Introduction

'Havens facilitate the plunder of public funds by corrupt elites in poor countries, which can represent a major barrier to economic and social development'. This observation which was made by Oxfam, reflects popular sentiment concerning the detrimental practices facilitated by Offshore Financial Centres (OFCs). However, OFCs are an integral part of the global economy albeit an integral part of each of the formal and informal economies. At their simplest, OFCs may be conceptualised as providers of financial services by banks and other financial institutions to non-residents. The definition provided by the International Monetary Fund (IMF) as to what constitutes an OFC is: 'a centre where the bulk of the financial sector is offshore on both sides of the balance sheet, (that is the counter-parties of the majority of financial institutions’ liabilities and assets are non-residents), where the transactions are initiated elsewhere, and where the majority of institutions involved are controlled by non-residents.' The IMF has also provided a typology that classifies offshore centres into three categories:

- International Financial Centres (IFCs): provide a complete range of financial services, have advanced settlement and payment systems, support large domestic economies with deep and liquid capital markets, and have a regulatory framework

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1 Policy Department of Oxfam (Great Britain), Tax Competition and Havens, from Oxfam’s Presentation for UN Financing for Development NGO Hearings (7 November 2000).
3 Ibid.
that is adequate to safeguard the integrity of their financial system. They include London, New York, and Tokyo amongst others.

- Regional Financial Centres (RFCs): have developed financial markets and provide a wide range of financial services, have advanced settlement and payment systems, and have a regulatory framework that is appropriate for the structure and nature of their financial system. However, RFCs tend to support smaller domestic economies and consequently act primarily as intermediaries for the flow of funds into and out of the region in which they are located. They include Bahrain, Hong Kong, and Singapore amongst others.

- OFCs: provide a range of specialised financial services to major financial institutions, have an adequate infrastructure, but limited resources to intermediate the flow of capital into the region in which they are located, tend to be lightly or flexibly regulated, have low or no taxes, and usually have bank secrecy laws that vary in their degree of rigour. OFCs tend to be small economies and while many financial institutions will register as being resident in these jurisdictions, these financial institutions will often, although not always, have little or no physical presence. They include Bermuda, Cayman Islands, and British Virgin Islands amongst others.

For the purpose of this thesis, RFC's such as Hong Kong and Singapore, are considered part of the OFC group. Hong Kong (also under threat from Shanghai) acts as the intermediary for capital flows in and out of China, from regional sources such as Taiwan and South Korea. Singapore, on the other hand, with its developed financial infrastructure, is the financial clearing house for funds from Indonesia to the south and Malaysia and Thailand to the north.
The money flowing through OFCs is considerable and for several OFCs these flows support a financial services industry that accounts for a significant portion of their Gross Domestic Product (GDP). Based on data provided by the Bank for International Settlement (BIS), the IMF has calculated that on-balance sheet cross-border assets held by OFCs in 1999 amounted to approximately US$4.6 trillion. An accurate assessment of the size of the OFC sector, however, remains impossible to calculate as the BIS is unable to collect accurate information. Smaller and more secretive OFCs do not submit information to the BIS. Meanwhile, OFCs do not tend to report information on the nationality of the associated lending and repository banks operating in their jurisdictions. At the same time, the BIS is usually unable to obtain information on off-balance sheet transactions concerning assets held by non-bank financial institutions. The effect of the incomplete nature of this information is to magnify the transparency problem. Lack of transparency has also meant that trade statistics for the global economy remain inaccurate as the trade accounts for individual countries do not reflect the real position of their economies. In turn, these inaccuracies can affect a country’s credit rating within the financial markets. Such inaccuracies, however, are nothing new for as long ago as 1984, the balance of trade statistics for the global economy indicated that the world was running a current account deficit with itself of US$100 billion. The important point is that a lack of transparency and accurate information on financial flows moving through the global economy makes questionable, detrimental, and nefarious activities, considerably more

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5 Ibid.
6 Ibid.
7 It also contributes to volatility in short term financial flows, which can have destabilising influences on the global economy. In this respect, see the work of Financial Stability Forum (FSF), Report of the Working Group on Capital Flows (2000) <http://www.fsforum.org> at 25 April 2003.
difficult to detect. Where opacity prevails, abuse of the financial services offered in the formal economy by actors in the informal economy becomes possible, while it is through this exploitation that the formal and informal economies become entwined.⁹

While the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the United States Senate has expressed concern about OFCs, the Committee on Banking and Financial Services of the House of Representatives has recognised that the services offered by OFCs can also be put to legal and beneficial purposes.¹⁰

Not all offshore financial centres are havens for money laundering, of course, and indeed, there are many legitimate reasons for corporations and citizens from other countries to transact business in such jurisdictions, including minimisation of tax exposure, freedom from exchange controls, and concerns over personal privacy or security. Offshore financial centres are also an integral part of a capital markets system in which funds are transferred electronically around the globe in search of the highest rate of return.

In respect of the Committee’s comments, some of these legal and beneficial purposes include the following. First, the low tax regimes offered by OFCs can be used to optimise profits by minimising income, corporate, withholding, and other taxes. Second, financial structures can be created that allow financial institutions to make better use of their capital by minimising the impact of requirements that obligate them

to hold capital in reserve on their balance sheets. Third, the company formation and management facilities provided by OFCs can be used to add flexibility to corporate structures. Fourth, secrecy and confidentiality provisions embedded within the laws of OFCs mean that companies can protect proprietary information, for example, by creating companies in these jurisdictions to hold intellectual property and other assets that are sensitive to public exposure. Fifth, the flexible regulatory regimes offered by OFCs can be used to avoid foreign exchange and capital controls and other obstacles that hinder trade. While they may be the most noteworthy services offered by OFCs, financial secrecy services are not the most important. Even if financial secrecy laws were eliminated in all OFCs tomorrow, the financial activity being routed through these jurisdictions would still be substantial. The Cayman Islands and its prominent position within the financial markets typifies the viable and profitable role which OFCs perform, having signed the Tax Information Exchange Agreement with the US in November 2001, to provide for exchange of information upon request, in respect of criminal and civil tax matters.\footnote{Hinterseer, above n 9, 229.}

It is in the context of these benefits that this thesis has its origin. OFCs are an indelible part of the international financial framework. Given the recent developments that seek to counter the perceived threat to the Organisation for Economic Cooperation and Development (OECD) economies, it is useful to identify an OFC which meets the requirements of the various groups concerned about OFCs. This thesis argues that, following a close examination of the requirements of the different initiatives, Singapore can be shown to meet those requirements. That and other advantages make Singapore a compliant jurisdiction of choice.
In order to determine what is an effective OFC, it is important to examine the different aspects of an OFC. Chapter 1 explores the nuances of the terminology and provides a current definition of an OFC. It goes on to distinguish offshore from other centres, provides an insight into the features of an OFC and gives examples of different OFCs.

From Chapter 1 it is evident that there would be concerns among developed economies about some features of OFCs. Chapter 2 provides the background to the various supranational directives that have arisen in response to these concerns about havens of low taxes, secrecy and money laundering. The OECD’s intentions were made known by the *Harmful Tax Competition: An Emerging Global Issue* report\(^\text{12}\) which was first released in 1998 and which was followed by 3 reports\(^\text{13}\) tracing the progress of the project to reduce harmful tax competition. The Financial Action Task Force (FATF) was involved through its issue of 40 recommendations in 1998 which aimed at combating money laundering. Since then, the FATF has released 4 reviews, one in each of the years 2000 to 2003,\(^\text{14}\) tracing the developments and updating the list of non-cooperative countries and territories to its anti-money laundering recommendations. The Financial Stability Forum (FSF) recognised the lack of financial infrastructure and co-operation which made some OFCs open for abuse and illegal activity. Its main aim in increasing transparency and adhering to international


financial regulatory standards was represented by its Report of the Working Group on Offshore Centres, which was delivered to the FSF’s secretariat on April 5, 2000.\textsuperscript{15} As illustrated in Chapter 2, the concerns of the FSF overlap some of OECD’s and FATF’s. Noticing the importance of these three supranational organisations, the private financial and banking sectors sought to improve their regulations such that they fell in line with the OECD, FATF and FSF, through the Wolfsberg Anti-Money Laundering Principles.\textsuperscript{16} These principles were initiated by 11 banks and were made with the FATF’s Recommendations in mind, with the slight difference that the parties involved are not countries, but banks.

While Chapter 2 discusses the measures undertaken by the supranational organisations, Chapters 3 and 4 present the four issues which are the focus of those measures: harmful tax practices, money laundering, offshore confidentiality and disclosure of information. Some or all four factors are evident in the OFCs. Chapter 3 examines harmful tax practices, tax evasion and money laundering, revealing the pace of the OECD’s project to curb harmful tax practices and the introduction of The USA Patriot Act\textsuperscript{17} which allowed easier access to foreign-based records in the US with the intention to stamp out tax evasion and money laundering. Chapter 4 examines offshore confidentiality, which is one of the key characteristics of OFCs and the exchange of information between OFCs and the countries whose citizens own assets in the OFCs. As this involves cross-border issues, the principles of comity and sovereignty are discussed.

\textsuperscript{17} The full title of the act is 'Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001'.
Chapter 5 presents the responses of principal OFCs to the OECD’s and FATF’s claims that they are tax havens and are open to illicit behaviour and exploitation through money laundering. Investigations into the OFCs reveal regulations to prevent the very concerns which the OECD and FATF have stated in their reports. All this has been done without compromising the confidentiality pledged to investors. This chapter also reveals the responses of OFCs to the OECD’s unflattering report of their involvement in harmful tax practices. Several issues are examined, such as: lack of involvement in the discussions of the subjects which were being reported; the uneven examination of the OFCs and OECD member countries which have similar characteristics of an OFC; the possibility of undermining sovereignty of the OFCs, which weakened the OECD report; and the demonstrated intention of the OFCs to prevent money laundering and harmful tax practices through law and regulations while protecting the confidentiality of their clients.

Chapter 6 analyses Singapore, which is another alternative to an OFC, with its compliant jurisdiction in place to adhere to the OECD’s views against harmful tax practices, the FATF’s aim at preventing money laundering and the Wolfsberg Principles practiced by the branches of the 12 major international private banks (ABN AMRO Bank N.V., Bank of Tokyo-Mitsubishi Ltd., Barclays Bank, Citigroup, Credit Suisse Group, Deutsche Bank AG, Goldman Sachs, HSBC, J.P. Morgan Private Bank, Santander Central Hispano, Société Générale and UBS AG) represented in Singapore. Fortified by law and regulations, the sound financial infrastructure is recognised by the growing amount of assets under management of the banking and financial sector of Singapore. The vote of confidence by foreign investors continues to strengthen in the island Republic.
However, the latest June 2004 report by OECD entitled *A Process for Achieving a Global Level Playing Field*ª seeks to prevent this migration of business, and thus will pose a challenge that is to be addressed by Singapore and the other named significant financial centres.ª

Chapter 7 concludes this thesis with a summation of the four identified major concerns of the OECD and FATF. Harmful tax practices, money laundering, confidentiality and exchange of information were discussed extensively in their reports. In response, the OFCs have presented regulations which are in place or are being drafted to nullify the accusation of being a harmful tax haven for money laundering and other illicit activities. The thesis concludes that Singapore is emerging as the new jurisdiction of choice for global wealth management. Singapore has in place the required infrastructure of a RFC, yet it has remained focused on the OECD’s and FATF’s recommendations against harmful tax practices and money laundering, all the while respecting the confidentiality of the investors.

Why is this thesis significant? As a result of the supranational initiatives being applied, new rules by the regulatory bodies are being formulated to facilitate the cross-border exchange of financial information. These new rules fuel concerns that information is being collected and exchanged without regard for financial privacy and human rights. Public scepticism is rife concerning the ability of governments to prevent unauthorised access to information and to resist the temptation to access such


º Besides Singapore, the other significant financial centres named are: Andorra, Barbados, Brunei, Costa Rica, Dubai, Guatemala, Hong Kong-China, Liberia, Liechtenstein, Macao-China, Malaysia (Labuan), Marshall Islands, Monaco, Philippines and Uruguay.
information for political, economic or other purposes. There are also concerns that information is being collected in an indiscriminate, rather than risk-based, manner.

To date, these new rules are being shaped solely by the developed countries, more specifically, members of the OECD, which seek to maintain control over this segment of the global economy. Offshore financial centres which are not members of the OECD ("Non-OECD OFCs"), the small and developing economies ("SDBs"), and trust and estate professionals, feel that they have been relegated to a subordinate role in the formulation of these rules.

There is uncertainty about a process for change controlled by the dominant participants in the global market for financial services. In particular, a flawed process premised on a restricted perspective will lead to flawed conclusions and fail to achieve the stated objectives of all parties. Business will simply migrate to jurisdictions overlooked or excused from full compliance with the new rules. There is a counterview that calls for new regulation premised on a truly level playing field, one in which all countries conducting cross-border financial services participate on an equal basis in setting the new standards which will affect them.

Trade in services is a rapidly expanding component of global trade. Many of the smaller jurisdictions competing with the OECD member countries in the provision of international financial services already have regulatory environments which meet or exceed standards existent in OECD member countries. The design of global rules for the conduct of trade is more universal for supranational bodies such as the World
Trade Organisation (WTO) which utilises processes developed to lessen inequities being imposed on smaller and developing countries.²⁰

There has also been a shift in emphasis in the structure of the offshore world and market environment for regulators, advisors and company and trust service companies. In the late 1990’s and especially in the 21st century, the move to fewer, better offshore financial centres has gathered pace. The legislative and supervisory changes required by international agencies have, in fact, created a more transparent and more professional regime. Those centres which remain in five years will embody leading edge approaches to regulation and service development.

One of the more evident trends of the past five years has been the emergence of low tax rather than no tax jurisdictions. Even though the Isle of Man and Gibraltar have committed to a zero-based corporate tax environment, for the vast majority of OFCs the reality of acceding to the will of the OECD, the IMF, the European Commission (EC) and the FATF has been that zero tax is no longer on the agenda.

For the more diverse and experienced centres like Jersey, the Isle of Man, Guernsey, Singapore and the Bahamas, participating in the formulation of internal regulation represents a future of greater co-operation where information may be exchanged, more business is referred and the world becomes somewhat less hostile. A key selling point of these jurisdictions is the modernity of their regulation. They have moved in a

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few short years from an absence of any regulation to becoming vibrant examples of creative and appropriate regulation.\textsuperscript{21}

All seriously-minded OFC's today demonstrate an independent regulator, usually in the form of a financial services commission, with a financial intelligence unit to handle suspicious transactions reports. What will distinguish offshore centres in the future is not the quality of their regulation – as that is a prerequisite. Instead it will be the quality of service provision, the diversity of talent – the depth in the advisory community, and creativity and innovation in products and services.\textsuperscript{22}

This thesis sets out the initiatives introduced by the supranational agencies, the issues that these reports highlight, and the regulatory responses by the leading OFCs.

The conclusion, as Reynolds\textsuperscript{23} has identified, is the emergence of Singapore as a financial centre with the attributes of an OFC, the credibility of an IFC and the depth of financial and legal infrastructure and innovative legislation to attract the second largest amount of managed funds outside of Switzerland. The thesis of this study is that Singapore is now becoming the new global wealth management centre for investors.

Sound fundamentals have inspired confidence in Singapore as a wealth management centre. Socio-political stability, a strong domestic economy, a clean and efficient legal infrastructure, best practice in financial sector regulation and supervision standards,

\textsuperscript{21} Guernsey is a good example. When the UK's Financial Services Authority failed to act on the split capital scandal it was the Guernsey Financial Services Commission which blew the whistle. Bob Reynolds, 'Editor's Notes' (2003) 8 Offshore Red: An OFC News Update, 129.
\textsuperscript{22} Ibid.
\textsuperscript{23} Ibid.
and a ready pool of experienced professionals have attracted the world’s top 20 private banks and more than 30 of the top 50 US and European fund managers to set up in Singapore, serving Asia and beyond.\textsuperscript{24}

Chapter 1: What Is Offshore

1.1 Introduction

This chapter sets out to define what is an offshore financial centre. With a clear definition, description of an OFC’s features and examples of OFCs, it is possible to understand the background to the supranational initiatives against OFCs.

The term “offshore” was used originally to refer to the tax havens off the shores of the United Kingdom and the United States, and by extension to any company or trust located in a tax haven or a country where tax could be kept low. In the context of financial transactions, the term ‘offshore’ refers to transactions which take place between non-residents. By this definition ‘offshore transactions’ can take place in any jurisdiction, but as a result of their fiscal and secrecy rules, some jurisdictions attract a very high number of offshore transactions and offshore banks, and have thereby become known as offshore financial centres.\(^{25}\)

Spitz asserts that the main new development is the amount of money offshore and the vast increase in the number of persons participating in offshore activities. He states that, never before have so many offshore companies and trusts been set up or have so many expatriates changed residence for purely fiscal reasons. His second point is that, there is the increase in the number of countries offering tax haven or finance centre possibilities. In particular, he states the seeming high tax jurisdictions are actively seeking new “offshore” business. His third point is that, the offshore area is found to

be widening its scope of offshore transactions and operations. Spitz argues that the esoteric is becoming more and more commonplace, and there is an ongoing merging of onshore and offshore. 26

1.2 Scope of Offshore

Offshore goes well beyond tropical islands. Barker reports some interesting statistics. 27 There are now almost seventy offshore financial centres in the world, many within the jurisdiction of major economic powers with ostensibly high levels of taxation. The sums involved are huge. For example, the Cayman Islands is reported to be the fifth largest banking centre in the world, having approximately 580 banks (with $500 billion28 in holdings), 2,238 mutual funds, 499 insurance companies and 40,000 offshore entities in total. The Bahamas is also another major centre, with sixty insurance companies, 580 mutual funds, 418 banks and 100,000 offshore entities in total. The Channel Islands and the Isle of Man have approximately $525 billion in foreign-owned assets. Financial services account for 80% of Isle of Jersey's income, the minimum non-resident account being $100,000. Switzerland, the world's largest private banking centre is managing about US$1.2 trillion of offshore assets while Singapore's offshore funds are estimated at US$120 billion. 29 In all, statisticians estimate that about $8 trillion worldwide is invested in offshore accounts and entities. 30

28 For all currency mentioned in the thesis, unless otherwise specified, it is in United States dollars.
30 Barker, above n 27.
1.3 Terminology: Offshore and Tax Havens

The term “offshore financial centre” or OFC, is now the more “politically correct” term for what used to be called a “tax haven”. However, the difference in vocabulary does make the important point that a jurisdiction may provide specific facilities for offshore financial centres without being in any general sense a tax haven.31

Chetcuti’s paper, Compliance vs. Competitiveness: Adapting to the new international legal order shows the difficulty in defining the terms, ‘tax havens’ and ‘offshore financial centres’.32 He asserts that, not only countries which we usually call ‘tax havens’ engage in the provision of offshore financial services. While London, New York, Frankfurt and Tokyo are among the largest offshore financial centres, Chetcuti states that none of these deserves the nomenclature of ‘tax haven’. Nor are these centres typically regarded as OFCs. The difficulty of definition is evident from the recent discrepancies present in the various rankings or black lists issued by the OECD, FATF and the Financial Stability Forum (FSF).

