OFFSHORE FINANCIAL CENTRES:

THE SUPRANATIONAL INITIATIVES

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The world's financial centres are undergoing rapid changes to accommodate the demands of an increasingly integrated global economy. The G7 countries are driving such changes through their continued support for the actions of several supranational agencies, particularly the *Organisation for Economic Co-operation and Development*, the *Financial Action Task Force* and the *Financial Stability Forum*.

Initiatives launched by these agencies foreshadow changes in the legislative and regulatory infrastructure of all international financial centres, particularly the so-called "tax haven" or "offshore" centres.

The success of the offshore world has led to scrutiny of such centres by onshore governments and their agencies. Explicit expressions of competitive concerns about "harmful tax" régimes have muted recently, but onshore governments remain apprehensive that the high levels of confidentiality traditionally available offshore invite illicit activity. The articulated rationales for change include the perceived needs to (i) counter money laundering, (ii) promote transparency to enhance onshore tax enforcement, and (iii) improve regulation in all international financial centres to limit global financial risks.

The debate over changing standards was conducted at the outset by lobbing bombs over the fence, particularly between the OECD Committee on Fiscal Affairs and the so-called "tax havens". However face-to-face dialogue between parties has softened negotiating positions and promoted better understanding of mutual interests. Accordingly, while the offshore centres remain committed to a robust defence of legitimate national interests, the current tone of discussions is increasingly constructive. There is now an improved prospect that the debates will lead to a resolution that takes reasonable account of the interests of all parties.

This paper considers the current complex and overlapping supranational initiatives proposing changes in the regulation of offshore financial centres. The underlying rationales for change are considered, as are the likely and appropriate responses for the stakeholders in the offshore centres, including governments, financial institutions and clients.

The author has acted for the Government of The Bahamas in these matters so this paper makes particular note of their response in the detailed discussion of the supranational initiatives. Views

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1. The Role of Offshore Centres in the World's Financial System

Offshore financial centres ("OFCs") are jurisdictions that attract a high level of non-resident financial services clients relative to the volume of domestically sourced business. Traditionally, the term "offshore centre" implies some or all of the following[1]:

- low or no taxes on business or investment income;
- no withholding taxes;
- light and flexible incorporation and licensing régimes;
- light and flexible supervisory régimes;
- flexible use of trusts and special corporate vehicles;
- no need for financial institutions and/or corporate structures to have a physical presence;
- client confidentiality based on bank secrecy laws; and
- limitation of certain incentives to non-residents.

The globalisation of business, enhanced mobility of individuals, increasing sophistication of the offshore world and the higher level of information available on planning opportunities have all fuelled the attraction of international and offshore financial services. Many offshore centres now offer a level of sophistication in particular areas which exceeds that available in the major onshore money centres.

The current scale of this industry is illustrated by a recent IMF study on OFC banks[2]. That report indicates that cross border assets and liabilities in offshore banks increased by 6% annually during 1992-97, to approximately U.S. $ 5 trillion in 1997. The rapid expansion of the world economy continues to increase global wealth, further enhancing asset growth in the offshore world[3]. This success is driven by institutions, corporate and individual clients voting with their feet to take advantage of the tax neutral status and lower costs resulting from lighter regulation found offshore[4].

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[1] See the discussion in Financial Stability Forum, *Report on the Working Group of Offshore Centres* (5 April 2000) at p 9 (hereafter the *FSF Report*)

[2] Luca Eric and Alberto Muslim, *Offshore Banking: An Analysis of Macro and Micro Prudential Issues*, IMF Working Paper (WP/99/5), January 1999

[3] The 2000 Merrill Lynch Gemini study, for example, notes that the number of U.S. dollar millionaires in the world economy has increased by 50% over the last three years, to a current total of approximately seven million millionaires.

[4] As the FSF Report notes at page 8, the growth of London as the largest offshore banking centre has been linked directly to regulations imposed on the U.S. banking sector: capital controls implemented through the Interest

Tax neutrality, the main appeal of the offshore world, will survive in most offshore centres despite the changes underway, and so such centres will continue their existing attraction for onshore clients. This is particularly true for those offshore centres with sophisticated expertise, which are conducting real and substantial activities for clients. Increased transparency will affect the appetite of the marginal users of the offshore environment, possibly increasing the significant proportion of illicit financial activity already conducted in the onshore international financial centres[5].

2. Overview of the Principal Onshore Initiatives

The principal supranational agencies seeking change are:

- the Paris-based OECD, which seeks greater transparency on tax matters, through the *Harmful Tax Competition* initiative. The main reports published by the OECD on their objectives are *Harmful Tax Competition* (27April, 1998), *Towards Global Tax Co-operation* (26 June, 2000), and *Improving Access to Bank Information for Tax Purposes* (24 March, 2000)[6];

- the *Financial Action Task Force* (FATF) housed in the OECD offices in Paris, charged with countering money laundering. The main reports published by the FATF are the *Report on Non-Cooperative Countries and Territories* (14 February 2000), and the *Review to Identify Non-Cooperative Countries or Territories* (22 June 2000)[7] ; and

- the Basle-based *Financial Stability Forum*, seeking enhanced standards for international banking regulation to address market integrity and prudential concerns. The relevant report published by the FSF is the *Report of the Working Group on Offshore Centres* (5 April 2000)[8].

