of the market are UK Non-Domiciliaries. These are people who can move to the UK (mainly London) and live there indefinitely and largely tax-free if they set-up offshore structures prior to their arrival. This is perfectly legitimate in UK law. For example, a family from the Middle East or Scandinavia may decide to move to London. Before arriving they will set-up an offshore trust in one of the Channel

Islands or the Isle of Man which purchases a town-house for say £5 million in London. The remaining assets are then invested offshore and the beneficiaries are sent say £100,000 in tax-free capital payments a month to meet their living expenses. Because of their status as UK Non-Domiciliaries, these arrangements are perfectly lawful.

Other OECD countries, do not have this category of tax-free non-domiciliary. The fact that it exists in the UK is an example of the discrepancies between OECD tax systems themselves that provide continuing opportunities for the offshore sector. Similarly, while the US does not have this category, the IRS will, if an application is successful, issue a Qualified Intermediary Regime (QRI) licence to offshore firms that allow them to act on behalf of their HWI clients (Interview, Singapore, February 2004). New Zealand has a category of tax-exempt offshore trust for non-residents. One interviewee commented that New Zealand Offshore Trusts could be utilised as vehicles to effectively hold property in Portugal. Then again Portugal, also an OECD member, has been permitted by the EU to develop an OFC on its Atlantic island of Madeira. It has only recently abolished this centre (OECD 2004).

Conclusion: financial diversity and the continuing appeal of offshore finance

Differences between tax systems of a number of OECD countries continue to provide a market for OFCs. One interviewee said there was no doubt that in time Switzerland and Luxembourg would meet OECD standards. But “the game still has a lot further to go yet”. For example this interviewee noticed that the USA did not meet many of the standards that the OECD itself is promoting, and that “they are a very long way from doing anything similar”. Although the US was drafting legislation to comply with these international standards, there was “massive opposition from corporate interests”. He continued “The concept of a global level playing will take a long time, if ever, to achieve”. In the absence of a level playing field, “there are still a lot of opportunities” for OFCs (Interview, Guernsey, December 2003).

Because of this, bank secrecy and exchange of information requirements can be accommodated without unduly damaging the leading OFCs. For clients who are concerned with privacy issues new jurisdictions, such as Singapore, have emerged. Singapore is evolving as a leading centre for private wealth management, and a

number of private banks and trust firms have established there in the past five years. Interviewees said it was an ideal place to structure assets in the region, having good connections with the US, UK and Canada. It was an ideal centre for world-wide tax planning.

When interviewees were asked at the very end of our discussions if they felt there was still hope for the offshore sector in the face of international initiatives, all, except two, were very optimistic. Only two expressed doubt as to the continuing viability and profitability of the offshore. One interviewee said “do I think that this industry will be here in another ten years, yes definitely, do I think that it will provide me with a successful career until I retire, yes definitely...the long term prospects are good”. Another said “Oh yes, I think it gets better every day”, and another “Oh God yeah...who would have thought even ten years ago that there would be millionaires in China who would need their wealth managed”. Finally one interviewee put it like this: “There will always be an offshore sector. We are the ball-bearings in the machine of the world’s financial markets” (Interviews, Guernsey, January 2004).

Maybe, then, OECD countries should not only be focusing on the jurisdictions that host OFCs, but also their own tax systems and the character of globalisation, that continues to make the offshore world so appealing.

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