In an attempt to narrow the scope of the definition, many have sought to define an OFC as a financial centre where the larger part of the financial service activity carried on is in respect of non-residents. Nonetheless, in absolute terms more offshore business can be expected to be undertaken through London or New York than the OFCs so more narrowly defined. Then there is the problem of categorising centres

31 Spitz, above n 26, 4.
such as Luxembourg and Switzerland who dislike the "offshore" label given them by the G8\textsuperscript{33} and FSF. There are also substantial differences between well established centres such as Hong Kong, Singapore, Jersey, Guernsey and the Isle of Man, which can be compared with Luxembourg and Switzerland in the range and level of financial services provided, and islands in the Pacific and Caribbean which engage in providing financial services to non-residents on a much more limited scale and with a much narrower range.

Irrespective of definition, the trend internationally is to distinguish "not between onshore and offshore centres, but between centres which comply with international standards and those which do not."\textsuperscript{34}

The majority of the offshore financial centres world-wide are 'have-not' countries that rely on financial services to provide them with much needed employment and tax revenues resulting from foreign company registration, bank services and trust management. A concerted effort by the developed nations to curtail these activities will most certainly hamper these developing nations in their effort for financial autonomy and political sovereignty.\textsuperscript{35}

The differences between offshore countries and home countries have also become blurred. In the struggle between states to attract investment in the face of high business costs (whether the costs be associated with expensive labour in developed countries or with lack of infrastructure in developing countries), many high tax

\textsuperscript{33} Group of Eight, which consists of Canada, France, Germany, Italy, Japan, Russia, United Kingdom and United States.  
\textsuperscript{34} Chetcuti, above n 32.  
jurisdictions act like tax havens, offering low tax burdens as an incentive to business. For instance, after lower tax or incentive countries attracted a substantial share of the world's shipbuilding (and the jobs associated with shipbuilding) away from home countries, many home countries began offering tax incentives in an attempt to lure the shipbuilders back.\(^\text{36}\)

1.4 Role of Tax Havens in International Finance

Regardless of the factors which influenced the development of the individual tax havens, all of those centres have become production interfaces linked to, yet separate from, onshore world capital markets and invisible production centres. The establishment of a network of such centres\(^\text{37}\) has constituted a new secondary trading system that is global in scope, unlike the largely intra-continental systems that preceded it. Motivated by economics of convenience, these offshore havens have served as an international common property resource for trans-national private-sector business in at least five basic respects.\(^\text{38}\)

\[(i) \text{ As centres of domicile through which international companies can incorporate and operate commercial holding companies and overseas subsidiaries in the most advantageous fiscal climate subject to minimal exchange control.}\]

\[(ii) \text{ As holding companies, which are used predominantly to control industrial or investment companies by holding major shares, to finance companies in a group by generating funds through the floatation of bond issues, and, not least, to receive dividends, interest, or royalty and licensing payments.}\]

\(^{36}\) Spitz, above n 31, 5.

\(^{37}\) Whether based on the Euromarkets or trans-national banking.

(iii) As locations from and through which to exploit international capital and money markets with a greater freedom of action than might be feasible from their countries of origin. Eurobonds create an urgent need for the services of countries with favourable tax legislation, such as an absence of withholding tax on interest and dividends, regardless of the bondholder's residence. Because Eurobonds are bearer securities that protect the anonymity of the holder, this is particularly important for the growing category of Eurobond investors who have taken care to arrange their affairs so that they escape liability to tax anywhere.

(iv) As secure havens for international earnings, savings, and pools of liquidity for investment in a tax-neutral environment.

(v) As assembly centres for components produced externally in on-shore centres and re-exported on-shore, through free trade zones.

Hence, OFCs have found themselves under attack. They are accused of introducing practices designed to encourage non-compliance with the tax laws of other countries. More specifically, they have been accused of allowing themselves to be used to hide drug money, for tax fraud, for the circumvention of foreign inheritance laws and for money laundering and the promotion of corruption in general, with the implied assumption that all the money they held came there illegally.39

1.5 Offshore versus Onshore Institutions

International tax planning has matured past a point of the mere establishment of holding structures and private accounts in offshore jurisdictions. International tax planning now includes such choices as where to operate the production plant, where to locate technology development, where to base the multinational information centre, and where to place service centres. Alongside established participants such as the Netherlands, Luxembourg, and Switzerland, countries like Ireland, Belgium, and Cyprus have become aggressive players in offshore/international tax planning procedures. 40

OFCs play a key role in facilitating the growing mobility of finance and the shaping of complex webs of interactions and relationships involving the nation-states, multinational corporations, the wealthy elite and ordinary citizens. 41 The emergence of multi-tasked financial institutions located in tax havens, as opposed to traditional bank organisations located in home jurisdictions, has expanded and diversified international finance. Multinationals, through years of shifting their funds offshore to escape uncompetitive tax burdens, now operate their own financial companies in competition with home jurisdiction banks. Companies can often provide, at a reduced cost, their own project financing, their own insurance, and just about any other service that used to be sourced from home institutions.

Offshore offers the potential for tailored financing, which has led to the development of financial instruments offering an array of variations in types of interest, maturity dates, advance refunding and conversion possibilities. Offshore offers the potential for structured insurance and reinsurance. Many high-risk insurance policies (such as

40 Spitz, above n 36, 7.
political risk or environmental casualty) could not be written onshore because of
government regulation and taxation, and many insurance companies would be forced
to significantly increase premiums if they were not allowed to reinsure groups of risk.

If an offshore centre attracts a poor reputation, corporate work shifts elsewhere. For
an offshore jurisdiction, reputation means everything. 42

1.6 What do the Offshore Centres offer

The principal products stocked by the offshore supermarkets are companies and trusts.
“Offshore companies” usually hold investments and may be involved in trading.
“Offshore trusts” protect the ownership of assets and, frequently of the companies
themselves. The ultimate beneficiaries are usually individuals residing in high tax
countries.

The number of offshore companies is expanding exponentially. They are put there for
a very good reason: An offshore company can be used for any purpose for which a
company in a high tax country can be used, and it generally does not have to pay tax
in the offshore jurisdiction. The bulk of offshore companies simply collect income
consisting of dividends, loan interest or patent royalties, and licence fees. But many
are also used for business purposes. Structured correctly, the offshore company plays
a turntable role using tax-exempt income to make more tax-exempt income. Apart
from tax, an offshore company can be used for other purposes such as privacy and
freedom from exchange control, or protection of assets against future developments in

42 Spitz, above n 40, 7-8.
the home country. Though companies in most offshore jurisdictions offer basic similarities, there are useful differences. For example, what information must be contained in the bylaws? Can the true promoters and beneficial owners be kept entirely out of the picture? What are the costs of incorporation? How much time is involved, and can it be accelerated? Are there limits on the powers of the company? Is there any limitation of liability? Can there be bearer shares, no par value shares, preference shares, and redeemable shares or shares with special rights? 43

The offshore trust is, in reality, a mutant designed specifically to meet the needs of offshore investment. Orthodox trust law rules have been modified to make the trust more commercially viable and mobile. These include laws relating to bankruptcy and enforcement of creditors' claims which preserve the integrity of offshore assets and provisions specifying the governing law of the trust and jurisdiction. The offshore trust is often closely linked to other offshore companies and, consequently, there exist changes to company law complementary to the offshore trust. The legal source for the offshore trust is statutory. The offshore trust itself, like its international business company or offshore company neighbour, is bound by confidentiality rules. 44

Offshore service providers are now moving up the value chain and creeping into more of a company's myriad business processes. Services range from functions requiring low technical training and no direct user contact to "front office" tasks, where outsourced personnel handle customer contact and provide interactive responses, such

43 Ibid, 9-10.
as remote online help-desk assistance, and, at a still higher level, telemarketing, customer care, and medical-or insurance-claims resolution with customers.45

An example of a different approach is Switzerland, which has traditionally been the world's guardian of bank secrecy, and now is being pressured towards some openness. This has been good for banking business in Austria, where secret savings accounts, available without any proof of identity, are eagerly promoted. Although theoretically restricted to Austrian citizens, there are an estimated 26 million savings accounts and an Austrian population of 8 million.46 This practice is considered by the European Union as "a flagrant breach of the principle of identification". This is outlined in the European Union (EU) anti-money laundering directive 91/308/EEC,47 which requires banks to know the identity of their customers. As discussed in subsequent chapters, severe pressure is currently being brought to bear on onshore and offshore jurisdictions to fight money laundering.

Singapore, as discussed in chapter 6, has not traditionally been considered a part of the offshore industry, offering such trust and offshore company facilities. However whilst providing an openness as such, it is now like Austria, beginning to capture some of this offshore activity and business.

As offshore outsourcers add value, it is possible to envisage a global economy in which key elements of customer relationships and the delivery of a company's core

\[\text{46 Ibid.}\]
business services are integrated and supported by offshore suppliers – rather than the company itself.\textsuperscript{48}

1.7 Types of OFCs

According to Spitz, there are five basic types of OFCs, many of which are known as tax havens:\textsuperscript{49}

1. Countries that have no income tax or that grant extensive tax exemptions;
2. Countries that only tax locally generated income (territorial basis of taxation that exempts foreign income);
3. Countries that combine features of (1) or (2) with a treaty network;
4. Low tax financial centres in countries offering special legislation; and
5. High tax countries offering special incentives for offshore companies and qualifying holding companies.

Examples of OFCs by category are set out below in a non-exhaustive list:\textsuperscript{50}

1. Countries that have no income tax or that grant extensive tax exemptions:
   Andorra, Anguilla, the Bahamas, Bahrain, Bermuda, Brunei (individuals),
   Campione, the Cayman Islands, the Cook Islands, French Polynesia, Grenada,
   Kuwait, Maldives, Monaco, Nauru, Oman (individuals only), the Turks and Caicos Islands, United Arab Emirates, Uruguay, Vanuatu.

\textsuperscript{8} Bierce, above n 45.  
\textsuperscript{9} Spitz, above n 43.  
\textsuperscript{50} Ibid.
2 Countries that impose no income tax on foreign source income: Costa Rica, Djibouti, Dominican Republic, Ecuador, France (special rules), Guatemala, Hong Kong, Ireland (non-resident company), Jordan, Kenya, Lebanon, Liberia, Macau, Panama, South Africa, Uruguay, Venezuela, Singapore.

3 Countries that can be used as low tax areas but also have certain tax treaty benefits: Cyprus, the Netherlands, the Netherlands Antilles, Switzerland.

4 Low tax financial centres and countries offering special incentives and privileges: Angola, Anguilla, Antigua, Barbados, the British Virgin Islands, Brunei, Cyprus, Gibraltar, Grenada, Guernsey, Hong Kong, Ireland, the Isle of Man, Jamaica, Jersey, Liechtenstein, Luxembourg, Macau, Madeira, Malta, the Marshall Islands, Mauritius, Montserrat, the Netherlands, Nevis, Philippines, Puerto Rico, San Marino, Seychelles, Solomon Islands, Sri Lanka, St. Helena, St. Vincent, Switzerland, Tuvalu, Western Samoa.\(^{51}\)

5 High tax countries offering special incentives and privileges for offshore companies and qualifying holding companies: Belgium, Cyprus, Denmark, France, Germany, Luxembourg, the Netherlands, the Netherlands Antilles, Singapore, Spain, Switzerland, the United Kingdom.

1.8 Conclusion

\(^{51}\) Certain countries mentioned in this point also offer tax treaty benefits.
From the above definitions and developments of OFCs, it can be seen why their success has provoked closer scrutiny by the international community and regulatory agencies, which have become less tolerant of the kind of competition offered by OFCs. On 26 June 2000, the OECD published its report on harmful tax practices and identified 35 tax havens that would face sanctions if they did not cooperate.\(^{52}\) A week earlier, on 22 June 2000, the FATF report on Money Laundering named 15 jurisdictions that did not sufficiently combat hot money\(^{53}\). Moreover, on 26 May 2000, the FSF identified 37 jurisdictions which were financial centres with significant offshore activities.\(^{54}\) The recent 2003 EU agreement on a system of tax on savings income that aims to abolish bank secrecy also affects OFCs, as the agreement is dependent on equivalent measures being negotiated with third country financial centres.\(^{55}\) Therefore, never before has the pressure been so high on the OFCs.\(^{56}\) The nature of this pressure is analysed in Chapter Two.


\(^{53}\) Hot money is most often associated with capital flight, which itself will be a combination of clean, grey (associated with illegal activity), and dirty money (associated with criminal activity), depending on the circumstances. Financial Action Task Force, Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures (2000).


Chapter 2: Supranational Directives and their Progress

2.1 Introduction

The definitions and features of OFCs outlined in chapter 1 show the rationale for the supranational initiatives against OFCs that emerged over the last fifteen years. Understanding the initiatives and OFCs responses to them, is critical in determining which OFCs are jurisdictions of choice in the current environment.

In recent years, the offshore industry and the relevant jurisdictions have faced enormous challenges in relation to their status as 'tax havens' and overly broad assertions that offshore companies are being used for money laundering. The OECD and the FATF have issued several reports seeking commitments to eliminate what they consider to be 'harmful tax competition' and gain greater transparency (in the case of the former) and to promote the adoption of international standards of anti-money laundering regulatory frameworks (in the case of the latter).58 This chapter briefly describes the make-up of the relevant regulatory bodies. It then sets out and analyses the reports and recommendations of the OECD and FATF. The last sections analyses the Wolfsberg Principles which are the product of the efforts of the private sector to reduce and prevent money laundering in line with several of the FATF's 40


Recommendations. The analysis of the recommendations will show that the four critical issues for OFCs to address are harmful tax practices, money laundering, confidentiality and exchange of information. These are addressed in detail in the subsequent chapters.

2.2 Supranational Organisations

(a) Organisation for Economic Co-operation and Development (OECD)

The OECD is an organisation with 30 Member countries, including all members of the G8 and EU, sharing a stated commitment to democratic government and the market economy. The OECD assists member governments to address the economic, social and governance challenges of a globalised economy. It is also an organisation designed, and mandated to promote the interests of its Member States.

(b) Financial Action Task Force (FATF)

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60 Historically the research units within the OECD have made significant contributions particularly in the area of economics. It appears that neither these research units nor the sound methodology which they normally adopt, were involved in the production of the OECD Report.


The aims of the Organisation for Economic Co-operation and Development shall be to promote policies designed to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy.
The FATF was established in 1989 and has 28 Member countries largely overlapping with that of the OECD. Its primary role has been to establish standards relating to money laundering laws and practices and to work to implement these standards throughout the world. The FATF has assumed a broader mandate to combat terrorism following the attacks in the U.S.

Like the OECD, the FATF has restricted membership. Regional bodies such as the Caribbean Financial Action Task Force support the work of the FATF. Although such regional bodies facilitate input from non-FATF members at a lower level, these groupings are “junior partners” in the processes undertaken by the FATF.

The need to cover all relevant aspects of the fight against money laundering is reflected in the scope of the 40 FATF Recommendations which were originally drawn up in 1990. In 1996 the Forty Recommendations were revised to take into account the experience gained over the previous six years and to reflect the changes which had occurred in the money laundering area. They cover the criminal justice system and law enforcement; the financial system and its regulation, and international cooperation.

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63 Members of Caribbean Financial Action Task Force comprise Anguilla, Antigua, Barbuda, Aruba, The Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Costa Rica, Dominican Republic, Grenada, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands and Venezuela.


65 For a full list of the 40 Recommendations, see Appendix G.

66 During the period 1990 to 1995, the FATF also elaborated various Interpretative Notes which are designed to clarify the application of specific Recommendations. Some of these Interpretative Notes have been updated in the Stocktaking Review to reflect changes in the Recommendations. The FATF adopted a new Interpretative Note to Recommendation 15 on 2 July 1999.

The FSF's recent focus on OFCs stems from its work concerning the stability of the global financial system. As an organisation, the FSF provides a cross-disciplinary forum for those interested in regulatory matters to meet, discuss, and pursue various initiatives with respect to the international financial system. At a summit of the G8's finance ministers and central bank governors on 3 October 1998, Hans Tietmeyer, the then President of the Deutsche Bundesbank, was given a mandate to prepare a report that would recommend new structures to enhance co-operation among national and international regulatory and supervisory bodies and public international financial institutions. On 11 February 2000, Tietmeyer presented his report where he observed that supervisory initiatives with respect to the international financial system over the previous few years had sharpened awareness of various risk-related issues.

He asserted that the existing international regulatory framework remains imperfect because it is viewed as having been grafted onto a system of nation-states. In particular, the regulatory responsibilities remain fragmented among a number of central banks, public financial institutions, and sector-specific groups. Although he identified various areas where existing supervisory arrangements could be strengthened, Tietmeyer rejected both wholesale institutional reform and a substantial reworking of existing arrangements. In other words, in his view, the nation-state is to remain the primary political construct through which regulatory issues related to the

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70 Ibid 3.
international financial markets are to be addressed. Instead, Tietmeyer recommended the creation of an international public forum, the FSF, through which international regulatory efforts could be co-ordinated.71

The FSF was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. Like the FATF, it was also established pursuant to a G8 initiative. At its inaugural meeting on 14 April 1999, the FSF established a so called “OFC” (Offshore Finance Centre) working group. The purpose of this group was to consider any potential role of financial institutions in non-OECD countries, in the stability of the world’s financial system.72

In May 2000, the FSF encouraged OFCs to undertake needed reforms and asked the International Monetary Fund (IMF) to put in place an assessment program that would ensure progress on a lasting basis.73 Almost all of the 42 jurisdictions that the FSF identified as having offshore financial activities have undergone an initial assessment by the IMF. These assessments identify strengths and weaknesses in relation to relevant international standards and codes and set out recommendations for improvement.74

71 Ibid 6.
72 Stickman Elliot, above n 64, 6-7.
(d) *International Monetary Fund*

The IMF is an organisation of 184 countries, established to promote international monetary co-operation, exchange stability, and orderly exchange agreements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment.\(^{75}\) The IMF is currently conducting assessments\(^ {76}\) of non-OECD IFCs, in part using discriminatory assessment criteria in the sensitive area of corporate and trust service providers, which the IMF does not apply to assessments of OECD States.\(^ {77}\)

In the IMF's assessment program of OFCs, the focus was placed on four areas:\(^ {78}\)

- Regular monitoring of OFCs' activities and compliance with supervisory standards;
- Improved transparency of OFC supervisory systems and activities;
- Technical assistance in collaboration with bilateral and multilateral donors;
- Collaboration with standards-setters and the onshore and offshore supervisors to strengthen standards and exchange of information.