Related initiatives include:

- EU efforts to impose effective taxation of savings through either a withholding tax or information reporting to support improved taxpayer compliance. This initiative culminated in the Feira Agreement on the taxation of savings reached in Portugal in June 2000[9]. Member States agreed to *information exchange* as the ultimate objective of EU policy, though members imposing withholding tax today can still do so until 2009. Member

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Equalisation Tax of 1964, the Foreign Credit and Exchange Act of 1965, cash reserve requirements on deposits imposed in 1977 and a ceiling on time deposits in 1979. By establishing foreign branches to which these regulations did not apply, U.S. banks were able to operate in more cost-attractive environments.

[5] The US National Money Laundering Strategy for 2000 acknowledges at page 7, for example, that a "substantial portion" of the money laundering in the world likely takes place in the United States. See also *Blacklist Leaves a Mark on Money Laundering*, Financial Times, December 5, 2000 for a discussion of money laundering activities, onshore and offshore.

[6] Available on the web at *www.oecd.org.*

[7] Available on the web at *www.oecd.org/fatf.*

[8] Available on the web at *www.fsforum.org.*

[9] Santa Maria da Feira, European Council, *Presidency Conclusions* (19 and 20 June 2000).

countries have committed to promote the adoption of similar information exchange policies in dependent and associated territories (e.g, the British Overseas Territories); and

- the U.S. program for *Qualified Jurisdictions* and *Qualified Intermediaries*, designed to facilitate monitoring of U.S. taxpayers investing back into that country through offshore structures. This initiative has the (incidental?) effect of projecting U.S. domestic regulation of financial intermediaries onto a global basis.

3. Implications of the Proposed Changes for Personal Financial Privacy

The complete record of an individual's financial transactions- now sought on a global basis- forms a revealing insight into the intimate details of one's personal life. The collection and sharing of such information, and the linkage of databases through the use of electronic tools, poses many concerns for the privacy of individuals.[10]

Governments have a voracious appetite for information. This is reinforced by the demands of their expert advisers. As Ian Lambert notes in his review of the recent report of the FSF:

> those schools of economics that occupy themselves with macro-economic modelling are institutionally resistant to legal and social structures that inhibit the gathering of financial data. For these economists- and they largely control the profession and the direction of its work- secrecy, confidentiality and even ordinary privacy more or less stand in the way of managing the economy.[11]

The recent OECD report on *Improving Access to Bank Information for Tax Purposes* contains informative insights into the scope of existing financial disclosure in onshore countries. France, for example, requires financial institutions managing stocks, bonds or cash to report to the Government on a monthly basis regarding the opening, modifications and closings of accounts of all kinds. This information is stored in a central computerised database which is used by French authorities for research, control and collection purposes. Four other OECD countries also maintain centralised databases, being Hungary, Korea, Norway and Spain.[12]

The OECD report on bank information attempts to quell privacy concerns by noting in paragraph 6 that "Allowing tax authorities access to bank information through direct or indirect means does not jeopardise the confidentiality of the information. Tax authorities in all OECD countries are subject to very stringent controls on how they use information, including bank information". It is comforting to know that rules to protect privacy *exist,* of course, but are such rules *observed*?

Scepticism concerning the ability of governments to resist the temptation to access information for unauthorised purposes is rife, particularly as there is, by definition, no opportunity to monitor

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[10] The *UN Declaration of Human Rights 1948* recognises and protects privacy as a basic human right. Article 12 reads:
No one shall be subjected to arbitrary interference with his privacy, family, home or correspondence, nor to attacks upon his honour and reputation. Everyone has the right to the protection of the law against such interference and attacks.

[11] Ian Lambert, *From Tax Haven to International Financial Centre- A Philosophical Overview of the OECD Initiative,* Conference Paper for the IBC Offshore Trust Summit 2000, October 2000

[12] Appendix, Section 3.1.2 of report on *Improving Access to Bank Information for Tax Purposes*

unauthorised access. Affluent taxpayers in at least one major OECD country also fear that tax data is routinely sold to criminal gangs seeking targets for kidnapping. Global sharing of information means that criminal access can occur at the weakest point of entry, multiplying the risks associated with unauthorised disclosure.[13]

The risks to personal privacy arising from the collection of financial information are disconcerting, even while apparently benign governments maintain control of the information and apparatus. The prospect of abuse where these vast and globally converged pools of information fall into the wrong hands en masse or through ad hoc unauthorised access is truly frightening. This is particularly so for the many families with direct experience of repressive or corrupt governments.