(e) *Links between Supranational Organisations*

There is significant commonality of membership of supranational organisations seeking to control the regulation of international financial services. Essentially, with


\(^{76}\) International Monetary Fund, above n 75.

\(^{77}\) The voting rights of the G8, OECD and other members of the IMF, which are set by economic contribution to the IMF, are set out in Appendix A.

\(^{78}\) International Monetary Fund, above n 74.
the exception of the International Tax and Investment Organisation (ITIO) which is composed of, and funded by SDEs, the organisations are the same developed countries operating in different forums.

As the supranational organisations put out their reports containing guidelines and recommendations, the Wolfsberg Principles emerged from the private sector's attempt to combat money laundering.

The similarity of composition and the complementary interlocking programmes of these organisations are perceived by the SDEs as suggesting a single agenda, that of the major developed countries. Accordingly, when one supranational body provides a recommendation or suggested course of action, endorsement from another organisation is, in substance, endorsement by the same member states. It is not an impartial validation as the process may imply to those unfamiliar with the overlapping memberships between such organisations.

For the purpose of this thesis, given the overlap across supranational organisations, each with a different focus, and the related approach of the Wolfsberg signatories, it is intended to take the three approaches of the OECD, FATF and Wolfsberg Principles to provide a broadly comprehensive range of initiatives against OFCs. In the context of these three approaches it is possible to determine what constitutes a compliant OFC jurisdiction. It will become clear that, to be a jurisdiction of choice for global wealth management, being a compliant OFC jurisdiction is essential.

The remainder of this chapter provides an outline and analysis of the recommendations of each body. Chapters 3 and 4 provide a detailed examination of the key aspects of: harmful tax practices, money laundering, offshore confidentiality and exchange of information. How a jurisdiction responds to these issues is a key determinant of its attraction for global wealth management.

2.3 OECD Report on Harmful Tax Practices

2.3.1 The OECD’s Position

In May 1996, Ministers called upon the OECD to “develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases, and report back in 1998”. In response to the Ministers’ request, the OECD’s Committee on Fiscal Affairs launched its project on harmful tax competition. The Harmful Tax Competition: An Emerging Global Issue report addressed harmful tax practices in the form of tax havens and harmful preferential tax regimes in OECD Member countries and non-Member countries and their dependencies. It focused on geographically mobile activities, such as financial and other service activities. The report defined the factors to be used in identifying harmful tax practices and went on to make 19 wide-ranging Recommendations to counteract such practices.

89 Organisation for Economic Co-operation and Development, above n 12.
81 Ibid 3.
82 Ibid.
In approving the report on the 9 April 1998, the OECD Council adopted a Recommendation to the Governments of Member countries and instructed the Committee to pursue its work in this area and to develop a dialogue with non-member countries. Luxembourg and Switzerland abstained from voting in Council on the approval of the report and the adoption of the Recommendation.

The existence of low or no income taxes is not in itself enough to constitute harmful tax competition. Rather, when low or no taxes are combined with other legislative or administrative features, such as "ring-fencing", a lack of transparency, or the absence of exchange of information, it was asserted then harmful tax competition, may arise. The OECD report provided a framework for identifying harmful regimes and suggests counter-measures for them. Accordingly, harmonising tax rates across countries or installing minimum tax levels was not the stated aim. Countries would remain free to decide their own tax rates, with checks and balances coming from competitive forces of the global marketplace. It was envisaged by the OECD report that this would encourage countries to adopt "best practice" policies on taxation.

The OECD's 1998 Harmful Tax Competition: An Emerging Global Issue report drew a distinction between three situations in which the tax levied on income from geographically mobile financial and other service activities in one country is lower than the tax that would be levied on the same income in another country:  

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83 Ibid.
84 Ibid 26-34.
85 Ibid 15 [26].
86 Spitz, above n 50, 236-7.

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1) the first country is a tax haven and, as such, generally imposes no or only nominal tax on that income;

2) the first country collects significant revenues from tax imposed on income at the individual or corporate level but its tax system has preferential features that allow the relevant income to be subject to low or no taxation; or

3) the first country collects significant revenues from tax imposed on income at the individual or corporate level, but the effective tax rate that is generally applicable at that level is lower than the tax rate levied in the other country.

Each of these situations may have undesirable effects when seen from the perspective of the other country. However, the report was careful not to suggest that there was some general minimum effective tax rate on income below which a country would be considered to be engaging in harmful tax practices.87

2.3.2 The OECD's Concept of "Tax Haven"

The OECD report defined a tax haven that conducts harmful tax competition in the three above mentioned situations and other activities such as:88

- Practices which prevent the effective exchange of relevant information with other governments on taxpayers benefiting from a low or no tax rate.

- General lack of transparency.

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87 Ibid.
88 Blackman, above n 35.
The absence of a requirement that the activity be substantial (investment that is purely tax driven.)

The OECD’s concept of “tax haven” thus refers to tax jurisdictions that offer themselves as a place that non-residents can use to escape tax obligations in their countries of residence. A number of factors identify these jurisdictions, in particular the virtual absence of taxes (combined with minimum business presence requirements) and a lack of legislative and administrative transparency. Bank secrecy and other features that prevent effective exchange of information are also discernible. 89

2.3.3 The Recommendations and the Guidelines

In order to deal with harmful preferential tax regimes, OECD countries agreed to non-binding Guidelines for Dealing with Harmful Preferential Tax Regimes. They undertook to eliminate within five years of the adoption of the OECD’s report on harmful tax competition (or, if a particular “grandfather clause” applies, no later than December 31, 2005) the features of those preferential tax regimes identified as harmful under the guidelines. 90

In the latest 2004 progress report on the OECD’s campaign against harmful tax practices, it was reported that while there is an overwhelming majority of countries and jurisdictions which have agreed to work towards transparency and effective exchange of information, a small number have not yet made commitments to those

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89 Spitz, above n 87, 238.
90 Organisation for Economic Co-operation and Development, above n 85, 70.
principles.\textsuperscript{91} These countries are identified in a List of Unco-operative Tax Havens issued by the Committee in April 2002 and revised in May 2003 and December 2003 to remove Vanuatu\textsuperscript{92} and the Republic of Nauru,\textsuperscript{93} respectively, from the list. The OECD was very pleased that Vanuatu and the Republic of Nauru have joined the growing number of countries that are committed to transparency and effective exchange of information and hopes that the remaining countries will follow this example. The remaining unco-operative tax havens are Andorra, the Principality of Liechtenstein, Liberia, the Principality of Monaco, and the Republic of the Marshall Islands.\textsuperscript{94} The OECD is currently engaged in a constructive ongoing dialogue with a number of these countries and looks forward to future commitments to transparency and effective exchange of information.\textsuperscript{95}

In addition to the tax haven list and the guidelines, both of which are of a multilateral character, recommendations were made on how the OECD countries might strengthen their domestic and bilateral measures against harmful tax practices. At the national level, OECD countries have been encouraged to adopt controlled foreign corporation (CFC) or equivalent legislation.\textsuperscript{96} This generally enables the home country of the parent to exercise taxing rights over low taxed foreign subsidiaries that the parent


\textsuperscript{94} Organisation for Economic Co-operation and Development, above n 91, 14 [27].

\textsuperscript{95} Ibid.

\textsuperscript{96} OECD Recommendation 1: “Controlled Foreign Corporations (CFCs) - Countries that do not have CFC rules consider adopting them.” OECD Recommendation 2: “Foreign investment fund or equivalent rules - Countries that do not have such rules adopt them to entities covered by practices considered to be harmful tax competition.”
controls. The OECD countries are also encouraged to adhere to certain defined standards in providing tax rulings and to apply strictly the 1995 OECD Transfer Pricing Guidelines, which provide for internationally agreed-upon standards for establishing prices on intragroup transactions.\(^7\)

Bilaterally, OECD countries have been encouraged to intensify their exchange of information on tax havens and preferential tax regimes.\(^8\) A provision is being considered for the OECD’s Model Tax Convention\(^9\) that would deny entities operating under harmful tax regimes access to certain or all of the Convention’s benefits. Furthermore, the OECD report asked countries to consider terminating any treaties they might have with tax havens.\(^10\)

After defining the factors to be used in identifying harmful tax practices, the report went on to make 19 wide-ranging recommendations to counteract such practices. The recommendations set out in the report and the accompanying guidelines addressed the problem of harmful tax practices from different angles. Taken together, the recommendations with the guidelines represent a comprehensive approach by member countries for dealing with the problems of harmful tax competition created by tax havens and harmful preferential tax regimes. Some of the recommendations

\(^7\)OECD Recommendation 6: “Transfer-pricing rules - Countries follow the guidelines set out in the OECD 1995 guidelines on transfer pricing and not promote harmful tax competition.” Transfer prices — payments from one part of a multinational enterprise for goods or services provided by another — may diverge from market prices for reasons of marketing or financial policy, or to minimise tax. To ensure that the tax base of a multinational enterprise is divided fairly, it is important that transfers within a group should approximate those which would be negotiated between independent firms.

\(^8\)OECD Recommendation 8: “Exchanges of information - Countries should undertake programs to intensify exchange of information concerning transactions in tax havens and preferential tax regimes constituting harmful tax competition.”


\(^10\)OECD Recommendation 12: “Tax treaties with tax havens - Countries consider terminating their tax conventions with tax havens and consider not entering into tax treaties with such countries in the future.”
encourage countries to refrain from adopting harmful tax practices. Others address the issue indirectly by focusing on tax evasion and avoidance, because many forms of harmful tax competition are aimed at taxpayers willing to engage in tax evasion and tax avoidance.

It is the view of the OECD that, the effectiveness of many of the recommendations concerning domestic legislation and tax treaties depends in part upon whether they can be implemented in a coordinated way. Consequently, one of the main recommendations was for the establishment of a forum on harmful tax practices in order to monitor the application of the guidelines and to undertake an ongoing evaluation of existing and proposed regimes. The forum would assess the effectiveness of countermeasures and to propose ways to improve their effectiveness. It would also be responsible for monitoring the implementation of the other recommendations.

The 19 recommendations made were broken into three categories:

- Recommendations concerning domestic legislation: starting from various counteracting measures currently found in domestic laws; these recommendations indicate how to increase their effectiveness;
- Recommendations concerning tax treaties: these recommendations deal with ways of ensuring that the benefits of tax conventions do not unintentionally make policies constituting harmful tax competition more attractive or prevent

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101 OECD Recommendation 15: "Guidelines and a forum on harmful tax practices - Member countries endorse the guidelines set out in the following list dealing with harmful preferential tax regimes."
102 Spitz, above 89, 239-40.
103 See Appendix H for a full list of the 19 recommendations.
the application of domestic counteracting measures, as well as ways to ensure that the exchange of information provisions of tax treaties are used in a more effective way; and

- Recommendations for intensification of international cooperation: these recommendations, including the guidelines, put forward new ways through which countries will be able to act collectively against harmful tax competition.

These recommendations may also be distinguished on the basis of the amount of cooperation needed to implement the recommendations. The first set of recommendations can be achieved largely unilaterally, which is to say they can be implemented solely through domestic legislation. The second set of recommendations involves bilateral negotiations to modify tax treaties, while the final set involves or requires multilateral cooperation in order to be effective.104

2.3.4 Analysis of the OECD's 19 Recommendations

Recommendation 1 states that countries that do not have CFC or equivalent legislation are to start establishing them and that those countries who do have such legislature, continue to harness them to stem harmful tax practices. This recommendation sets the tone of the OECD's main purpose: to combat harmful tax practices and it should start at a national level where CFC legislation provides for taxation of low-taxed foreign subsidiaries. The CFC rules are intended to tax the income of multinational investors that is most easily transferred. The recommendation encourages countries to extend their CFC regimes to income arising in tax havens or

harmful preferential regimes and would coordinate the legislation in terms of their effectiveness in counteracting harmful tax practices. 105

Recommendation 2 continues the similar path of foreign corporations and investments, stating that taxation rules have to be laid for foreign investments funds. For countries without such rules in place, they should consider establishing them while for the countries which have such legislation in place, should have the rules directed at preventing abuse with harmful tax practices.

Recommendation 3 concerns eliminating double taxation by granting exemptions of tax to foreign entities. Countries which take on this approach in eliminating double taxation should take care that exemptions are not granted to entities which have benefited through tax practices that constitute harmful tax competition.

Recommendation 4 recognises that globalisation has made taxation all the more complicated and encourages rules to be put in place for the reporting of international transactions and foreign operations of resident taxpayers. Countries which have such legislation in place should consider exchanging information to have a more effective and accurate tax system, thus minimising harmful tax competition.

Recommendation 5 continues the notion of exchanging information to reduce harmful tax competition. It recommends that decisions which concern the position of a taxpayer be revealed before planned transactions and releasing the ruling details such as granting, denying or revoking the taxpayer’s request to the public.

Recommendation 6 deals with transfer pricing. Transfer prices are payments from one part of a multinational enterprise for goods or services provided by another. They may diverge from market prices for reasons of marketing or financial policy, or to minimise tax. To ensure that the tax base of a multinational enterprise is divided fairly, it is important that transfers within a group should approximate those which would be negotiated between independent firms.\textsuperscript{106} Countries are encouraged to follow the transfer pricing rules as set out in OECD’s 1995 \textit{Guidelines on Transfer Pricing} so that the transfer pricing rules applied by the countries would not fall in line with harmful tax competition.\textsuperscript{107}

Recommendation 7 is similar to recommendations 4 and 5 as it too dwells on the importance of information what it concerns tax collection. The benefiting party here is intended to be the tax authorities. By reviewing the legislation to strengthen the countries’ tax authorities power to view banking information, this can in some way come into conflict with the private banking sector’s principle of client confidentiality. It is up to the individual country to maintain a balance between banking confidentiality and the abuse of the system through harmful tax practices.

Recommendation 8 pushes for co-operation between countries in the exchange of information, particularly for that of tax havens or OFCs. Transactions that take place in OFCs or tax havens and contribute to harmful tax competition should be recorded and made available to the resident countries. With recommendations 4, 5 and 7 in


place, recommendation 8 is simply to further the same intention but with the co-operation between countries and especially the OFCs.

Recommendation 9 concerns entitlement to treaty benefits. Countries are encouraged to not extend tax treaty benefits to countries whose practices are considered to be in line with harmful tax practices. Countries are also advised to take into consideration the OECD’s Model Tax Convention on Income and on Capital which was last updated in January 2003 when forming their tax conventions.108

Recommendation 10 concerns the clarification of the status of domestic anti-abuse rules and doctrines in tax treaties. The Commentary on the Model Tax Convention is to be clarified to remove any uncertainty or ambiguity regarding the compatibility of domestic anti-abuse measures with the Model Tax Convention.

Recommendation 11 involves the co-operation and involvement of countries in their list of specific exclusion provisions in their tax treaties. The details, such as certain entities or income are to be provided to the OECD Committee on Fiscal Affairs. As such, they will have a reference to benefit their negotiations in tax conventions and will serve as a basis for discussions in forums. Revealing such information is a huge step forward in the exchange of information to prevent harmful tax practices and give support to the OECD’s campaign against harmful tax competition.

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Recommendation 12 advises countries which have existing tax treaties with tax havens to terminate the treaties. Tax havens only serve to perpetuate harmful tax competition and maintaining tax treaties with them would only aid in the competition.

Recommendation 13 concerns the co-ordinated enforcement regimes such as joint audits and co-ordinated training programmes among countries. With such co-ordinated effort, taxpayers who benefit from practices constituting harmful tax competition can be stopped.

Recommendation 14 calls upon the assistance in the recovery of tax claims. Countries are encouraged to review the current rules applying to the enforcement of tax claims of other countries while the OECD Committee on Fiscal Affairs pursues its work in this area with a view to drafting provisions that could be included in tax conventions for that purpose. This is not easy, as a country which maintains sovereignty over itself does not have any obligation to a second country to help collect the second country’s taxes. This runs into conflict with the principle of comity.

Recommendation 15 covers establishing guidelines and a forum on harmful tax practices. OECD member countries should endorse the guidelines on harmful preferential tax regimes set out in 1998 Harmful Tax Competition: An Emerging Global Issue report, strengthening their legislative and administrative practices to combat harmful tax practices. If the countries are found to have tax regimes which constitute to harmful tax practices, they have up to December 31, 2005 to remove them. Through forums, member countries should raise their co-operation to an

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109 Organisation for Economic Co-operation and Development, above n 90.
international level by co-ordinating their efforts in treaties and encourage non-member countries to join them in their efforts.

Recommendation 16 extends the intention of the forum between member countries of the OECD to establish a list of tax havens based on the factors identified in the 1998 *Harmful Tax Competition: An Emerging Global Issue* report.\(^{110}\)

Recommendation 17 concerns the links with tax havens. Countries which have established political or economic links with tax havens are to take care that their links do not give way to harmful tax practices. Also, countries with dependencies that have similar links to tax havens do not allow the links to contribute to harmful tax competition.

Recommendation 18 commissions the OECD Committee of Fiscal Affairs to be responsible for developing and actively promoting a set of principles that should guide tax administrations in the enforcement of the 19 Recommendations. As this Committee is led by the members of the OECD, OFCs which are not members may feel left out as they are not consulted in this seemingly international effort which will no doubt affect them the greatest.

Recommendation 19 takes the OECD 19 Recommendations beyond the OECD members. Motivated by the sole intention and joint efforts at combating harmful tax competition, OECD members recognise that they cannot succeed if they are not supported internationally, thus it is imperative that they encourage non-members to

\(^{110}\) Ibid.
take on the guidelines through engaging them in various forums. This extends the influence of the Recommendations to that of tax havens and OFCs.

2.3.5 OECD Initiatives Updates

On 18th April 2002, almost two months after its original deadline date of 28th February 2002\textsuperscript{111}, the OECD released its list of uncooperative countries or territories involved in harmful tax practices.

The following jurisdictions, which had not yet made commitments to transparency and effective exchange of information, were identified by the OECD's Committee on Fiscal Affairs in the List of Unco-operative Tax Havens.\textsuperscript{112}

- Andorra
- The Principality of Liechtenstein
- Liberia
- The Principality of Monaco
- The Republic of the Marshall Islands
- The Republic of Nauru
- The Republic of Vanuatu\textsuperscript{113}

\textsuperscript{112} Ibid.
\textsuperscript{113} Asia Pacific Offshore Institute, www.asiaoffshore.org.
Since the OECD began its initiative against what it perceived as harmful tax practices, where 35 jurisdictions were listed as tax havens,\textsuperscript{114} 31 jurisdictions initially made commitments, including the BVI and Samoa.\textsuperscript{115}

In *The OECD’s Project on Harmful Tax Practices: The 2004 Progress Report*, Vanuatu and the Republic of Nauru have joined the growing number of countries that are committed to transparency and effective exchange of information, resulting in the removal of these two countries in the List of Unco-operative Tax Havens.\textsuperscript{116}

### 2.3.6 Analysis of OECD’s Campaign against Harmful Tax Competition

*OECD’s Concept of Harmful Tax Competition Flawed*

One of the major weaknesses of the “Harmful Tax Practices” report can be identified as the vagueness of the concept of ‘harmful tax competition’ itself. While the report concedes that tax competition can, indeed, be beneficial, ‘when tax competition ceases to be beneficial and starts to be harmful is not clear, and is essentially, subjective’.\textsuperscript{117} In determining whether a jurisdiction has a low or nominal tax rate, the 1998 OECD Report\textsuperscript{118} failed to provide an exact figure or range that would determine the threshold.\textsuperscript{119} For example, in the Tax Reform Act of 1986,\textsuperscript{120} the US Congress

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\textsuperscript{115} Ibid.

\textsuperscript{116} Organisation for Economic Co-operation and Development, above n 95, 14.


\textsuperscript{118} Organisation for Economic Co-operation and Development, above n 110.

reduced the maximum marginal rate on corporate income to thirty-four percent. Compared to other industrialised nations at that time, this rate was low.\textsuperscript{121} However, the United States has not found itself a target, even though it likely diverts significant revenue from other nations\textsuperscript{122} due to firms seeking the greatest return on their capital.\textsuperscript{123}

The OECD acknowledges that countries should be free to design their own tax systems.\textsuperscript{124} However, this must be according to internationally accepted standards. The problem is that the \textquote{international accepted [tax] norms\textquot; with which offshore financial jurisdictions are encouraged to align themselves, are non-existent. The implication is that such norms are, in fact, those which will be determined solely by high tax, onshore countries afraid of tax competition. \textquote{What the report really objects to is that some countries, such as \textquote{tax havens}, advocate totally free markets in capital and investment and are not willing to impose the distortions as the OECD countries do through their tax systems.}\textsuperscript{125} This suggests, perhaps unintentionally, that the only justifiable tax regime is one which supports the welfare state through high taxes in a mixed economy.

The notion of harm is misplaced in another sense. Given that the jurisdiction to tax is recognised as territorial and that onshore countries have no solid claim to investments

\textsuperscript{121}See Karen B Brown, \textquote{Harmful Tax Competition: The OECD View\textquot; (1999) 32 George Washington Journal of International Law and Economics 311, 316 (book review) (stating that 34\% was a comparatively low marginal corporate tax rate)

\textsuperscript{122}See Mitchell B Weiss, \textquote{International Tax Competition: An Efficient or Inefficient Phenomenon?\textquot; (2001) 16 Akron Tax Journal 99, 108 (providing Latin American countries as examples)

\textsuperscript{123}Javier G Salinas, \textquote{The OECD tax competition initiative: a critique of its merits in the global marketplace.\textquot; 25 Houston Journal of International Law 531, 555.

\textsuperscript{124}Organisation for Economic Co-operation and Development, above n 118, 15.

\textsuperscript{125}Gaffney, above n 117, 308.
outside of their borders, no real harm has taken place: ‘Lost opportunities to which one has no right in the first place are not harms suffered in any thing but metaphorical sense’. 126 The OECD’s accusation of ‘poaching’ must be assessed against the backdrop of a global environment which lacks a consensus on the question of the ownership of taxable worldwide income. 127

A significant flaw in the OECD’s argument is the way in which the well-established legal distinction between tax avoidance and tax evasion is diluted with the result that all tax planning efforts are treated as unethical and unlawful. The capacity of offshore financial centres to allow persons to ‘escape’ tax is condemned in totality, implying that such centres may not legitimately facilitate any kind of tax mitigation or planning within their borders. This means, further, that disclosure can then be justified as a tool to thwart such tax planning. 128

The erroneousness of the OECD’s argument is highlighted even more by the fact that several onshore financial centres offer similar tax functions to non-residents. Yet, these are not treated as engaging in ‘harmful tax competition’.

The US facilitates non-resident investment by reducing tax in exactly the same way as other ‘harmful tax practices’. For example, by putting shipping operations in the United States, a combination of credits and allowances which are granted, produces zero tax. The United States (Delaware) has beaten Panama and Liberia at their own

126 Ibid 309.
127 Antoine, above n 44, 314-5.
128 Ibid.
game, because if there is one thing better than paying no tax, it is paying negative tax. The government actually pays tax credits.129

Similarly, the OECD report pays scant respect or regard for the well-established rule of international law which states that one state does not enforce the tax laws of another. This rule recognises the territorial application of tax law.130 The OECD simply asserts the inaccurate presumption that it is unfair or harmful for offshore countries to continue enforcing this rule.131 This is despite the fact that the rule continues and, presumably, will continue to be applied by onshore nations outside the offshore financial concept.

The OECD report goes one step further. It accuses offshore financial centres of ‘ring fencing’ and discriminatory practices.132 This speaks to a legal system where the positive benefits of the fiscal policy are reserved only for non-residents. This is a simplistic and inaccurate assumption made about offshore financial jurisdictions as a whole. Several offshore financial centres, such as Hong Kong and Singapore, in fact, do not make distinctions between residents and locals in their tax policies. This is also the case in The Bahamas and the Cayman Islands, for example, where there are no direct taxes but rather, consumption taxes, which apply to all. Further, even if such a claim for other offshore nations is accepted, this places them in the same category as several other onshore jurisdictions which exempt non-residents from paying taxes on

129 Spitz, above n 102, 6.
such items as their bank deposits. Indeed, the very criteria used by the OECD in identifying ‘harmful’ tax havens are challenged by offshore countries.133

Competing Philosophies

The first five years of the initiatives against offshore financial centres can be viewed as driven by a different philosophical approach on how to deal with the major flaw in the system of direct taxation - that capital is mobile. But there is another problem relating to this form of taxation, which is that of a new political correctness which states that tax competition be viewed as essentially unjust competition.

Whichever way it is interpreted, a direct system of income tax in large part must rely on voluntary compliance by its citizens for it to work.134 This in part explains the effort expended by onshore treasuries on negative publicity about the offshore world. However, it remains a fact that, historically speaking, some jurisdictions such as the US, the UK and Canada have had relatively high taxpayer compliance,135 while tax evasion has been endemic in many European and Latin American countries.136 It is because tax evasion has been so pervasive in Europe137 that automatic reporting appeals so much to the EU governments, but not, unsurprisingly, to Switzerland,

133 Antoine, above n 128, 314-9.
Austria, Belgium, Luxembourg and now Guernsey, which are favoured jurisdictions for discrete banking.\textsuperscript{138} While traditionally the UK has favoured the liberty and privacy of the individual and championed the rule of law, the Government's current position\textsuperscript{139} in support of automatic exchange of information can be understood only as driven by the need to keep a mandatory withholding tax from driving the Eurobond market out of the City of London and the desire to maintain competition among the various income rates internally within the EU. Its perceived high-handed and inappropriate attitude towards its overseas territories can only be understood in this context.\textsuperscript{140}

Uneven Hand

As discussed above, having produced its report entitled, *Harmful Tax Competition: An Emerging Global Issue* in 1998,\textsuperscript{141} the OECD then initiated, in a unilateral and arbitrary manner, the identification of jurisdictions that it considered to be competing in tax matters in a way that was harmful to its member-states. In 1998 the OECD indicated that there were 47 jurisdictions it deemed to be tax havens. Later that year six of these jurisdictions were dropped but the OECD never disclosed their identity. It can only be surmised that the OECD decided to exclude these six undisclosed jurisdictions for political reasons such as the reluctance of its member-states to engage in a confrontation with the Governments concerned. It is noteworthy, for instance, that

\begin{itemize}
\item \textsuperscript{139} Inland Revenue (United Kingdom), *Countering Cross-Border Tax Evasion by Individuals* <http://www.inlandrevenue.gov.uk/esd/> at 10 July 2004.
\item \textsuperscript{141} Organisation for Economic Co-operation and Development, above n 132.
\end{itemize}
Hong Kong was never named as a tax haven, yet, by every criteria that the OECD established, Hong Kong should have been a prime target. Was Hong Kong’s omission an indication that the OECD did not want to offend the Peoples Republic of China?142

When the OECD produced a report in 2000 entitled, Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices,143 it was revealed that the Organisation was treating its member states quite differently from the unilateralist and arbitrary stance taken with the targeted jurisdictions. First, while the targeted jurisdictions were quite categorically named as “tax havens”, some OECD members, such as Switzerland, Belgium, Portugal, Luxembourg, Canada and the United States, were described only as having regimes that were “potentially harmful”. Second, the OECD carried out a unilateral evaluation of the jurisdictions they subsequently labelled as ‘tax havens’, but its own members each performed “a self-review” to determine whether or not they had preferential tax regimes.

One observation offered by one such labelled “tax haven”, Antigua and Barbuda,144 is that the OECD countries are the principal advocates of the virtues and merits of competition in the provision of goods and services globally. For them “competition” is the new panacea for the world’s economic ills, because their industrial and agricultural capacity has reached the point where it needs unrestricted entry to global markets to continue to provide employment and profits to their people. Yet, while they (G8) promote competition in everything else, they seemed to decry it in taxation.

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143 Organisation for Economic Co-operation and Development, above n 115.
144 Ronald Michael Sanders, ‘The OECD’s ‘Harmful Tax Competition’ Scheme: The Implications For Antigua And Barbuda’ (Speech delivered at the luncheon meeting of the Antigua and Barbuda Chamber of Commerce and Industry, Antigua and Barbuda, 27 March 2001).
Their objection appears to be derived from the fact that, in a globalised world, the mobility of financial and other services, such as shipping and internet gambling, provide an opportunity for small states, and pose a threat to them. The low tax or no tax regimes of these small states coupled with literacy in English and good telecommunications gives them an advantage with which many OECD countries cannot compete. Instead of trying to vie with small states by lowering their own taxes, the OECD responded by demanding that these small jurisdictions change their tax systems and structures or face damaging sanctions.

In an OECD paper entitled: *Globalisation: Impact on Tax Policy and Administration*, the OECD revealed its thinking behind the ‘harmful tax competition’ scheme. It says:

> In this new global environment multinational enterprises will continue to move their manufacturing activities to low-cost countries... All countries will be forced to compete for this footloose investment: either by lowering regulatory standards or creating incentives, particularly tax incentives, to attract business to their jurisdictions.

Sanders suggests a fear in the OECD countries that they will lose investment in a range of activities to developing countries that offer tax incentives to win investors.

The OECD’s concern is that its member states will lose investors who would

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146 Ibid.
147 Ibid.
otherwise be subject to their high taxation. Their purpose is to tax the profits and interest income of those investors wherever they may be. The consequence would be to deprive small developing countries from advancing their economic development through their tax structures and systems.

Of course, the OECD argument represents the views of its member states which have reached a high level of industrial development precisely because of tax competition in which they lured foreign investment into their countries by tax breaks. In fact, many of them continue to do so.\footnote{Ibid.}

In the United States, for instance, institutions, both banks and non-banks, held more than $1.8 trillion in deposits from foreign persons at the end of 2000.\footnote{Bureau of Economic Analysis (BEA), U.S. Department of Commerce, ‘The Net International Investment Position of the United States at Yearend 2000’ Harlan W. King (ed.), in Survey of Current Business, July 2001.} That money is there because the US exempted the holders of those accounts from taxes on their interest income. The US banking system, particularly in Florida and New York, could face collapse if these trillions of dollars were to be withdrawn and taken elsewhere – a fact well known to the Governor of the State of Florida, J E Bush, who lobbied strongly against US exchange of information with tax authorities of other governments, including those from the OECD. In June 2001, Governor Bush sent a letter to US Treasury Secretary Paul O’Neill arguing that regulation, contemplated by the Inland Revenue Service, to allow information to be passed to other countries about interest payments made to their nationals ‘would place US banks at a competitive
disadvantage relative to banks in the Caribbean and Europe... and would seriously
hamper the ability of US banks to continue to attract foreign depositors.”

The United Kingdom also operates similar regimes designed to attract funds to its
banks and bond markets from overseas. It is therefore very significant that in its 1998
report, the OECD declared that, “the tax treatment of interest on cross-border savings
instruments, particularly bank deposits, is not considered in this first stage of the
project”.151

Modification of OECD Stance

Hence, it was the new Republican administration of George W Bush, which came to
office in January 2001, that caused the OECD to review its initiative which had been
strongly supported by the previous Democratic Party government of Bill Clinton and
particularly by his Treasury Secretary, Lawrence Summers. Much of the success with
the Bush government was due to the collaboration of some Caribbean governments
with the Center for Freedom and Prosperity (CFP) in Washington. The CFP was
established by a group opposed to tax harmonisation and information exchange on the

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151 In Harry Huizinga and Gaetan Nicodeme’s “Are International Deposits Tax-Driven?”, European
Commission Economic Paper No 152, by using data on the cross-border ownership of deposits and on
the tax rates and information-sharing regimes (domestic and international) in effect in different
countries, Harry and Gaetan find that some mechanisms are more influential than others in driving
deposits offshore. In particular, high income and wealth taxes and domestic reporting of interest to the
tax authorities (15 OECD countries require their banks to generally report ‘interest paid and to whom it
is paid’) are strong influences. A point estimate is that a tax that lowers the net interest return by 100
basis points causes deposit placements abroad to increase by 146 per cent. In contrast, there is less
evidence that interest withholding taxes discourage such depositing, likely because the rates of
withholding tax are typically rather low.
basis of the damage that would be done to the US economy.\(^{152}\) The CFP informed members of the US Congress and Senate and the new US Government of the serious flaws in the OECD initiative. As a consequence, the new US Secretary of the Treasury, Paul O'Neill, caused the OECD to amend its initiative.\(^{153}\) While there were other countries, such as Canada, that earlier saw the wisdom of such change, they lacked the strength to resist the domination of the OECD by the 15 EU countries who had been the driving force behind this scheme. In the event, the OECD modified its initiative in November 2001, but only to refocus it on what O'Neill called its “core element”, ie, “the need for (OECD) countries to be able to obtain specific information from other countries upon request in order to prevent non-compliance with their tax laws”.\(^{154}\)

Thus the OECD initiative switched its focus to “transparency” and “effective exchange of information”.\(^{155}\)

OECD’s Authority

A fundamental difficulty still remained. It was one that had far reaching implications and was by no means limited to this particular initiative of the OECD. Should the offshore jurisdictions around the world accept that the OECD has the right or authority to set itself up to make tax rulings which they expect non-members to follow? By doing this, would these jurisdictions, targeted by the OECD as ‘tax havens’, not be


\(^{154}\) Sanders, above n 144.

\(^{155}\) Ibid.
opening the floodgates to a raft of other demands by an organisation with no international authority except the coercive power of its member states? The OECD is a multinational grouping of thirty countries. It is not an international organisation and it has no legal authority to speak for the world or to establish rules, norms or standards for any state except its own members. Nonetheless, it is now dictating terms on what, in short, could be described as cross-border tax matters.

The jurisdictions have now had to take serious account of it in reaching a decision about whether or not to make a commitment to the OECD on the two remaining aspects of “transparency” and “effective exchange of information”. By the same token, they also had to consider carefully the consequences to their economies of the application of sanctions by those members of the OECD who are important partners to them in trade and financial services. The key players in this regard would have been the US, Canada and the UK.

The OECD report Harmful Tax Competition: An Emerging Global Issue itself acknowledges that there is no compelling reason why any two countries should have the same tax policies and structure. It views this as a political decision.156 Mitchell, an opponent of the OECD, has accused the ‘unelected paper-pushers’ and bureaucrats at the OECD of seeking to set up a ‘tax cartel’ that would set tax policy for the world. His view is that this campaign is a backdoor manoeuvre aimed at ‘undermining national sovereignty’ of countries by placing the setting of a global tax policy in a few hands.157

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156 Organisation for Economic Co-operation and Development, above n 141, 15[26].
September 11, 2001

Prior to September 11, 2001, Treasury Secretary Paul O’Neill and his staff opposed certain aspects of the OECD harmful tax competition initiative and were lukewarm on the rest of it. However this attitude changed in the wake of the atrocities. Evidence of the changed mood in the US was an executive order by President George W Bush on 24th September 2001 requiring jurisdictions to establish a new counter-terrorism economic sanction and export control regime under the threat of more economic penalties. Further, the US introduced The USA Patriot Act imposing a series of extra-territorial measures targeting offshore financial institutions in the belief that they could be used to fund terrorist organisations. The belief that the terrorists and particularly the al-Qaeda organisation of Osama Bin Laden had used offshore financial centres to move money to finance their activities caused the US Treasury to temper its criticism of the OECD initiative. In the first place, the US needed the other OECD member-states to help forge its coalition against terrorism, and in the second it was easy to believe that financial institutions in small jurisdictions might have unwittingly provided facilities for terrorist organisations through legitimate companies. As it turns out, most of the terrorist bank accounts were actually in OECD countries including the US and the UK.

Offshore Financial Services by OECD Members


159 “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001”.

160 Sanders, above n 155.
Sanders offered some interesting findings worth noting: 161 80% of the total offshore financial services industry is located in the OECD countries. The remaining 20% is in the non-OECD countries, with even this segment dominated by a few large centres such as Hong Kong and Singapore which, the OECD had not named as ‘tax havens’. This means that approximately less than 10% of offshore business in the world is done in the targeted jurisdictions.

Account should also be taken of the fact that searches of banks throughout the world for money used to finance terrorism in the wake of the atrocities of 11th September 2001 in New York and Washington, revealed that most of the hundreds of millions of dollars of the al-Qaeda organisation and other terrorist groups was found in the banks of OECD countries. 162 Only US$20 million was discovered in The Bahamas after a search by that country’s authorities, and even then it was in a branch of a bank headquartered in an OECD country. Despite these findings, the pressure for OFCs to adhere to the “transparency” and “effective exchange of information” requirements is only increasing. As fittingly put by the Minister of Finance of the Bahamas, Sir William Allen: 163

The events of September 11 and their consequences are very unlikely to leave financial services unaffected. Already, there are indications of a likely adjustment in the trade off between individual privacy and collective security. The balance is a delicate one.