4. Compromise of the Rights of OFC States

There is no precedent in world financial history for a large scale, loosely co-ordinated effort to influence (dictate?) the laws of some forty offshore jurisdictions, many of them sovereign states. At the outset, many of the offshore states simply insisted that the OECD had no right or authority to force changes in their domestic laws. This is true, of course, but it ignores the fact the OECD is not dictating changes as such, but rather requesting changes with the threat of sanctions for those centres which do not respond to OECD demands.

An offshore banking centre exists because it is able to:

- solicit clients from other jurisdictions;
- access international banking networks; and
- invest in onshore securities markets.

Offshore centres rely on such access to foreign markets to conduct a local financial services industry much larger than that which could be supported by domestic demand. Accordingly, it is not practical for an OFC to isolate itself from outside pressure by unplugging from the international grid unless the centre is prepared to restrict the local financial sector to the purely domestic environment, typically tiny markets in most OFCs.

The OECD now accepts that OFCs are free to operate income tax-free fiscal régimes. High tax OECD régimes deserve similar tolerance from OFCs. This means, at minimum, that as long as such mutual respect for different systems of taxation exists, service providers in OFCs ought not to undermine high tax OECD régimes by inviting tax evaders to seek refuge in confidential offshore financial structures.

The opportunity to participate in the markets of other countries also implies some minimum standards of behaviour in order to justify access. Thus, onshore countries can and do take the

[13] A UN Report published in 1998 notes, alarmingly, that in a part of the former Soviet Union (not an OECD member), criminal gangs bought banks in order to determine which families had bank accounts large enough to make kidnapping worthwhile. United Nations Office for Drug Control and Crime Prevention (UNODCCP), *Financial Havens, Banking Secrecy and Money-Laundering*, Double issue 34 and 35 of the Crime Prevention and Criminal Justice Newsletter, and Issue 8 of the UNDCP Technical Services, 1998 at page 68.

position that they can prevent or restrict access to banking and securities markets for institutions and their clients in jurisdictions that are perceived to be poorly regulated or overly secretive.

As a general rule there are few effective limits on the right of an onshore country to restrict market access. Possible avenues include resorting to the World Trade Organisation for a challenge based on denial of market access pursuant to the General Agreement on Trade in Services. An alternative basis may be that such sanctions constitute an improper infringement of Article 8(2) of the International Monetary Fund Agreement, which limits the ability of IMF Members to impose restrictions on international fund transfers.[14]

In any event, decisions to deny market access are often discretionary, and as a result are difficult to attack. The recent banking advisories issued following the June 2000 FATF *Review of Non-Cooperative Countries or Territories*, for example, did not *preclude* market access but rather simply advised caution in dealing with institutions situated in centres deemed "un-cooperative". Another recent similar example of a decision which is difficult to review is the U.S. program designating "qualified jurisdictions" entitled to access U.S. security markets with reduced withholding tax compliance burdens. Some response and accommodation for the demands of the onshore countries and their agencies is accordingly appropriate and desirable, as a practical matter, if an OFC desires continued market access.

4. A Level Playing Field for International Financial Services?

Despite the fact that the changes are being demanded by the most powerful countries, brute force is not an acceptable means of achieving change. Accordingly, it is necessary for the OECD, in particular, to show just cause. This has proved to be more difficult than anticipated, mainly because it has become apparent that the offshore centres are being asked to adhere to the rules not universally observed by the members of the club (the OECD) seeking changes. The force in this contention has blunted the OECD initiative in particular, but applies equally to elements of the other initiatives.

Concerns about a level playing field for the OECD initiative have arisen in two principal contexts. The first emerged when the 1998 OECD *Report on Harmful Tax Competition* acknowledged and attacked, to its credit, harmful tax preferential tax régimes in *both* the onshore and offshore world. The latest report by the OECD, *Towards Global Tax Competition* tabled on June 26, 2000 listed (in paragraph 10) some 60 harmful tax preference régimes which continue to exist in OECD member states. Member States are exhorted in paragraph 15 to take steps to terminate harmful tax régimes by April 2003, but no co-ordinated sanctions against member states are proposed for those who do not comply.

Secondly, Switzerland and Luxembourg, both OECD members, dissented from the 1998 Report and continue to resist pressure to exchange information for tax enforcement purposes. The OECD appears to take the position that this dissenting view is *de minimus*, as twenty seven other countries approved the Report. However, this overlooks the fact that the non-cooperating OECD states are

[14] See Bruce Zagaris, "OECD Harmful Tax Competition Report and Related Initiatives Leave the Caribbean Offshore 'in Irons'", *Tax Notes Int'l* (21 August 2000) and *Caribbean Tax Havens Seek Refuge in the Arms of the WTO*, Financial Times, Tuesday 3 October 2000.

the principal onshore competitors for the offshore world, and account for the vast majority of the tax neutral structures run onshore within the OECD.