161 Ibid.
162 Ibid.
2.4 The FATF 40 Recommendations

2.4.1 The Focus of the FATF Report

In response to the mounting concerns over money laundering, the FATF was established by the G-8 Summit that was held in Paris in 1989. Recognising the threat posed to the banking system and to financial institutions, the G-8 Heads of State or Government and President of the European Commission convened the Task Force from the G-8 member States, the European Commission, and eight other countries.164

The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. It is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

In 1990, the FATF issued 40 recommendations165 intended to fight the phenomenon of money laundering. Based on those recommendations, the members of the FATF underwent a process of internal monitoring designed to bring their internal legislation and procedures into line with the recommendations on money laundering. The report on non-cooperative countries or territories released in 2000166 was a logical extension

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165 Financial Action Task Force, above n 67. For a full list of the 40 Recommendations, see Appendix G.
of this process, turning as it did from internal housecleaning measures to the examination of offshore jurisdictions.

The reason for this change of focus can be summarised by the following excerpt from the introduction to the report.\textsuperscript{167}

Existing anti-money-laundering laws are undermined by the lack of regulation and, essentially, by the numerous obstacles on customer identification, in certain countries and territories, notably offshore financial centres.

Recent years have witnessed a sharp increase in the number of jurisdictions offering financial services without appropriate control or regulation and protected by strict banking secrecy.

To ensure the stability of the international financial system and effective preventions of money laundering, it is desirable that all financial centres in the world should have comprehensive control, regulation, and supervision systems. It is also important that all financial intermediaries or agents be subject to strict obligations, notably as regards the prevention, detection, and punishment of money laundering.

Firstly, the report\textsuperscript{168} identified what the FATF considered to be the detrimental rules and practices that obstruct international cooperation against money

\textsuperscript{167} Ibid.
\textsuperscript{168} Ibid.
laundering. Secondly, it outlined the steps that would be taken by the FATF to “encourage constructive anti-money-laundering action.”

The 11 criteria identifying detrimental rules and practices that “enable criminals and money launderers to escape the effect of anti-money-laundering measures” are broken down into four categories:

- loopholes in financial regulations;
- obstacles raised by other regulatory requirements;
- obstacles to international cooperation; and
- inadequate resources for preventing and detecting money laundering activities.170

2.4.2 Analysis of the FATF 40 Recommendations

The first set of criteria concerns regulatory loopholes. Within this category, the FATF identified five sub-classes of detrimental rules and practices, which are summarised as follows.171 The first sub-class concerns regulatory and supervisory practices that fall seriously short of recognised international standards regardless of whether these practices relate to the regulation and supervision of financial institutions that operate either onshore or offshore. These criteria follow from Recommendation 26172, which

169 Ibid 14.
170 Hinterseer, above n 11, 236-38.
172 FATF Recommendation 26: “The competent authorities supervising banks or other financial institutions or intermediaries, or other competent authorities, should ensure that the supervised institutions have adequate programs to guard against money laundering. These authorities should cooperate and lend expertise spontaneously or on request with other domestic judicial or law enforcement authorities in money laundering investigations and prosecutions.”
states that financial institutions should have in place adequate programmes to guard against money laundering.

The second sub-class relates to procedures for the incorporation and licensing of financial institutions. These criteria are based on Recommendation 29\textsuperscript{173}, which states that the appropriate domestic authorities should implement and enforce effective legal and regulatory measures to protect financial institutions registered and operating in these jurisdictions from infiltration by criminal organisations. The type of procedures regarded as inadequate by the FATF include a lack of rules that obligate financial institutions to investigate the background of the corporate officers and to verify the true identity of the beneficial owners of the corporate counter-parties with whom they do business, rudimentary requirements within countries concerning the registration and licensing of financial institutions that seek to operate in their jurisdictions, and the absence of measures within countries to guard against a significant investment being made in or control or management functions being obtained over the financial institutions operating in their jurisdictions by criminal organisations.

The third sub-class involves inadequate customer identification requirements concerning the opening and operation of accounts. These criteria follow from Recommendations 10, 11 and 12.\textsuperscript{174} In particular, these recommendations respectively concern the need for financial institutions not to maintain anonymous accounts or accounts in obviously fictitious names, the requirement to verify a client's and beneficiary's identity, and the need to maintain relevant records for a reasonably time

\textsuperscript{173} FATF Recommendation 29: "The competent authorities regulating or supervising financial institutions should take the necessary legal or regulatory measures to guard against control or acquisition of a significant participation in financial institutions by criminals or their confederates."

\textsuperscript{174} Financial Action Task Force, above n 171, 6-7.
period. In the context of Recommendations 10, 11 and 12, the FATF notes that the associated obstacles are of two types. The first concerns a lack of any legal obligation to verify a counter-party’s identity. In particular, lack of effective legal requirements to verify both a client’s and beneficiary’s identity at the time a commercial relationship is initiated and no obligation to re-verify this information when questionable activities arise. Also included are no requirements for financial institutions to develop and maintain a money laundering training programme for employees. The second pertains to procedural obstacles. In particular, no obligation to maintain records for a reasonable period of time (five years) and the existence of legal, administrative, or other obstacles that hinder the exchange of information with other domestic as well as foreign regulatory and law enforcement agencies. By their nature, these procedural obstacles tend to hinder the exchange of information concerning a client’s and beneficiary’s identity and the financial activities conducted through the accounts they operate.

The fourth sub-class concerns excessive legal provisions embedded in domestic laws as well as administrative and other requirements that shelter questionable activities from regulatory oversight. These criteria follow from Recommendations 2 and 37. Recommendation 2 is one of the Forty Recommendation’s general framework recommendations and it states that domestic secrecy laws should not be structured in such a manner so as to inhibit the implementation of the recommendations. Meanwhile, Recommendation 37 states that countries should have in place measures

175 FATF Recommendation 2: “Financial institution secrecy laws should be conceived so as not to inhibit implementation of these recommendations.” FATF Recommendation 37: “There should be procedures for mutual assistance in criminal matters regarding the use of compulsory measures including the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in money laundering investigations and prosecutions and in related actions in foreign jurisdictions.”
to provide assistance when requested to do so by other countries. These mutual assistance measures include compulsory measures in respect of requirements to produce records, conduct searches, and seize evidence for use in investigations. Although the FATF accepts that the use of secrecy and confidentiality services maybe valid in certain circumstances, the FATF's concerns relate to excessive secrecy measures that pre-empt both the supervision of financial institutions and the investigation of suspicious activities. In particular, measures that hinder investigations by domestic and foreign regulatory and law enforcement agencies especially measures that effectively block money laundering investigations and prosecutions because they can not be waived, revoked or modified by the relevant authorities in appropriate circumstances.

Finally, the fifth sub-class relates to the lack of a suspicious transactions reporting regime or the existence of such a regime whose operation is ineffective. At the core of the Forty Recommendations is the principle that financial institutions should report all of the suspicious activities they identify to the relevant authorities. Obviously, the control of money laundering will be hampered where no such authority has been designated to receive such reports. An equally significant problem, however, concerns situations where a jurisdiction designated such as authority, but the operation of that authority is ineffective. In particular, where the designated authority is staffed in a deficient manner, lacks sufficient resources, is unable to disseminate material information as appropriate, or has ineffective powers to conduct investigations, the effect is the same as if no such authority had been designated.
The second set of criteria concerns obstacles that are embedded in a country's laws that hinder the investigation and prosecution of money laundering. This set of criteria follows from Recommendation 15, 16 and 17. Recommendation 15 states that financial institutions should be required to promptly report suspicious activities. Recommendation 16 recommends the exemption of financial institutions from civil and criminal liability where such a report is made in good faith, even if the financial institution has no knowledge as to what constitutes the underlying crime, and regardless of whether any illegal activity has actually occurred. Meanwhile, Recommendation 17 concerns measures that a country should put in place to prevent financial institutions from passing on to clients, details of the information that has been reported about the client's activities.

At the same time, the FATF recognises that it is insufficient, ineffective, and a waste of resources to develop and implement a suspicious reporting regime if the mechanisms of that regime do not operate in an effective manner. Here, the FATF's concerns focus on other domestic legal, regulatory, and administrative requirements that effectively neutralise the measures detailed under Recommendations 15, 16 and 17 and they include the following. First are inadequate legal requirements within countries related to the registration of companies, trusts, charitable foundations, and other organisations with legal personality. In particular, inadequate measures within

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176 FATF Recommendation 15: "If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the competent authorities." FATF Recommendation 16: "Financial institutions, their directors, officers and employees should be protected by legal provisions from criminal or civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, if they report their suspicions in good faith to the competent authorities, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred." FATF Recommendation 17: "Financial institutions, their directors, officers and employees, should not, or, where appropriate, should not be allowed to, warn their customers when information relating to them is being reported to the competent authorities."

countries to identify, record, and make available information concerning the name, legal form, address, directors, and articles of association of legal entities registered in their jurisdictions. Second are lack of requirements within countries to identify, verify and maintain current information on the beneficial owners of legal entities. An example of such an obstacle would be a situation where intermediaries are allowed to intercede in a transaction with the effect that the identity of the transaction’s beneficiary is hidden. This second set of criteria is to be read expansively as it is based on Recommendations 19 and 25. These recommendations focus on additional money laundering control measures that may be required with respect to professions other than the banking profession and are measures that relate to the regulation and monitoring of the activities of shell companies. Consequently, the FATF has flagged this second set of criteria as practices that are especially detrimental and are therefore of particular concern.

The third set of criteria concerns obstacles that hinder international co-operation in investigating and prosecuting money laundering. Given the transnational nature of organised crime, the control of money laundering requires more than the mere collection of information. Information must be shared as appropriate with other relevant domestic and foreign organisations in order to help build and bring comprehensive cases. Here, the obstacles of concern pertain to those that exist at the administrative and judicial level, while the associated criteria follow from

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178 FATF Recommendation 19: “Financial institutions should develop programs against money laundering. These programs should include, as a minimum: (i) the development of internal policies, procedures and controls, including the designation of compliance officers at management level, and adequate screening procedures to ensure high standards when hiring employees; (ii) an ongoing employee training programme; (iii) an audit function to test the system.” FATF Recommendation 25: “Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities.”
Recommendation 32. This recommendation states that regulatory and law enforcement agencies should be in a position to promptly exchange information as and when necessary and without undue restrictions.

The particular criteria identified by FATF to be of concern include the following. First are obstacles that hinder co-operation among administrative authorities. These obstacles include legal or administrative requirements that either prohibit or unduly restrict the exchange of information with both relevant foreign and domestic agencies especially the financial intelligence units of other countries. These obstacles also include laws or regulations that prohibit domestic authorities from pursuing enquiries or investigations on behalf of foreign agencies. In effect, they include any obstruction that manifests an obvious unwillingness to respond constructively to enquiries and to support investigations. Second are obstacles that hinder international co-operation among judicial authorities. The identification of these obstacles follows from Recommendations 4, 36 and 40. Recommendation 4 concerns the requirement to make money laundering a criminal offence, while the latter two recommendations

179 FATF Recommendation 32: “Each country should make efforts to improve a spontaneous or ‘upon request’ international information exchange relating to suspicious transactions, persons and corporations involved in those transactions between competent authorities. Strict safeguards should be established to ensure that this exchange of information is consistent with national and international provisions on privacy and data protection.”

180 FATF Recommendation 4: “Each country should take such measures as may be necessary, including legislative ones, to enable it to criminalize money laundering as set forth in the Vienna Convention. Each country should extend the offence of drug money laundering to one based on serious offences. Each country would determine which serious crimes would be designated as money laundering predicate offences.” FATF Recommendation 36: “Co-operative investigations among countries’ appropriate competent authorities should be encouraged. One valid and effective investigative technique in this respect is controlled delivery related to assets known or suspected to be the proceeds of crime. Countries are encouraged to support this technique, where possible.” FATF Recommendation 40: “Countries should have procedures in place to extradite, where possible, individuals charged with a money laundering offence or related offences. With respect to its national legal system, each country should recognise money laundering as an extraditable offence. Subject to their legal frameworks, countries may consider simplifying extradition by allowing direct transmission of extradition requests between appropriate ministries, extraditing persons based only on warrants of arrests or judgements, extraditing their nationals, and/or introducing a simplified extradition of consenting persons who waive formal extradition proceedings.”
relate to the exchange of information. An obvious red flag that identifies non co-operative countries and territories is the absence of laws that make the laundering of the proceeds of crime a criminal offence. In general, related obstacles include any legal, regulatory, administrative or other requirements that manifests an obvious unwillingness to respond to requests for assistance made under a mutual legal assistance treaty. Particularly where the request relates to matters recognised to be offences under the law of both countries or to issues involving tax and other fiscal offences.

The fourth set of criteria concern the inadequate allocation of resources by governments to their regulatory and law enforcement agencies to enable these agencies to identity, investigate, and prosecute money laundering. The control of money laundering requires an integrated approach in that it requires the public and private sector to work together. In ascertaining whether at least the framework to allow for such an approach is in place on the public sector side, two sets of criteria are especially relevant. First are insufficient operational resources such that administrative and judicial authorities lack the necessary financial, technical, and human resources to do their jobs. Second is the absence of a financial intelligence unit or equivalent body that is charged with collecting, analysing, and disseminating information to other administrative, judicial and law enforcement bodies. While financial institutions have primary responsibility for identifying and reporting money laundering activity, the state retains responsibility for analysing this information, conducting investigations, and of course bringing prosecutions. As a matter of principle, to justify the bureaucratic and financial burden imposed on financial

181 In this respect, a complimentary issue of importance that has been identified by the PATF concerns that of corruption, which must be addressed if efforts to control money laundering are to succeed.
institutions to identify suspicious activities, governments should ensure that they have in place effective mechanisms to analyse and use the information they require to be collected. Otherwise, the private sector is forced to bear an unnecessary burden that unduly ties up financial resources.\textsuperscript{182}

In October 2001, 8 more Recommendations from the FATF were added, incorporating the global fight against terrorism into its combat against money laundering.\textsuperscript{183}

\textbf{2.4.3 FATF Initiatives Updates}

In June 2000, the FATF released a second report.\textsuperscript{184} This report represented the implementation of the first recommendation of the earlier report, namely the establishment of a list identifying non-cooperative countries or jurisdictions in the area of money-laundering.

The FATF identified 29 countries for review.\textsuperscript{185} These countries were reviewed by four regional review groups which analysed the anti-money-laundering regimes in those jurisdictions. As provided for in the initial report, the reviewed jurisdictions were involved in face-to-face meetings and were invited to make comments on their respective draft reports. Of the 29 countries that were studied, 15 were ultimately considered to be non-cooperative. The report contains a summary of the conclusions reached with respect to each country under consideration.

\textsuperscript{182} Hinterseer, above n 170, 238-41.
\textsuperscript{183} See Appendix G.
\textsuperscript{184} Financial Action Task Force, above n 169.
\textsuperscript{185} See Appendix F.
On October 5, 2000, the FATF issued a press release stating that of the jurisdictions identified, 15 had either changed their legislation or had made a commitment to change their legislation in response to the June 2000 report. Of the jurisdictions identified, only Lebanon, Niue, and Nauru had not made some type of legislative change or political commitment to change or implement money laundering legislation. Notwithstanding this commitment, the FATF declined to remove any jurisdiction from the list of non-cooperative countries or territories at that time. In addition, it stated that it would later review more jurisdictions for possible inclusion in the list.

On 21st June 2002, the FATF released its annual report that included the list of Non-Cooperative Countries and Territories (NCCTs).

"The FATF issued its thirteenth annual report on 21st June, which outlines the main achievements of the FATF in 2001-2002 under the presidency of Hong Kong, China, including the significant progress that has been made in combating terrorist financing and in the work on non-cooperative countries and territories (NCCTs). Four regional groups (Americas; Asia/Pacific; Europe; and Africa and the Middle East) meet regularly to prepare the NCCTs discussions in the plenary.

To decide whether a jurisdiction should be removed from the list, the FATF must first be satisfied that the jurisdiction has addressed the deficiencies previously identified by enacting significant legislation and regulations. The

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187 Sieker, above n 104.
FATF removed Hungary, Israel, Lebanon; and St. Kitts and Nevis from the list of non-cooperative countries and territories (NCCTs) in the fight against money laundering."

"The list of NCCTs is as follows: Cook Islands; Dominica; Egypt; Grenada; Guatemala; Indonesia; Marshall Islands; Myanmar; Nauru; Nigeria; Niue; Philippines; Russia; St. Vincent and the Grenadines; and Ukraine. For those jurisdictions which were identified as non-cooperative in 2000 and in 2001 and which had not made adequate progress, the FATF has a policy to recommend further countermeasures in a gradual, proportionate and flexible manner. Accordingly, the FATF calls on its members to update their advisories requesting that their financial institutions give special attention to businesses and transactions with persons, including companies and financial institutions, in listed countries or territories to take into account the changes in the list.

The FATF welcomed further progress made by a number of the 15 jurisdictions on the list. On the basis of the progress made, Grenada, Niue, Russia and St. Vincent and the Grenadines will be invited to submit implementation plans to enable the FATF to evaluate the actual implementation of their legislative changes. At its next plenary meeting on 9-11 October 2002, the FATF reviewed again the situation of each NCCT."
In 2003, the same report had several updates, including a fall from 15 to 9 NCCTs.\(^{189}\)

The FATF recognised that St. Vincent and the Grenadines, listed as non-cooperative in the fight against money laundering in June 2000, had sufficiently addressed the deficiencies identified by the FATF through enactment and implementation of appropriate legal reforms. In October 2002, the Plenary recognised that Russia, Dominica, Niue and Marshall Islands, identified as NCCTs in June 2000, had addressed the identified deficiencies and therefore removed them from the NCCTs list.\(^{190}\) And in February 2003, the Plenary removed Grenada from the list of NCCTs after enactment and implementation of legal reforms addressing identified deficiencies. Consequently, the procedures prescribed in FATF Recommendation 21 were withdrawn.\(^{191}\) To ensure continued effective implementation of these reforms, the FATF will monitor the developments in St. Vincent & the Grenadines, as well as Dominica, Niue, the Marshall Islands, and Grenada, in consultation with the relevant FATF-style regional body and particularly in the areas laid out in this NCCT report.\(^{192}\)

Although removed from the NCCTs list in June 2001, the Bahamas has been subjected to FATF monitoring since that time. The FATF encouraged the Bahamas to improve mechanisms for international co-operation so that the FATF may end formal monitoring.\(^{193}\)


\(^{190}\) For a deeper insight into the fulfilled regulations which will grant a country or territory removal from the NCCTs list, please see Appendix J.


\(^{192}\) Financial Action Task Force, above n 189.