The OECD initiative purports to seek a common standard, universally applicable to all OECD states and co-operating OFCs. This should and must be the bedrock principle on which the initiative is based, as otherwise the credibility of the project suffers. To attain this goal, and acknowledge the need for transparency of process noted above, the OECD has now proposed a collective agreement which can be acceded to by any OFC through press release from a senior government official.[15]

Many of the terms in the new collective Memorandum of Understanding continue to pose difficulties for the OFCs, as they would for most countries, i.e., including OECD members. In view of the OECD commitment to a level playing field, the OECD must require their member countries to sign the collective Memorandum of Understanding if their request for adherence by non-member countries is to retain credibility.

Representatives of more than forty jurisdictions including OECD and Commonwealth countries met in Barbados on 8-9 January, 2001 to discuss a mutually agreed process for responding to the harmful tax initiative. A joint working group composed of representatives from the Commonwealth, Caricom, the Pacific Islands Forum and OECD countries and territories was created to review the issues of transparency, non-discrimination and effective exchange of information. The working group will be co-chaired by Australia and Barbados. The provisional list of members also includes Antigua and Barbuda, the British Virgin Islands, the Cook Islands, France, Ireland, Japan, Malaysia, Malta, the Netherlands, the United Kingdom and Vanuatu. The OECD has indicated that this process, if successful, would replace the proposed OECD process set out in the Memorandum of Understanding[16]

5. The Current State of the Initiatives

The OECD, Harmful Tax Competition

Following publication of the 1998 Report, the OECD identified 47 jurisdictions as putative tax havens. Following representations, six of those were dropped before the 2000 Report was published. Shortly before publication of the 2000 Report an additional six of the identified havens entered into an *advance commitment* to make domestic changes in support of the OECD Harmful Tax Initiative. These jurisdictions were Cayman, Bermuda, Cyprus, Malta, Mauritius and San Marino. The OECD announced on the 13 December 2000 that it has now reached agreement with the Isle of Man and the Netherlands Antilles. The remaining 35 jurisdictions on the list are, according to the current terms of the Project, subject to sanctions if no agreement is reached with the OECD by June 2001. (See list of classified jurisdictions in Appendix A.)

[15] The OECD remains willing to proceed by way of a bespoke bilateral agreement with a particular OFC. However, any future agreements must be made public.

[16] OECD news release – *Commonwealth Agree to Work towards Global Co-operation on Harmful Tax Practices*, 10 January, 2001.

The OECD published the cover letters from the advance commitment jurisdictions on the internet[17] but not the actual text of the accompanying agreements. Accordingly the deals struck with the advance commitment jurisdictions remain confidential, unless disclosed at the option of the relevant jurisdiction. Undisclosed deals are inappropriate and disruptive in a project designed to be premised on fairness and transparency.

There have been a number of changes from the initial stance set out in the 1998 Report, as follows:

- First, the OECD is *no longer suggesting that offshore centres must impose income tax*.[18] This is fair and crucially important to the OFCs as it preserves the competitive advantage of the OFCs in offering a tax neutral environment. Interestingly, this concession implies the fairness of an obligation placed on the OFCs to co-operate with tax information exchange on criminal matters, as this is a means of showing reciprocal respect for the tax systems extant in the onshore countries.

- Secondly, the OECD now accepts (at the level of the Secretary General) that their initiative is properly limited to *tax evasion and illegal tax avoidance.*[19]

- Thirdly, the OECD accepts, in principle, that the OFCs are entitled to demand a *level playing field*[20]. This means that the OFCs are entitled to insist that their commitments should reflect adherence to a common standard, universally adopted by all onshore centres and all non-sanctioned offshore centres. Importantly, this addresses a principal concern of the offshore centres, by limiting the risk of erosion in the competitive position of any particular OFC as against any other competing international financial centre (onshore or offshore).

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[17] See *www.oecd.org*.

[18] The 1998 OECD Report implied that countries which did not impose an *income* tax were for that reason alone engaged in harmful tax competition. Thus, the 1998 Report stated in paragraph 26 that "countries should remain free to design their own tax systems, *[only] as long as they abide by internationally accepted principles in doing so.* (italics added). The 2000 OECD Report, by contrast, explicitly acknowledged in the Executive Summary that "the [harmful tax competition] project is not primarily about collecting taxes and is not intended to promote the harmonisation of income tax rates or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates"

[19] The 1998 Report confused observers with a reference to the concept of *tax escape*, a new term in the tax lexicon which appeared designed to blur the line between tax evasion and tax avoidance. Was the OECD taking issue with the legitimacy of all tax planning, including that conducted within the law? The OECD position has become more reasonable since. In remarks of the "High Level Symposium on Harmful Tax Competition" in Paris held on the 29-30 June 2000, Donald Johnston, Secretary-General said:

> "I would like to be clear at the outset that *the focus of the OECD's work and our discussion today is tax evasion and illegal tax avoidance* (italics added). I personally was a tax lawyer for many years and I know these definitions can be tricky. Tax evasion is easy : it involves breaking the law. By "tax avoidance" OECD means "unacceptable avoidance" where the taxpayer has circumvented or even subverted the law in order to avoid paying taxes due. *This can be contrasted with acceptable tax planning*. What is critical is transparency.

[20] In *Towards World Tax Co-operation, OECD Observer* (27 June 2000) Jeffrey Owens, OECD Head of Fiscal Affairs reviewed the OECD's demands for transparency and a reduction in Harmful Tax Competition and then stated:

> "And let me emphasise that it is going to be the same standards for all member countries and non-member countries."

The reasonableness of the OECD is based, in part, on pragmatism. The OECD has some difficulties with their own position as follows:

- There is a plethora of preferential tax régimes in OECD Member States over 60 being listed in the 2000 Report. (The Primarolo Report drafted in a parallel E.U. initiative published on 28 February 2000 listed 200 similar régimes in Member States and a further 85 régimes in dependent or associated territories[21]).

- Secondly, the OECD faces reluctance by two of its own Member States, Switzerland and Luxembourg, to exchange financial data. Switzerland is a decentralised federal state and, even if the Federal Council were minded to negotiate on this point, there are cumbersome constitutional limitations on its ability to agree on measures to negotiate on bank secrecy.

- Thirdly, the ultimate success of the OECD initiative depends on imposition of sanctions on OFCs that refuse to comply. Sanctions are, effectively, restrictions on access to onshore banking and securities markets. Such denial of access will hurt the country imposing the sanctions through a loss of business when the doors are closed to particular jurisdictions. If all countries do not agree to impose sanctions in a co-ordinated fashion, the OECD initiative could unravel. No doubt it is in part for this reason that the OECD has articulated the goal of having concluded agreements with all listed jurisdictions so that there are no OFCs left to sanction by the June 2001 deadline.[22]

- Fourthly, there is some evidence that OECD resources are strained by their heavy workload in the Harmful Tax project, and there are understandable concerns about their role at the vortex of what has become a political minefield[23]

The OECD now seeks agreements from the putative tax havens with elements as follows:

1. *Criminal information exchange*: The OECD seeks procedures for efficient administrative exchange of reliable financial data by 2004, achieved through treaties with OECD member countries.

The Bahamas Position: The "level playing field" principle indicates that the appropriate standard is the one unanimously agreed by OECD members in paragraph 21[24] of the OECD's April 2000

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[21] EU Code of Conduct (Business Taxation)/Primarolo Group Report to ECOFIN council, Annex A (Description of listed measures).

[22] See OECD News Release Dated 19 October 2000 wherein Philip West, until recently International Tax Counsel at the US Treasury and co-chair of the OECD forum is quoted as saying "Our ultimate goal is to have a list of unco-operative tax havens with no names on it".

[23] *OECD Calls for More Funds for Tax Haven Probe*, Daily Telegraph, Monday October 30, 2000

[24] Paragraph 21 of the OECD Report on *Improving Access to Bank Information for Tax Purposes* reads as follows: The Committee on Fiscal Affairs encourages Member countries to:

(a) undertake the necessary measures to prevent financial institutions from maintaining anonymous accounts and to require the identification of their usual or occasional customers, as well as those persons to whose benefit a bank account is opened or a transaction is carried out. The committee will rely on the work of the Financial Action Task Force in ensuring the implementation of these measures by Member countries;

(b) re-examine any domestic tax interest requirement that prevents their tax authorities from obtaining and providing to a treaty partner, in the context of a specific request, information they are otherwise able

Report on *Improving Access to Bank Information for Tax Purposes*. The Bahamas is likely to agree to this emerging standard for the exchange of criminal tax information. Given the parameters of paragraph 21, this obligation would be limited to exchanging information in circumstances involving the following:

- a specific request
- in respect of deliberate conduct
- which is subject to criminal tax prosecution

2. *Civil tax information exchange*: the OECD seeks procedures in place for efficient administrative exchange of "civil" tax data by 2006. Once again, this would be limited to circumstances where there is a specific request.

The Bahamas Position: OECD Member States are not agreed on this, so the OECD request for this does not observe the "level playing field" principle. The Bahamas is prepared to engage in multilateral discussions with OECD member countries and co-operating OFCs to achieve this goal.

3. *Access to ownership and financial data*: The OECD seeks effective government access to locally maintained information regarding beneficial ownership and financial statements for companies and trusts to facilitate the requested exchange of tax data.

The Bahamas Position: Service providers for IBCs and licensed trustees of trusts will be obliged to know beneficial ownership for such structures. IBCs will be required to follow general record keeping requirements applicable to domestic Bahamian companies. Such information would be accessible to local authorities, on specific request, when required.