\(^{193}\) Ibid.
The FATF welcomed the progress made by the Cook Islands, Egypt, Guatemala, Nigeria, the Philippines, Ukraine and Nauru in addressing deficiencies and calls upon them to continue this work. Until the deficiencies have been fully addressed and the necessary reforms have been sufficiently implemented, it believes that scrutiny of transactions with these jurisdictions, as well as those with Indonesia and Myanmar, continues to be necessary and reaffirms its advice of June 2000 to apply, in accordance with Recommendation 21, special attention to such transactions. The FATF notes with particular satisfaction that Egypt, Guatemala, and the Philippines have enacted most, if not all legislation needed to remedy the deficiencies previously identified. On the basis of this progress, the FATF will invite those countries to submit implementation plans to enable the FATF to evaluate actual implementation of the legislative changes in each jurisdiction according to the principles agreed upon by its Plenary.

With respect to jurisdictions de-listed in June 2002 and subject to the monitoring process from June 2002 to June 2003, future monitoring for St Kitts & Nevis will be conducted within the context of the Caribbean Financial Action Task Force’s (CFATF) relevant monitoring mechanisms. Future monitoring of Hungary will be conducted within the Council of Europe’s MONEYVAL and its relevant monitoring mechanisms.

194 Ibid 1.
195 In 2002, the PC-R-FY formally changed its name to MONEYVAL. MONEYVAL was established in September 1997 by the Committee of Ministers of the Council of Europe to conduct self and mutual assessment exercises of the anti-money laundering measures in place in 25 Council of Europe countries, which are not members of the Financial Action Task Force (FATF). The effort includes encouraging jurisdictions to improve their anti-money laundering measures in keeping with the FATF Forty Recommendations and to enhance international co-operation. MONEYVAL also engages in a regular typologies exercise focused on the methods and trends of money laundering activity.
At June 2003, the list of NCCTs comprised the following jurisdictions: Cook Islands, Egypt, Guatemala, Indonesia, Myanmar, Nauru, Nigeria, Philippines and Ukraine. The FATF called on its members to update their advisories requesting that their financial institutions give special attention to businesses and transactions with persons, including companies and financial institutions, in those countries or territories identified in the report as being non-cooperative.\textsuperscript{196}

The FATF noted with concern the failure by the governments of Indonesia and Myanmar to make more substantive progress since June 2002. Although they have enacted some anti-money laundering measures, serious deficiencies remain that will inhibit implementation of comprehensive anti-money laundering systems.\textsuperscript{197}

In February 2004, Egypt and Ukraine were dropped from the list of NCCTs due to their substantial implementation of anti-money laundering reforms.\textsuperscript{198} The annual review report released on 2 July 2004 recognised the efforts of Guatemala and removed it from the NCCTs list.\textsuperscript{199} According to the 2004 review report, the remaining jurisdictions under the NCCTs list are: Cook Islands, Indonesia, Myanmar, Nauru, Nigeria and Philippines.

2.5 \textbf{Financial Stability Forum (FSF) and Global Economic Stability}

Three general objectives define the scope of the FSF’s work. The first is to identify points of vulnerability within the international financial system where detrimental

\textsuperscript{196} Financial Action Task Force, above n 194.
\textsuperscript{197} Ibid.
\textsuperscript{198} Financial Action Task Force, above n 191.
practices may fester and problems and crises may develop. The second is to make recommendations and to oversee the actions necessary to address these vulnerabilities. The third is to improve communications and the exchange of information among the various authorities responsible for promoting international financial stability. The FSF noted:

Weakness in supervision and lack of co-operation by some OFCs together lead to two types of problems, which can be inter-related, in the oversight of the international financial system: prudential concerns, relating to the scope for effective supervision of internationally active financial intermediaries; and market integrity concerns, relating to the effectiveness of international enforcement efforts in respect of illicit activity and abusive market behaviour.

Of particular concern for the FSF is the general lack of transparency and oversight related to the financial activities originating in and flowing through OFCs. In this respect, its concerns overlap with those of FATF and OECD. However, while the FATF's and OECD's concerns are focused on specific issues, the FSF's remit is much broader.

As the FSF observes, "Implementation of standards varies considerably across OFCs, with some making serious efforts to adhere to internationally accepted standards, while others making little or no effort, or actively use supervisory laxity as a means of promoting their attractiveness to investors and customers." To address this concern,

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201 Financial Stability Forum, above n 54, 2.
the FSF, like the FATF and OECD, has adopted a "name and shame" strategy\(^{203}\) to bring international pressure to bear on countries in order to encourage them to modify their practices. The FSF’s approach is set out in its initial report entitled *Report of the Working Group on Offshore Centres*, which was delivered to the FSF’s secretariat on April 5, 2000 (the "April 5, 2000 Report").\(^{204}\) The FSF surveyed a number of OFCs and based on this survey, recommended that the IMF, in collaboration with the World Bank, undertake a more detailed assessment,\(^{205}\) which is currently ongoing. This assessment focuses on the adherence by OFCs to international regulatory standards with the aim of encouraging OFCs to adopt, where they are identified to be deficient, internationally recognised regulatory standards. To encourage OFCs to participate in the process, a combination of coercion and incentives have been used.\(^{206}\) They include, for example, the publication of a list of OFCs that details their progress to date in improving their regulatory structures as well as the provision of technical assistance to help countries bring their domestic regulatory structures into line with internationally recognised standards.

Contrary to conventional political policy, it is argued here that the adoption of a pure "name and shame" approach may even prove counterproductive. Tampering with reputational mechanisms might, at the same time, not only miss the target but also reach the wrong target.\(^{207}\)

\(^{203}\) Ibid 31.
\(^{204}\) Ibid.
\(^{205}\) Ibid 24.
\(^{206}\) Ibid 29.
Of particular note are the seven criteria used by the FSF in preparing its April 5, 2000 Report to identify those countries deemed to be deficient in adhering to international regulatory standards, as these criteria are the same as those used by the FATF and OECD.13

1. Lack of due diligence requirements imposed on financial institutions operating within their jurisdictions to check and verify the identity of the owners and beneficiaries that stand behind these companies;
2. Inadequate rules imposed on financial institutions operating in their jurisdiction concerning the disclosure of material information to regulators and the financial markets;
3. Restrictions and limitations either directly or indirectly imposed on regulatory agencies that mean they are unable to develop adequate knowledge about the financial institutions and the activities they conduct within their jurisdictions;
4. Insufficient allocation of resources to regulatory agencies to allow these agencies to effectively monitor the activities of the financial institutions operating within their jurisdictions;
5. Limitations imposed on regulatory agencies in respect of co-operating with regulators in other jurisdictions particularly those in IFCs;
6. The existence of excessive secrecy laws that impede the exchange of information with foreign counter-parties; and
7. General lack of political will to improve the quality of regulatory oversight.

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The FSF has noted that although these seven "regulatory weaknesses" exist to varying degrees within most OFCs, the standard of regulation varies across OFCs such that in some jurisdictions, the concerns to which these criteria give rise are minimal. The Bahamas, for example, is a highly respected OFC that is often singled out as making extensive efforts to comply with international standards.\textsuperscript{209}

Several recommendations with respect to the future focus of efforts to improve the transparency of OFCs were made in the report and these can be grouped into three main categories:\textsuperscript{210}

1. Measures to implement customer identification and record keeping requirements;
2. Initiatives to improve cross border co-operation with respect to the exchange of information; and
3. Plans to provide technical assistance in order to enhance the supervisory powers and abilities of domestic regulators.

The FSF recognises that adherence to international standards will not be automatic and that this goal will only be achieved over time. To assist OFCs in improving their domestic regulatory standards and capabilities, the April 5, 2000 Report set out a five stage process that the IMF and World Bank, with the FSF’s assistance, is to oversee:\textsuperscript{211}

1. An OFC makes a commitment to pursue reform;
2. The OFC conducts a self assessment exercise to identify deficiencies;

\textsuperscript{209}Hinterseer, above n 182, 258-9.
\textsuperscript{210}Financial Stability Forum, above n 208, 28.
\textsuperscript{211}Ibid 26.
3. The OFC, in co-operation with the FSF, develops a plan and associated set of milestones to remedy the deficiencies;

4. An independent third party conducts an independent review; and

5. The OFC works with the FSF to monitor its progress and continued compliance with international regulatory standards.

An important finding of the report was that, to date, OFCs do not appear to have been casual factors in creating instability within the financial markets. To date, no evidence has been found, for example, to support detrimental changes in interest or currency rates of any economy.\(^{212}\) However, this does not mean that OFCs have neither been sources of past, nor will be of future, instability. As the financial markets grow ever more interdependent, detrimental market practices and the problems to which they give rise will be transmitted throughout the international financial system much more quickly. To the extent that they protect or promote questionable market practices, OFCs may be a source of instability. A conclusion of the report is a concern echoed by the FATF and OECD, which is that among the primary problems posed by OFCs to the stability of the international financial system, is inadequate supervision and regulation of the legal entities\(^{213}\) being created in and operating both within and through these jurisdictions. The FSF’s concerns, like those of the FATF and OECD, are that significant growth in the assets held by these legal entities and the financial flows they route through OFCs, in combination with a lack of transparency and

\(^{212}\) Contrary to this, the paper entitled ‘Tax Havens: Releasing the Hidden Billions for Poverty Eradication’ by the Policy Department of Oxfam (Great Britain) suggested that “Tax havens and OFCs are now thought to be central to the operation of global financial markets. Currency instability and rapid surges and reversals of capital flows around the world became defining features of the global financial system during the 1990s. The financial crisis that ravaged East Asia in the late 1990s was at least partly a result of these volatile global markets.” Policy Department of Oxfam (Great Britain) Tax Havens: Releasing the Hidden Billions for Poverty Eradication (2002) ATTAC International <http://attac.org/fr/ oil/doc/oxfam2.htm> at 22 October 2003.

\(^{213}\) In the context of the work pursued by each organisation, “legal entities” should be given wide meaning to include companies, trusts, charities and any other economic vehicle with legal personality.
growing market interdependence, increases prudential and market integrity concerns. Together, the work of the FSB, FATF, and OECD is mutually reinforcing and it is therefore no wonder that OFCs have felt under threat from the international community.

2.6 Wolfsberg Anti-Money Laundering (AML) Principles

On October 30, 2000, a new initiative to combat money laundering was unveiled. What differentiates this initiative from many of the existing initiatives is that it has been put forward by the private sector, in the absence of coercion by a public sector body. Eleven banks originally signed the Wolfsberg Principles, which are a non-binding set of best practice guidelines governing the establishment and maintenance of relationships between private bankers and their clients. As Dr Peter Eigen, the Chairman of Transparency International, observed on the release of the Wolfsberg Principles, "This is a unique event – few would expect the leading anti-corruption organisation and the leading banks to be standing on the same platform." Guided by active and former FATF members who help ascertain whether these principles meet

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214 Financial Stability Forum, above n 210, 16.
215 Hüscher, above n 209, 258-62.
217 For a bank to become a signatory of the Wolfsberg Principles, the bank must merely deliver a signed commitment letter that incorporates the following statement: "We hereby confirm that having read and understood the Wolfsberg AML Principles (Global Anti-Money-Laundering Guidelines for Private Banking), as such principles appear on the Wolfsberg-Principles.com website as of October 30, 2000, we are committed to applying these principles in full and without conditions. Please add our name to the list of banks that wish to reflect their commitment to these principles on such website. Our name for purpose of inclusion in such list should be (name of bank and internet link)." The commitment should be signed by at least two authorised signatories. Letters not in strict conformity with the above will be rejected. Of note, the 11 original authors of the Wolfsberg Principles reserve the right to change or amend the Wolfsberg Principles at any time without the consent of the other parties. As worded, banks who subsequently register a commitment may be excluded from this process. This could hinder banks adopting the principles although for practical reasons this observation may be more apparent than real.
international standards to control money laundering and making references to the Forty Recommendations where appropriate, the Wolfsberg Principles were formed.

Two years were required to draft the Wolfsberg Principles, which are named after the United Bank of Switzerland (UBS) training centre where the negotiations took place. Eleven banks took part in the process: ABN Amro Bank, Banco Santander Central Hispano, Barclays Banks, The Chase Manhattan Private Bank, Citibank, Credit Suisse Group, Deutsche Bank, Hongkong Shanghai Bank Corporation, JP Morgan, Societe del Gottardo and UBS.\(^{219}\) The inclusion of UBS and the Credit Suisse Group are of particular note as they are two of Switzerland’s most important financial institutions, while Switzerland itself continues to be one of the world’s most important financial centres for private banking. However, notable by the absence of their signatures are Merrill Lynch, Morgan Stanley, Goldman Sachs, and any South American banks. It is also of note that of the 11 banks that signed the Wolfsberg Principles, most have been associated with financial and money laundering scandals of one form or another within the past decade.\(^ {220}\) It is of little wonder then that on the signature of the Wolfsberg Principles, some private bankers dismissed them as a mere public relations exercise.\(^ {221}\)

2.6.1 Analysis of the Workings of the Wolfsberg Principles


\(^{220}\) There are 12 banks currently, with the inclusion of Bank of Tokyo-Mitsubishi Ltd.

The following analysis of the Wolfsberg Principles, is in greater detail than the previous analysis of the OECD and FATF recommendations, in that the Wolfsberg Principles as agreed to by the participating banks, are more relevant to Singapore as a Regional Financial Centre and in regards to its aspirations to become a global wealth management centre.

Wolfsberg Principle 1.1\textsuperscript{222} states that the primary purpose of the Wolfsberg Principles is to ensure that the private banking services offered by the banks are not abused for criminal purposes. This is an extension of the existing international framework to control money laundering promoted by the FATF based on the know-your-client (KYC) principle. It therefore means that banks should not keep anonymous accounts and should not enter into or maintain commercial relations with counterparties either whose true identity cannot be readily identified, or whose activities reveal a questionable pattern of activity. This principle also manifests the idea that money laundering is best fought at the placement stage of the process by instituting various checks and disclosure requirements in order to make it as difficult as possible for criminally tainted money to enter the financial system. It is of interest that it is the private banker who introduces the client to the firm who is charged with the primary responsibility for discharging the obligation to establish that the funds of the potential client derive from a legitimate source. This is surprising. Placing an obligation on the private banker is to make him/her accountable to the bank in that if the client he/she introduces to the bank turns out to be engaged in nefarious activity, then he/she will be held accountable and probably lose his/her job. However, to a certain extent, the effect of this is to unduly shift the onus of responsibility from the bank on to the

\textsuperscript{222} The Wolfsberg Group, above n 219.
private banker. The temptation may exist on the part of some private bankers or banks to redirect profitable, but questionable activities, to subsidiaries located in jurisdictions with relatively more flexible regulatory regimes.

The Wolfsberg Principles do not aim to address this situation as they are premised on an implicit assumption that the private bankers that work for the banks will not act in a manner that would lead to their collusion in, or the promotion of, money laundering activity. The reality, however, is that several of the most significant financial scandals recently involved the evasion of internal guidelines and policies that aimed to check questionable activity by individual bank employees. The Wolfsberg Principles obviously cannot accommodate situations where bank employees are determined to follow a course of action that runs counter to a bank's compliance requirements. However, banks need to be aware of the potential for such activity and, just as the client activities need to be monitored, the activities of individual private bankers may also need to be watched and reviewed.

Wolfsberg Principle 1.2 deals with identification and states that 'The bank will take reasonable measures to establish the identity of its client and beneficial owners and will only accept clients once this process has been completed.' Although Wolfsberg Principle 1.1 places primary responsibility on the private banker, the effect of Wolfsberg Principle 1.2 is that at least secondary responsibility is assumed by the bank. In other words, the bank assumes secondary responsibility for ensuring that reasonable measures are taken to establish the clients and beneficial owners. This requirement is consistent with FATF Recommendation 11.

\[223\] Ibid.
Wolfsberg Principle 1.2.1 focuses on the documentation required in respect of establishing a client’s true identity. The required documents are in line with FATF Recommendation 10, which states that financial institutions ‘... should be required ... to identify, on the basis of an official or other reliable identifying document, and record the identity of their clients, either occasionally or usual, when establishing business relations or conducting transactions...’ For natural persons, identity will be established to the bank’s satisfaction where official papers (like a passport, driver’s licence, or government identification card) or other evidence appropriate for the circumstances is provided to the bank. For corporations, partnerships, and foundations, documents concerning the due organisation and existence of the relevant entity will suffice. For trusts, the banks will require the identity of the trustees and evidence to prove that the trust has not only been formed in the correct and proper manner, but also that its existence remains valid.

Wolfsberg Principle 1.2.2 focuses on the need to establish the beneficial ownership of each account. Under this Wolfsberg Principle, ‘Due diligence must be done on all principle Beneficial owners...’. This Wolfsberg Principle is in line with FATF Recommendation 11. In respect of natural persons under Wolfsberg Principle 1.2.2, ‘... when an account is opened in the name of an individual, the private banker must establish whether the client is acting on his/her own behalf.’ If the private banker has doubts, then the bank will seek to establish the capacity in which, and on whose behalf, the account holder is acting. Given that the bank is willing to assume this

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224 Natural persons means individuals, while in contrast legal persons means corporations, charities, trusts, and other organisations with legal personality.
responsibility, a statement of joint responsibility between the private banker and the bank would be more appropriate.

Wolfsberg Principle 1.2.3 concerns accounts held in the name of money managers and similar intermediaries. "The private banker will perform due diligence on the intermediary and establish that the intermediary has due diligence process for its clients, or a regulatory obligation to conduct such due diligence, that is satisfactory to the bank." A narrow reading of this Wolfsberg Principle would seem to impose an unduly onerous requirement. Given that the intermediary will invariably be a legal entity, the implication is that the private banker would have to develop an understanding of the operations of the entity in line with Wolfsberg Principle 1.2.2.

In addition, the private banker would have to ensure that the intermediary has in place a due diligence programme concerning clients or at the very least is subject to a regulatory obligation to conduct due diligence on prospective clients. Presumably, the private banker need only to establish that the intermediary has a due diligence programme or is subject to such a regulatory obligation and is not obligated to develop an understanding of the intermediary's business. It is arguable that it would have been more appropriate for the bank to have assumed sole responsibility for conducting the necessary due diligence. The reason is that the money manager or other intermediary are most likely to be at an institution with which the bank regularly deals and as such the bank as an institution will have more familiarity with the intermediary than that the individual private banker.
Wolfsberg Principle 1.2.4 concerns power of attorney and authorised signatories. This requirement is in line with Wolfsberg Principle 1.2.2 regarding natural persons.