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to obtain for domestic tax purposes with a view to ensuring that such information can be exchanged by making changes, if necessary, to their laws, regulations and administrative practices. The Committee suggests that countries take action to implement these measures within three years of the date of approval of this Report;

(c) re-examine policies and practices that do not permit tax authorities to have access to bank information, directly or indirectly, for purposes of exchanging such information in tax cases involving intentional conduct which is subject to criminal tax prosecution, with a view to making changes, if necessary, to their laws, regulations and administrative practices. The Committee acknowledges that implementation of these measures could raise fundamental issues in some countries and suggest that countries initiate a review of their practices with the aim of identifying appropriate measures for implementation. The Committee will initially review progress in this area at the end of 2002 and thereafter periodically.

The Committee notes the international trend to increase access to bank information for tax purposes. In the light of this trend, the Committee encourages countries to take appropriate initiatives to achieve access for the verification of tax liabilities and other tax administration purposes, with a view to making changes, if necessary, to their laws, regulations and administrative practices. The Committee intends to engage in an on-going discussion, within the constraints set out in the preface, to promote this trend."

4. *Not attracting business without substantial domestic activity*: The OECD requests that entities qualifying for preferential tax treatment should be permitted to carry on business in the local market and should be capable of being owned by local residents.

The Bahamas Position: There is no income tax in the Bahamas, so there are no income tax concessions favouring foreigners. The Government is nevertheless prepared to permit Bahamian IBCs to carry on business locally, and to permit locals to own IBCs, subject to the usual exchange control consents.

The Financial Action Task Force - Counter Money Laundering

The former IMF Managing Director, Michael Camdessus, has estimated that the volume of cross-border money laundering is between 2 and 5 percent of the world's gross domestic product.[25] Although money laundering by its nature defies detection, this suggests that U.S. $600bn is laundered annually through the world's financial system.

The Financial Action Task Force was established by the G7 summit held in Paris in 1989. The FATF examines money laundering techniques and trends and sets and communicates standards for combating such activity. The FATF was established with 16 member countries, and now has 29 members.[26] Regional bodies such as the Caribbean Financial Action Task Force support the work of the FATF.

The FATF published a report on June 22, 2000 entitled *Review to Identify Non-Cooperative Countries or Territories.* That report was preceded by a review of twenty-nine jurisdictions over a four month period to analyse anti-money laundering régimes. A number of other jurisdictions have not been reviewed or rated. *More than half* of the reviewed jurisdictions were identified as "un-cooperative". (See Appendix A). The FATF has announced plans to review additional jurisdictions shortly. There have been suggestions from informed sources that "the number of countries targeted next year by the FATF is likely to be nearly as high as the 15 named this year"[27].

The FATF labels the offshore jurisdictions that it sees as requiring improvement as "non-cooperative". This description is inapt in many cases, as it suggests that the jurisdiction is being deliberately obstructive. While there are issues of *adequacy* in the régimes of a number of offshore centres (as there are in many onshore centres[28]), there is little doubt about the desire of most offshore centres to *co-operate* to eradicate money laundering.

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[25] *U.S. National Money Laundering Strategy for 2000*, pages 6-7.

[26] The twenty-nine FATF member countries and governments are: Argentina; Australia; Austria; Belgium; Brazil; Canada; Denmark; Finland; France; Germany; Greece; Hong Kong; China; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; Singapore; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States.

[27] Former Deputy Secretary of the US Treasury, Stuart Eizenstat, reported in *Blacklist Leaves a Mark on Money Laundering*, Financial Times, December 5, 2000

[28] Proposed adoption of "know your customer" regulations that would have required banks and thrifts to investigate customers' identities and monitor their transactions were withdrawn by US federal regulators on 15 March 1999. The withdrawal followed receipt of more than 200,000 complaints regarding the spreading burden, cost and intrusions of government. See Bruce Zagaris, *The Assault on Low Tax Jurisdictions*, April 1999. Counter money

The FATF did not articulate standards at the time of their review for removal of jurisdictions from the non-cooperative list. However, the FATF is taking the position that only legislation which is passed and currently in force will be taken into account. FATF has advised that while technical help is available, such help is provided only *after* legislation has been adopted. This is curious, of course, since one would expect that the FATF would value consistent, quality legislation to address issues in a comprehensive fashion. The current process appears to place a premium on speed, rather than the quality of the response. This would seem to be at odds with the FATF's goal of designing a robust and comprehensive global scheme for the interdiction of money laundering activity.

The FATF plenary in October 2000 considered, among other matters, the progress of countries on their non-cooperative list. No jurisdictions were removed from the FATF list at that plenary, including those with hastily adopted legislation. It now appears that the FATF has added the requirement of a track record for administration of counter-money laundering legislation before removal from the list will be considered.