Wolfsberg Principle 1.2.5 concerns walk-in clients and electronic banking relationships. ‘A bank will determine whether walk-in clients or relationships initiated through electronic channels require a higher degree of due diligence prior to account opening.’ What this provision amounts to is a statement that in situations where a person who neither has a prior relationship with, nor is known to the bank (for example, through a course of prior dealing unrelated to private banking), approaches the bank in order to initiate a business relationship, the bank will determine if any higher level of due diligence is required with respect to this prospective client. In terms of the standard of due diligence required, the private banker will need to look to the Wolfsberg Principles to determine what, at a minimum, is required and then inquire about any additional requirements the bank may choose to mandate. To place the primary responsibility on the private banker to ensure that only clients whose wealth can be proven to be legitimate are accepted may, in this situation, be criticised. Here, an individual seeking to initiate a private client relationship will have approached the bank.

Consequently, it is not the private banker, but the bank that is in effect sponsoring the client for acceptance. As such, the bank should bear primary responsibility for conducting the due diligence especially if the bank seeks to impose additional due diligence requirements. This Wolfsberg Principles contemplates electronic banking relationships and its provisions are in line with FATF Recommendation 13. This recommendation states that ‘Countries should pay special attention to money laundering threats inherent in new or developing technologies that might favour..."
anonymity, and take measures, if needed, to prevent their use in money laundering schemes.

Wolfsberg Principle 1.3 sets out what is required with respect to the due diligence process.\textsuperscript{225} Of note, this Wolfsberg Principle states that it is only necessary to collect and record the information, but remains silent as to whether supporting documentation is required. Presumably, this is a matter for each bank to decide. Given the potential litigation and damage to reputation to which both the bank and private banker may be exposed, it would be helpful to have supporting documentation. Inclusion of the word “reputation” is odd. Surely, what is relevant is not the reputation of the business, but the substantial activity it conducts.

Consequently, requesting the last audited accounts or a business plan, where such documents exist and are available, would be more helpful than collection character references that are easy to fabricate. Meeting a prospective client is certainly helpful, especially where the meeting is documented in order to demonstrate that all reasonable steps had been taken in conducting due diligence. The principle goes on to state that ‘Unless other measures reasonably suffice to do the due diligence on a client (e.g. favourable and reliable references), a client will be met prior to account opening’. However, accepting a client based solely on such a meeting should be resisted. The very fact that they cannot provide basis information should itself be a red flag indicating potential money laundering activity. Moreover, given that those engaged in

\textsuperscript{225} Wolfsberg Principle 1.3: “It is essential to collect and record information covering the following categories: purpose and reason for opening the account, anticipated account activity, source of wealth (description of the economic activity which has generated the net worth), estimated net worth, source of funds (description of the origin and the means of transfer for monies that are accepted for the account opening), and reference to other sources to corroborate reputation information where available.” The Wolfsberg Group, above n 223.
money laundering are individuals most likely to fabricate a story, a meeting without
other evidence to demonstrate proof of identity and wealth may be of questionable
value.

Wolfsberg Principle 1.4 states, "There will be a requirement that all new clients and
new accounts be approved by at least one person other than the private banker."\textsuperscript{226}

Presumably, this person will be another employee of the bank. Given that the bank
will be reviewing the due diligence conducted by the private banker, joint
responsibility under Wolfsberg Principle 1.1 would be a more appropriate standard.
Moreover, this Wolfsberg Principle would have been strengthen if a provision had
been included that ran as follows: If the person who approves the new account
believes that the due diligence conducted by the private banker was unsatisfactory,
then, as in Wolfsberg Principle 1.2.2 (natural persons), the bank will take the
necessary reasonable measures to ensure that the due diligence process is completed
both in an acceptable manner, and to an acceptable standard.

Wolfsberg Principle 2 concerns client acceptance and sets out situations that require
additional due diligence and attention.\textsuperscript{227} Under Wolfsberg Principle 2.1, "Numbered
or alternate name accounts will only be accepted if the bank has established the
identity of the client and the beneficial owner." This goes against FATF
Recommendation 10, which reads in part, 'Financial institutions should not keep
anonymous accounts or accounts in obviously fictitious names.'\textsuperscript{228} Debate as to
whether numbered accounts and similar financial instruments that disguise beneficial
ownership, serve any useful commercial function are ongoing. Certainly numbered

\textsuperscript{226} Ibid.
\textsuperscript{227} Ibid.
\textsuperscript{228} See Appendix G for a list of the FATF 40 Recommendations.
accounts and accounts in alternate names have played a prominent role in facilitating crime. However, the use of such accounts and similar financial instruments per se should not be prohibited so long as access to the relevant information can be gained when necessary by the appropriate authorities.

To strengthen this Wolfsberg Principle, and to bring it more in line with FATF Recommendation 10, adding a statement to the effect that such information will, subject to compliance with the relevant legal requirements, be made to the relevant local law enforcement and regulatory authorities as and when requires, would have been useful. In addition, the banks could have included a provision that states that they will monitor these accounts to ensure that a pattern of suspicious activity does not develop. In any event, the mere fact that a potential client requests that an account in an alternate name be opened and maintained may be enough, depending on the circumstances, to warrant the filing of a suspicious transaction report with the relevant authorities.

Wolfsberg Principle 2.2 states, ‘The bank will apply heightened scrutiny to clients and beneficial owners resident in and funds sourced from countries identified by credible sources as having inadequate anti-money laundering standards or representing high-risk for crime and corruption.’ This is in line with the FATF’s work and with FATF Recommendation 21. Again, one set of developments that banks will need to closely monitor concerns the expanding number of predicate offences that will give rise to a money laundering charge. In the United States over 160 offences have been designated as predicate offences and this number is set to increase. The work of the OECD and current consideration being given to the inclusion of fiscal offences as
predicate offences highlights this trend. Given the importance of tax considerations in shaping the business conducted within the private banking industry and the fine line that divides tax avoidance from tax evasion, banks will need to monitor these developments with extreme care.

Wolfsberg Principle 2.3 states that ‘Risks associated with entities organised in offshore jurisdictions are covered by due diligence procedures laid out in these guidelines.’ To closely monitor and scrutinise the nature of the financial activities originating in and being conducted through offshore jurisdictions will therefore be important. Banks will need to ensure that financial flows that come from offshore jurisdictions, and which are channelled through their organisations via the service they offer, are clean. In this respect, the FATF’s work on non-compliant countries and territories should be taken into account by banks.

Wolfsberg Principle 2.4 concerns high-risk activities.\textsuperscript{229} It states that ‘Clients and beneficial owners whose source of wealth emanates from activities known to be susceptible to money laundering will be subject to heightened scrutiny.’ Undoubtedly this will be important in order to protect the bank from potentially becoming involved in money laundering activity. In identifying individuals whose wealth emanates from questionable sources, banks should be aware of designations made under the US \textit{Foreign Narcotics Kingpin Designation Act 1999}.\textsuperscript{230} Under this act, the Department

\footnotesize{\textsuperscript{227} The Wolfsberg Group, above n 227. \textsuperscript{228} Measures can then be enforced against these individuals under the \textit{International Emergency Economic Powers Act 1995} and Executive Order 12978. The office of Foreign Assets Control is responsible for implementing sanction against countries designated under the \textit{International Emergency Economic Powers Act} as posing a threat to national security, economy, or foreign policy of the United States. In consultation with the Department of State, the Office of Foreign Assets Control develops a list of Specially Designated Narcotics Traffickers against which a Presidential Finding may be issued. In 1998, for example, the Office of Foreign Assets Control had listed 451 companies and individuals against which prohibition and blocking order had been made. The list includes four “Kingpins” of the}
of the Treasury, Department of Justice, Department of State and the Department of Defence are required to consult each year to develop a list of recommended "Kingpins" for Presidential designation on 1 June of each year. Once designated, the Secretary of State, the Attorney General and other relevant bodies will consult and impose appropriate sanctions on American companies and citizens to prohibit them from engaging in transactions with these "Kingpins" and their associates. The jurisdiction claimed by the United States in enforcing its money laundering laws is becoming ever more expansive. Banks, so long as they conduct business either in or through United States, will need to be cognisant of developments such as these and adjust their internal compliance and training programmes as appropriate.

Wolfsberg Principle 2.5 concerns high-risk activities. "Individuals who have or have had positions of public trust such as government officials, senior executives of government corporations, politicians important political party officials etc and their families and close associates require heightened scrutiny." This Wolfsberg Principle is in line with the OECD’s work on corruption. What this principle implies about the democratic process is of note. To a certain extent, it is a manifestation of the trend inherent in the expanding scope of money laundering laws that concerns how banks relate to their clients. The legal sanctions that can be imposed following a conviction for money laundering mean that banks must now approach client relations from a position of suspicion in contrast to the past where clients were at least given the

Calic Cartel. The listing of Julio Cesar Nasser David alone affected 154 companies and 292 additional individuals involved in his organisation’s legal activities. See United States Department of the Treasury, Treasury under Secretary (Enforcement) Raymond W Kelly, House Committee on Banking and Financial Services, 11 June 1998. See also United States Department of the Treasury, Treasury under Secretary (Enforcement) Raymond W Kelly, House Judiciary Committee on Crime, 24 July 1997.

231 The Wolfsberg Group, above n 229.

232 See appendix L for a list of the initiatives put forward by the OECD related to corruption. See also Society for Advanced Legal Studies Anti-Corruption Working Group, Banking on Corruption: The Legal Responsibilities of Those Who Handle the Proceeds of Corruption (2000 Society for Advanced Legal Studies, 2000)
benefit of the doubt. The effect of this Wolfsberg Principle, however, is to state that public officials cannot be trusted. In fact it implies, precisely because they hold a position of public trust, government officials should not be trusted to be engaged in commercial activities that are entirely clean and legal in nature. When moving from the realm of theory and the idea that the rule of governments ought to be based solely on principles of justice into reality and the realisation that the interests of the latter may be sacrificed, it opens the possibility for corruption to spread. Unfortunately, this Wolfsberg Principle manifests a practical reality of public life.

Wolfsberg Principle 3 concerns updating client files. 233 ‘The private banker is responsible for updating a client’s file on a defined basis and/or when there are major changes.’ This Wolfsberg Principle merely manifests prudent commercial practice, while the information such an exercise provides should be views as part of the ongoing competitive need to provide and tailor services to clients. Of note, the private banker’s supervisor or an independent control person will review relevant portions of the client files on a regular basis to ensure consistency and completeness. This is important as it means that banks will take some responsibility for ensuring that their clients are not engaged in questionable activity. To ensure that the exercise is conducted in an objective manner, an independent person within the bank should of course perform this function. As client files are updated, the requirements of FATF Recommendation 12 should be kept in mind.

233 The Wolfsberg Group, above n 231.
Wolfsberg Principle 4 focuses on the practices associated with identifying unusual or suspicious activities. Wolfsberg Principle 4.1 states, 'The bank will have a written policy on the identification of and follow-up on unusual or suspicious activities. This policy will include a definition of what is considered to be suspicious or unusual and give examples thereof.' It goes on to states that unusual or suspicious activities may include account transaction or other activities that are not consistent with the due diligence file, cash transactions over a certain amount and pass-through/in-and-out transactions. The list is not exhaustive, which is necessary given the dynamic nature of the money laundering process.

In brief, money laundering will only be successfully controlled where banks, regulators and law enforcement agencies are able to work together in a co-operative manner. As part of building a co-operative relationship, banks will require feedback on the usefulness of the information they provide to regulatory and law enforcement agencies. Only through adequate feedback will it be possible for banks to maintain a comprehensive and up-to-date compliance programme. As part of the process it will be important for regulatory and law enforcement agencies to communicate the transactions and activities to the banks and they believe constitute suspicious activity. In this respect, the work of the FATF, in particular its work on identifying money laundering typologies, methods, and trends, will be of use, as well as the biannual report that the Financial Crimes Enforcement Network has begun to publish on the same matter.

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234 Ibid.
235 The FATF's work on money laundering typologies can be found at www.oecd.org/fatf.
236 The biannual report published by the Financial Crimes Enforcement Network can be found at www.treasury.gov/fincen.
Wolfsberg Principle 4.2 deals with the identification of unusual or suspicious activities and states that unusual or suspicious activities can be identified through monitoring transactions, contact with the client him/herself, third party information, and the private banker’s internal knowledge of the client’s environment. This non-exhaustive list is sensible.

Wolfsberg Principle 4.3 focuses on how suspicious activities are to be followed-up. It states that the private banker, management, or the “control function” will conduct an analysis of the background of the unusual or suspicious activity. If no plausible explanation for the suspicious activity can be identified, than a decision will be made that involves the “control function” concerning whether the business relationship is to be continued with increasing monitoring, or whether to be cancelled, or reported to the authorities. This principle goes on the state that “… senior management may need to be notified”. In general, senior management should be appraised of all suspicious activity reports that are being made. At the very least, a summary of the reports should be reviewed at each board meeting so that senior management will be aware of the suspicious activity to which their bank may be exposed and how this exposure has changed over time.

Wolfsberg Principle 5 concerns monitoring and states that a sufficient monitoring programme must be in place. Like Wolfsberg Principle 1.1, primary responsibility is placed with the private banker who must monitor the activity of the account. From one perspective this is inappropriate because, as Wolfsberg Principle 5 states (and in line with Wolfsberg Principle 4.3), the private banker will be familiar with the activity

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337 The Wolfsberg Group, above n 234.
of, and significant transactions conducted through, the account and will be especially aware of unusual or suspicious activities. However, the same critique made against the banks under Wolfsberg Principle 1.1 for not accepting joint responsibility along with the private banker can be made here. This critique is particularly relevant given that Wolfsberg Principle 5 goes on to state that the bank will decide to what extent fulfilment of this monitoring responsibility will need to be supported through the use of automated systems or other means.

This is a variation of FATF Recommendation 22, 'Countries should consider implementing feasible measures to detect or monitor the physical cross-border transportation of cash and bearer negotiable instruments, subject to strict safeguards to ensure proper use of information and without impeding in any way the freedom of capital movements.' Although this recommendation applies to "countries", FATF Recommendations 8 states that Recommendations 10 to 29 should apply to banks as well. After all, to leave with the bank the decision of how much of its operating budget to allocate to technology with respect to compliance issues, is a commercial necessity. Given the desire to avoid the adverse publicity associated with a money laundering scandal, the bank is expected to allocate an acceptable portion of its budget to adopting and implementing the appropriate technology that would easily allow the private banker to meet his/her responsibility.

Wolfsberg Principle 6 concerns control responsibilities. It states that a written control policy will be put in place by each bank establishing standard control procedures to be undertaken by the various "control layers" meaning private banker,

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238 Financial Action Task Force, above n 177.
239 The Wolfsberg Group, above n 237.
independent operating unit, compliance, internal audit etc. The control policy will cover issues of timing, degree of control, areas to be controlled, responsibilities and follow-up. In covering these matters, the control policy must delineate clear lines of responsibility and provide those designated as responsible with sufficient power and authority to implement the policy. Invariably the control policy will obviously be tailored to each bank’s internal idiosyncrasies. In tailoring this policy, the role to be performed by regulatory and law enforcement agencies in providing feedback is again worthy of note. Feedback will be important as it will help banks to be aware of both traditional and emerging money laundering threats and to adapt and tailor their control policies as appropriate.

Wolfsberg Principle 7 concerns reporting. It states, ‘There will be regular management reporting established on money laundering issues’ and then lists some of the items that will be included in the reports. A glance at Wolfsberg Principle 4.3 may lead to the conclusion that this requirement has already been covered. The difference is that in Wolfsberg Principle 4.3, the word “senior” is included, while in Wolfsberg Principle 7, it is absent. Wolfsberg Principle 7 merely states that regular reports to management will be made. It does not say how far up the management hierarchy that these reports should go. Any system of reports will of course need to be tailored to the idiosyncrasies of the individual bank. In addition, maintaining such general working introduces flexibility and therefore helps to facilitate the objective of promoting the adoption of the Wolfsberg Principles by the widest number of banks as possible. Money laundering is a type of risk about which banks need to be aware. It is a form of market risk which can cause banks to lose considerable amounts of money.

\[1\] ibid.
The problem is not easy an easy risk to quantify. Assessing the nature of the threat posed by money laundering to a bank is certainly more of an art than a science. In this respect, useful information can be taken from the suspicious transaction reports filed by the banks, and from the background information and circumstances that cause the report to be made. This information need to be repackaged and presented to senior managers in a form that will allow senior management to understand the potential threat to which their bank may be exposed. As such, stating, "There will be regular senior management reporting" could have strengthened this Wolfsberg Principle.

Wolfsberg Principle 8 concerns education, training, and information.241 "The bank will establish a training programme on the identification and prevention of money laundering for employees who have client contact and for Compliance personnel." Regular training, described as annual training, will include training on how to identify and follow-up on unusual or suspicious activities. In addition, employees will be informed about any major changes in anti-money laundering laws and regulations. However, with respect to the undertaking that "...employees will be informed about any major changes in anti-money laundering laws and regulations", it would have been more appropriate for each bank to have undertaken in this principles to inform their private bankers of these changes in a timely manner. In addition, they should be provided with an adequate explanation of what these changes entail.

Given the wide scope that is characteristic of criminal money laundering laws in the United Kingdom and the United States, a private banker, when he/she transacts

241 Ibid.
business either through London or New York, could be exposed to the money laundering laws of these countries. Moreover, the civil penalties associated with money laundering are also onerous. As such, it is in the interests of the banks to ensure that their private bankers are adequately educated with respect to their legal obligations. In general terms, the banks should ensure that all their employees have appropriate training concerning the risks posed by money laundering to the banks and the legal obligations they are under.

Wolfsberg Principle 9 covers record retention requirements.\textsuperscript{242} It states that each ‘banks will establish record retention requirements for all anti-money laundering related documents.’ It goes on to state that ‘The documents must be kept for a minimal of five years.’ This Wolfsberg Principle is in line with FATF Recommendation 12 which is based on the idea that records kept by the bank must be sufficient to enable a client’s course of dealing to be reconstructed so as to provide, if necessary, evidence of criminal behaviour. Presumably, this Wolfsberg Principle will include within its scope all account opening information, and information related to transactions conducted though the accounts including the amounts and types of currency involved. One of the side effects of the know-your-client policy promoted to control money laundering activity is the amount of paper it generates in terms of the documents that need to be stored. It will therefore be important that proper storage guidelines exist and that any data stored electronically can still be retrieved as the bank updates the technology it uses.

\textsuperscript{242} Ibid.
Wolfsberg Principle 10 covers exceptions and deviations.\textsuperscript{243} It states, 'The bank will establish an exception and deviation procedure that requires risk assessment and approval by an independent unit.' Unfortunately, this Wolfsberg Principle states nothing further and appears to be a catch-all provision. It may have been more appropriate to state this Principle earlier on, both around Wolfsberg Principle 1.1 and possible reiterating it around Wolfsberg Principle 5. Placed in these two locations, this Wolfsberg Principle would have reinforced the idea that the reality is that the private banker and the bank must both share responsibility for ensuring that clients are not involved in questionable activity both at the time they are accepted as clients and throughout the time the banker-client relationship subsists.