Financial Stability Forum

The Financial Stability Forum was established pursuant to a G-7 initiative in early 1999. At its inaugural meeting on 14 April 1999 the Forum established an OFC working group chaired by John Palmer, Superintendent of Financial Institutions, Canada. The purpose of the group was to consider the role of OFC banks in the stability of the world's financial system.

The mandate of the working group was as follows[29]:

- to consider the uses of OFCs and the possible role they have had or could play in posing threats to the stability of the financial system;

- to evaluate the adherence of OFCs to internationally accepted standards and good practices; and

- to make recommendations, including to enhance problematic OFC's observance of international standards.

In conducting its mandate the FSF was primarily concerned with the activities of the OFC banks in two areas as follows:

- *prudential concerns,* relating to the scope for effective supervision of internationally active financial intermediaries; and

- *market integrity*, relating to the effectiveness of international enforcement efforts in respect of illicit activity and abusive market behaviour.

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laundering legislation was also dropped in October in response to lobby efforts. See October 2, 2000, Dow Jones Newswires *US House Measure To Fight Money Laundering Probably Dead.*

[29] See Financial Stability Forum Report at p 6, *supra* at note 1.

An interesting and well-researched report was tabled by the working group on 5 April, 2000. The report contained a number of observations on the role and workings of the offshore world and concluded with an evaluation of the existing calibre of regulation in a number of OFC jurisdictions. (See Appendix A.) Not surprisingly, the report concluded that the enhanced acceptance and implementation of international standards by OFCs would address many of the concerns raised about OFC regulation.

The FSF classified OFCs into three groups as follows[30]:

- The **first group** are jurisdictions generally viewed as co-operative jurisdictions with a high quality of supervision, which largely adhere to international standards.

- The **second group** of OFCs are jurisdictions generally seen as having procedures for supervision and co-operation in place, though actual performance falls below international standards, and there is substantial room for improvement.

- A **third group** of OFCs are jurisdictions generally seen as having a low quality of supervision, and/or being non-cooperative with onshore supervisors, and with little or no attempt being made to adhere to international standards.

The majority of OFCs (25 jurisdictions, including The Bahamas) were placed into category three, with nine and eight, respectively being placed in categories two and one.

The Prime Minister of The Bahamas, the Minister of Finance and the Governor of the Central Bank met with Andrew Crockett, Chairman of the FSF in early October to consider a co-operative approach to keep pace with emerging practice for regulation of international financial centres. The Government indicated that it was committed to the adoption of administrative and legislative steps to strengthen the regulation of the financial sector.

In view of these commitments and other discussions with the supranationals, wide ranging changes to legislation regulating the financial sector were passed by The Bahamas Parliament during 2000. These changes follow detailed benchmarking of the legislation of a number of onshore and offshore international financial centres. Recently adopted Bahamian legislation includes:

- A new *Financial Intelligence Unit Act, 2000;*

- A new *Proceeds of Crime Act, 2000;*

- A new *Criminal Justice (International Co-operation) Act, 2000;*

- A new *Banks and Trust Companies Regulation Act, 2000* to repeal and replace the former *Banks and Trust Companies Regulation Act* and the *Banks Act;*

- A new *Financial Transactions Reporting Act, 2000;*

[30] See Financial Stability Forum report at p 46, *supra* at note 1.

- A new *Central Bank of The Bahamas Act, 2000* to repeal and replace the former *Central Bank of The Bahamas Act;*

- A new *Financial and Corporate Service Providers Act, 2000;*

- A new *International Business Companies Act, 2000* to repeal and replace the *IBC Act* of 1989.

Conclusion

The remarkable success of the world's offshore centres has invited scrutiny from onshore governments and their agencies. A chorus of overlapping demands for change have followed, so much so that the offshore centres now suffer from "initiative fatigue".

Offshore centres rely on access to onshore clients, banking and securities markets for their success. Countries which provide such facilities are in a position to restrict access for jurisdictions perceived to be unruly customers. Such decisions are open to challenge, but the prospects for that are cumbersome and uncertain, particularly where the decisions involve discretionary elements determined behind closed doors.

A constructive response to the reasonable concerns of onshore countries is essential for any OFC, unless it is prepared to unplug from the international grid. Responsible OFCs will take steps to ensure that their service providers refrain from disrupting the fiscal systems of high tax countries by inviting tax evaders to establish in the jurisdiction. OFCs must also be prepared to devote resources and provide active assistance in the international fight against money laundering.

Onshore countries and their agencies, in turn, should recognise that they will be judged by the fairness of their demands and process. At minimum, this means that *there must be a level playing field for all parties*; OFCs need to know that the same rules will be applicable to all. It is not sufficient to say that *most* members of the club (i.e. the OECD) adhere to the rules demanded. This is particularly so where the dissenting voices emanate from those jurisdictions which compete most effectively with the offshore world. In all of this change, OFCs will retain the great advantage of being able to transact business in a tax neutral fashion. Competitive pressures and the international initiatives will encourage the leading offshore jurisdictions to meet the regulatory and commercial sophistication of the onshore international financial centres. The offshore centres which respond deftly to the pending changes are likely to find themselves occupying an increasingly successful role in the global economy.

	Organisation for Economic Co-operation and Development		Financial Action Task Force		Financial Stability Forum		
	Classified As Tax Havens		Anti-Money Laundering Review		Standards of Financial Regulation		
	Commitment Agreed	No Agreement yet with OECD	Rated but Not Censured	Non-Cooperative	I High	II Medium	III Low
Andorra		X				X	
Anguilla		X					X
Antigua and Barbuda		X	X				X
Aruba		X					X
The Bahamas		X		X			X
Bahrain		X				X	
Barbados		X				X	
Belize		X	X				X
Bermuda	X		X			X	
British Virgin Islands		X	X				X
Cayman Islands	X			X			X
Cook Islands		X		X			X
Costa Rica							X
Cyprus	X		X				X
Dominica		X		X			
Dublin (Ireland)					X		
Gibraltar		X	X			X	
Grenada		X					
Guernsey		X	X		X		
Hong Kong SAR					X		
Isle of Man	X		X		X		
Israel				X			
Jersey		X	X		X		
Labuan (Malaysia)						X	
Liberia		X					
Lebanon				X			X
Liechtenstein		X		X			X
Luxembourg					X		
Macau SAR						X	
Maldives		X					
Malta	X		X			X	
Marshall Islands		X		X			X
Mauritius	X		X				X
Monaco		X	X			X	
Montserrat		X					
Nauru		X		X			X
Netherlands Antilles	X						X
Niue		X		X			X
Panama		X		X			X
Philippines				X			
Russia				X			
St Kitts and Nevis		X		X			X
St Lucia		X	X				X
St Vincent & the Grenadines		X		X			X

Samoa		**X**	**X**				**X**
San Marino	**X**						
Seychelles	**X**						**X**
Singapore					**X**		
Switzerland					**X**		
Tonga		**X**					
Turks & Caicos		**X**					**X**
US Virgin Islands		**X**					
Vanuatu		**X**					**X**

OECD: *Towards Global Tax Co-operation*, dated 26 June 2000 (June 2001 deadline for agreement with OECD to avoid proposed sanctions)

FATF: *Review to Identify Non-Cooperative Countries and Territories*, dated 22 June 2000 (Additional jurisdictions now under review)

FSF: *Report of the Working Group on Offshore Centres*, dated 5 April 2000 (IMF now undertaking OFC assessment and assistance program)

	OECD countries which meet the tax haven criteria	**OECD advance commitment jurisdictions**	**FATF Co-op**	**FATF Non Co-op**	**FSF I**	**FSF II**	**FSF III**
Andorra	**X**					**X**	
Anguilla	**X**						**X**
Antigua & Barbuda	**X**		**X**				**X**
Aruba	**X**						**X**
The Bahamas	**X**			**X**			**X**
Bahrain	**X**					**X**	
Barbados	**X**					**X**	
Belize	**X**		**X**				**X**
Bermuda		**X**	**X**			**X**	
British Virgin Islands	**X**		**X**				**X**
Cayman Islands		**X**		**X**			**X**
Cook Islands	**X**			**X**			**X**
Costa Rica							**X**
Cyprus		**X**	**X**				**X**
Dominica	**X**			**X**			
Dublin (Ireland)					**X**		
Gibraltar	**X**		**X**			**X**	

Grenada	X						
Guernsey	X		X		X		
Hong Kong SAR					X		
Isle of Man	X		X		X		
Israel				X			
Jersey	X		X		X		
Lebanon				X			X
Liberia	X						
Labuan (Malaysia)						X	
Liehtenstein	X			X			X
Luxembourg					X		
Macau SAR						X	
Maldives	X						
Malta		X	X			X	
Marshall Islands	X			X			X
Mauritius		X	X				X
Monaco	X		X			X	
Montserrat	X						
Nauru	X			X			X
Netherlands Antilles	X						X
Niue	X			X			X
Panama	X			X			X
Philippines				X			
Russia				X			
Samoa	X		X				X
San Marino		X					
Seychelles	X						X
Singapore					X		
St Kitts & Nevis	X			X			X
St Lucia	X		X				X
St Vincent & the Grenadines	X			X			X
Switzerland					X		
Tonga	X						
Turks and Caicos	X						X
US Virgin Islands	X						
Vanuatu	X						X

X = jurisdictions which have been considered by the relevant Supranationals, and categorised as set out above.

0 = jurisdictions which were *not* considered by the relevant Supranationals

OECD: "Towards Global Tax Co-operation", dated 26 June 2000

FATF: Review to Identify Non-Cooperative Countries and Territories: Increasing The Worldwide Effectiveness of Anti-Money Laundering Measures, dated 22 June 2000

FSF: Report on the Working Group on Offshore Centres, dated 5 April 2000