Wolfsberg Principle 11 concerns the creation of an anti-money laundering organisation.\textsuperscript{244} It states, 'The bank will establish an adequately staffed and independent department responsible for the prevention of money laundering (e.g. compliance, independent control unit, legal).’ The establishment of such an organisation will be important and its structure should conform to the characteristics of the organisation. Banks that have signed the Wolfsberg Principles should give consideration about how to institutionalise a process by which the lessons learned through implementing the Wolfsberg Principles may be used to prevent future money laundering problems. In particular, the banks may consider creating an informal "Wolfsberg Forum” to discuss money laundering related matters as they affect the private banking industry on an ongoing basis. Certainly, there are lessons that could be shared through sanitised examples, contact to be made, and collective best practice guidelines to be discussed in pursuit of a level commercial playing field. Given that

\textsuperscript{243} Ibid.
\textsuperscript{244} Ibid.
intra-governmental forums such as FATF exist, a similar private sector body would at least be useful in providing the industry with a united voice to deal with organisations like the FATF.\textsuperscript{245}

With the exception of Bance Santander Central Hispano, the other 11 banks which had signed the Wolfsberg Principles (ABN AMRO Bank N.V., Bank of Tokyo-Mitsubishi Ltd, Barclays Bank, Citigroup, Credit Suisse Group, Deutsche Bank AG, Goldman Sachs, HSBC, J.P. Morgan Private Bank, Société Générale and UBS AG) have branches in Singapore. All banks in Singapore had their license approved by the Monetary Authority of Singapore (MAS), and would be operating in the accordance of the Bank Association Guidelines of Singapore (ABS), guided by regulations and proper training to combat money laundering and conduct due diligence.

2.7 Conclusion

The growing concern which the rest of the non-OFCs have about the OFCs is represented by all the regulatory bodies’ initiatives. The initiatives put forward by regulatory bodies and non-OFCs as analysed in this chapter are:

- OECD’s work on harmful tax practices being used to identify how tax and money laundering issues are increasingly interlinked.
- FATF’s work on non-compliant countries and territories which reveals the money laundering threats posed by OFCs and how they can be dealt with.

\textsuperscript{245} Hinterseer, above n 215, 266-80.
- FSF’s focus on the operation of the global financial system which is being examined to identify how the specific issue of lack of transparency with respect to the financial activity being conducted within and through OFCs is being addressed.

- The Wolfsberg Anti-Money Laundering Principles (the “Wolfsberg Principles”) on private banking being used to assess a private sector initiative to control money laundering that is being pursued by certain banks.

In addition to the earlier mentioned organisations, there are many others, both public and private, that are pursuing various money laundering control initiatives. Their activities have led to a number of agreements, memoranda of understanding, statements, codes and standards of conduct, all of which have legal significance. As such, their work may be characterised as what Professor Joseph Norton calls “soft law”, which, adapting Professor Norton’s definition, may be understood as follows: legally significant international rules emanating from international bodies that are intended to be binding (notwithstanding their non-legal characterisation), and which subsequently come to be enforced or adhered to in some form.

What should be kept in mind throughout, is that each of these initiatives forms a kind of “soft law”. None has resulted in the creation of legal international rules in the traditional sense in that these initiatives have not culminated in the signature of any formal treaties or the creation of legal customs. In fact, debate persists as to whether

246 Joseph Norton, Devising International Bank Supervisory Standards (1995) xxv. Professor Norton’s discussion is focused around the work of the Basle Committee and the definition of soft law that Professor Norton actually uses is as follows: “… liberty is taken in using the term ‘international soft law’ to depict ‘legally significant international rules’ of the Basle Committee emanating from national supervisory authorities that were intended by these authorities to be binding (notwithstanding their non-legal characterization) among the involved authorities and that subsequently became enacted into national laws or administrative rules subsequently in accord with the substance and intent of the Basle Committee pronouncement.”

247 Hinterseer, above n 245, 224.
nternational rules outside of traditionally recognised sources of international law, like treaties and legal customs, exist. The reason this debate is ongoing is that the principles of state sovereignty and equality of states means that neither a state nor the citizens of a state can be made subject to the laws of another state in the absence of some form of enabling legal mechanism.

An important challenge that has confronted regulatory agencies in recent years is how to effectively monitor the operations of banks, their subsidiaries, and the financial activities in which they are engaged. The approach that has been adopted is to create a flexible supervisory structure by allowing banks to develop internal mechanism of risk control and management. As such, the Wolfsberg Principles represent an element of this flexible regulatory approach. These principles constitute a series of measures adopted voluntarily by certain banks. They focus on monitoring and collecting information on the activities of clients in order to be in a better position to identify suspicious activities.

It is in recognising that the establishment of policies and procedures to adhere to these guidelines, is the responsibility of management. As a set of guidelines as to how management is to fulfil this responsibility, the Wolfsberg Principles provide the starting point with respect to private banking activities. When analysing the Wolfsberg Principles, it is important to remember that they are a voluntary code of best practice guidelines. As Dr. Eigen observes, ‘The language is blunt. The burden for monitoring the implementation and day-to-day operations of the guidelines rests squarely with the banks. Their reputations are at stake.’ Although the Wolfsberg

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48 Eigen, above n 218.
Principles may be dismissed as a mere public relations exercise, if implemented with vigour, they have the potential to make a meaningful contribution to combating money laundering.²⁴⁹

As seen by the analysis in this chapter, the supranational closely related directives of the OECD, FATF and FSF have focused on the four major areas of “harmful tax practices and money laundering” and “confidentiality and exchange of information” which will now be further analysed in the following two chapters. This will then allow consideration of the OFC’s responses including that of Singapore.

²⁴⁹ Hinterseer, above n 247, 281-2.
Chapter 3: Harmful Tax Practices and Money Laundering

3.1 Introduction

In the previous chapter, the analysis of the supranational approaches to OFCs showed that two of the four main concerns relate to harmful tax practices and money laundering.

The increasing globalisation of the banking and securities businesses presents a whole new range of problems to the domestic regulators. It is clear that the traditional concept of jurisdiction limited by territorial boundaries is wholly inadequate in the context of the developing global market. Simultaneously, as demonstrated in the previous chapter, there has been an increasing recognition of and determination to tackle money laundering which is an inherent feature of international and organised crime. There has been a growing appreciation and acceptance, in the securities industry, of the principle of the ‘integrity’ of the market; in other words, that confidence in financial markets can only be preserved by the provision of simultaneous and, where possible, instantaneous access for all to all relevant information.250

In this chapter, the issues of harmful tax practices and money laundering are analysed in the context of the supranational directives, thus laying the foundations for the subsequent responses of the OFCs. First, some definitions are required.

250 Francis Neate and Roger McCormick (eds), Bank Confidentiality (1990) xix.
3.1.1 Tax Avoidance

In the legal debate of tax avoidance, the primary focus is clearly on contrived and artificial schemes, which do not change the substantive character of an activity or transaction but may serve nevertheless to the activity within some tax-exempt or more tax-favoured legal category. Assuming a literal interpretation of the legislation by the courts, minor or essentially cosmetic changes may allow quite massive tax avoidance without significant cost to the taxpayer whether in legal fees, or, in economic terms, from the adoption of inferior business forms or commercial practices.

Substitutability between taxable and non-taxable alternatives may accordingly be most perfect and, although revenue losses may be very large, the direct efficiency losses or excess burdens may be small. As Cooper asserts, the lost revenue must, however, be made up by rate increases on a narrower base, thus increasing welfare cost, or public expenditure benefits must be reduced. The social costs of tax avoidance in this narrow legal sense may accordingly be very large and are not necessarily diminished by the absence of direct efficiency losses. In equity terms, tax progressivity may be greatly reduced without offsetting effects from excess burden and, since certain types of artificial schemes may not be widely available, horizontal inequities may be considerable.\(^{251}\)

Tax avoidance in the narrow legal sense remains therefore highly objectionable and there is a view that it must be dealt with if the tax system is to retain credibility and if

tax compliance and social acceptable of the democratic budgetary system is to be preserved.  

3.1.2 Tax Evasion

Tax evasion is an illegal activity. It is a criminal as well as a civil wrong. It will often involve the taxpayer hiding assets; or, alternatively, failing to declare income and/or capital gains; or, in the further alternative, making a fraudulent return by deliberately under-declaring income/gains to the revenue authorities of the country where he resides for tax purposes.

In England the approach of the revenue authorities to tax avoidance used to sum up in a decision of Lord Tomlin in IRC v Westminster and has been cited in courts throughout the common law system:

Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Taxes Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure that result, then, however unappreciative the Commissioners of Inland Revenue (the IRS) or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

253 IRC v Westminster [1936] AC1. This speech may no longer represent the modern approach in the UK which has now enacted a number of anti-avoidance provisions and which is now more inclined to strike down sophisticated anti-avoidance structures without any commercial benefit (other than to avoid tax) as a ‘sham’ and collect tax on the basis of the reality of the structure of transaction as a whole. See Ramsay v IRC [1982] AC300. However, the quote sums up the traditional view of tax avoidance.
On the other hand, tax evasion involves a taxpayer cheating the revenue authorities. Dishonesty will generally be present. The scheme to evade tax will include fraud, either

- a deception - a deliberate dishonesty such as a misrepresentation of income, earnings, profits, assets etc. on the taxpayers' annual tax return, supporting statements and/or accounts, or
- a deceitful concealment of income and/or assets etc.

The type of tax fraud illustrated above is a criminal offence. It is often an offence contrary to the relevant tax legislation in the jurisdiction where the taxpayer is deemed to reside for tax purposes. It may also be an offence contrary to the general criminal law, particularly if the taxpayer makes an actual misrepresentation to the revenue authorities, for instance, in his accounts or on his tax return. In such case the taxpayer could find himself criminally liable for offences of fraud, forgery, false accounting or deception.254

In both the United Kingdom and the United States 'tax avoidance' is doing what you can within the law: it has always been regarded as entirely lawful, albeit requiring or relying on expert advice. On the other hand, 'tax evasion' has always been (and remains) unlawful, and depending on its severity and extent, 'evasion' may also be criminal.255 In Australia, some forms of tax avoidance are illegal and this was made

254 Cooper, above n 251, 84-5.
clear under the provisions of Part IVA of the Income Tax Assessment Act 1936 (Commonwealth) and tax evasion is always against the law.256

3.1.3 Money Laundering

According to Blum, clean money is worth more than dirty money. Clean money257 can be invested in profitable activities, or spent on consumption, more or less conspicuous, without risk of incrimination. Dirty money can generally only be invested or spent less profitably, less visible, and at the risk of punishment. It also carries the risk of being used as evidence of the initial crime. Virtually all income from criminal activities must be disguised to be of use to the criminal. Money laundering is that process of disguise.258 It has remained high on the law enforcement agenda since the 1990s.259 It has moved quickly from being marginal in the early 1980s, not even a ground for confiscation, let alone a crime, to a position at the centre of efforts for co-operation in the ‘war on drugs’, the ‘struggle against organised crime’ and the ‘war on terrorism’.260 These efforts as have been previously noted, are international in scope and consequently require revision of the traditional view of the relationships between national systems of criminal justice.

3.2 OECD Measures to Combat Harmful Tax Practices

256 Income Tax Assessment Act 1936 (Cth) pt IVA.
257 Money untainted by criminal association.
258 For Jack Blum et al, Financial Haven, Banking Secrecy and Money-Laundering UNDCO technical series issue 8 (1998 United Nations) 6, the origin of the term is in the use of cash based retail service industries like laundries to disguise the origins of cash acquired through rackets in the United States. The object was to mix legally and illegally obtained cash to avoid the attention of corrupt police officers, competitors, and (from the time that prosecution for tax evasion came to be a potent weapon in the hands of the authorities unable to being successful prosecutions for specific substantive offences) the tax authorities.
3.2.1 OECD's Concepts of Unfair Tax Competition

It is argued that, the solution that is now being urged by OECD is that small or developing countries with OFCs be pressed into service as subsidiary tax enforcers to boost OECD coffers. The OECD approach is multifarious, involving the criminalisation of tax avoidance and the elimination of various forms of tax competition from these OFCs in all geographically mobile service industries, including financial, but also distribution services, shipping, service industries and company headquartering.

But what could be more reasonable? That, in the interest of comity between nations and the protection of their mutual sovereignty, nations should help each other catch 'tax cheats' by insisting on transparent legal structures and exchange of tax information on request or even spontaneously? Is this not a self-evident case of collective interest in effective law enforcement?261

And if nations are successful in increasing revenue by deterring or catching tax cheats, will they not be able to lower tax rates, improve economic efficiency, expand output and deliver rising living standards?

So stated, the current OECD campaign to eliminate tax havens seems to make both legal and economic sense.

261 Antoine, above n 133, 314.
But, as with many apparently self-evident truths propounded in the popular press, such propositions may not withstand closer examination.

The OECD argues that tax competition may alter the structure of taxation (by shifting part of the tax burden from mobile to relatively immobile factors and from income to consumption) and may hamper the application of progressive tax rates and the achievement of redistribution goals.

But is the OECD correct to see tax competition as a problem to be solved by enforcing residence (or pseudo-residence) taxation of mobile capital income?

If tax competition shifts the tax burden from mobile to relatively immobile factors, it is doing the world a service. Economic theory has always held that, from an efficient point of view, taxes should be laid on things which are inelastic in supply (of which the prime example is land rents). As for progressive marginal income tax rates and income redistribution, there are many economists who would argue that both are economically inefficient. It is odd that a report which complains that tax havens are

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262 Indeed, the OECD seems to be intent on eliminating what they regard as 'harmful' fiscal competition in vast segments of key global industries. However, on closer inspection, their efforts seem to be focused on industries in which OECD countries are more competitive. Hence the rather telling omission of agriculture, which has 'harmful' fiscal competition amounting to USA$360 billion provided by the OECD countries to their farmers at the expense of farmers in many poor developing countries as well as countries such as Australia and New Zealand. The agricultural sector is never mentioned in all the OECD exhortations for other countries to eliminate harmful fiscal practices. Ibid 315.

263 Organisation for Economic Co-operation and Development, above n 156, 14[23].

264 In fact, the operation of controlled foreign company or trust income attribution rules often means that OECD countries are asserting the right to tax foreign income of a foreign company or foreign trust (even several times removed), even if their residents have no legal or equitable right to that income. The residence 'principle' is really becoming in reality a mercantilist export tax on capital in the form of perpetual taxation by the country of residence of the original source of the mobile capital. Antoine, above n 261, 315-6.

265 Ibid.

266 Organisation for Economic Co-operation and Development, above n 263, 15[25].
“free riders” accepts as given the “free riding” implicit in redistributive taxation.\textsuperscript{267}

Some “free riders” are more equal than others, it seems.\textsuperscript{268}

Real-world constraints mean that tax competition can be inefficient or harmful in the sense that it distorts the delivery of public goods and services, as well as the allocation of resources in the private market. Distortions in the level and pattern of the provision of public goods and services arise in a non-cooperative environment in which governments compete for mobile individuals, capital, and consumption.\textsuperscript{269}

The competitive process is reflected in differences in tax rates and structures that are intended either (1) to reflect differences in preferences for public goods and services and differences in redistributive goals, or (2) to attract mobile tax bases. In either instance, mobile individuals or capital may respond to the tax differences with allocative effects. Consider the example described above. Inefficient tax competition between jurisdictions A and B can arise in one of two simple ways. First, jurisdiction A may wish to increase its tax rate above that in jurisdiction B in order to fund an increase in desired public goods and services. If the relevant tax base is mobile, jurisdiction A may perceive itself to be constrained in raising its rate, since the mobile factors of production may migrate to jurisdiction B in order to avoid the increased transfer payments. The migration is induced by the character of the taxes as transfers.

\textsuperscript{267} Ibid 14(23).
and not as user charges for goods or services provided to the factors of production. Alternatively, jurisdiction A or B may lower its tax rate in an effort to attract mobile factors of production away from the other jurisdiction. In either instance, the competition between the two jurisdictions for a mobile tax base may induce them to lower tax levels below those required to support public goods and services desired by residents. In effect, the constraint imposed by other competing jurisdictions prevents the provision of public goods and services to the point at which marginal costs equal marginal benefits. 270

The economic literature attributes this inefficient allocation of public goods and services to the "horizontal fiscal externality" or "horizontal spillover effect" arising between two or more governments at the same level (that is, subnational or local governments). 271 These labels refer to the fact that, in setting tax levels to fund public goods and services, policy makers in a particular jurisdiction consider only the welfare of their residents, and not that of the residents of a competing jurisdiction that may benefit from the migration of factors of production in response to increased taxes. This externality may cause policy makers to forgo the tax increase and associated public goods and services in order to avoid "tax base flight." In terms of the allocative effects, it does not matter whether differences in tax rates and tax structures that would otherwise arise are attributable to differences in preferences for public goods and services and redistributive policies, or to an attempt to attract mobile tax bases with "beggar-thy-neighbour" policies. 272

272 For other views on this point, see Michael Keen, 'Preferential Regimes Can Make Tax Competition Less Harmful' (2001) 54 National Tax Journal 757-62 (suggesting that
3.2.2 The Effects of Globalisation and Liberalisation on Harmful Tax Practices

Tax competition refers to the competition to attract investment or funds by providing an attractive fiscal environment. It usually takes the form of offering special incentives, in the form of tax exemptions or reductions, low rates of tax or by having no tax at all.\(^{273}\)

Earlier, it was discussed how, liberalisation and globalisation have led a number of governments to introduce special tax structures. Today virtually every high tax country has adopted some type of preferential tax regime. As noted previously, over recent years, the number of tax havens has more than doubled, while the value of investments into low tax jurisdictions has expanded exponentially.

Because these tax policies may result in the siphoning off of parts of countries' tax bases, this proliferation of what are considered harmful preferential tax regimes and tax havens has become a growing concern for governments.

The position of the OECD is that, if the situation is not redressed, governments may increasingly be forced to engage in competitive tax bidding in order to attract or retain targeted tax preferences are preferable to general rate reductions, because they confine the efficiency-reducing effects of tax competition to mobile tax bases that are the targets of the preferences; and Eckhard Janeba and Michael Smart, "Is Targeted Tax Competition Less Harmful Than its Remedies?" International Tax and Public Finance (forthcoming) (finding that restrictions on tax competition are more likely to be desirable when tax bases are on average highly responsive to a coordinated increase in tax rates by all governments, and when tax bases with large domestic elasticities are mobile internationally).

mobile activities, thus leading to a "race to the bottom", in which location and financing decisions become primarily tax driven.274

3.2.3 Tax Harmonisation & Withholding Tax

On 3 June 2003, the EU Council of Finance Ministers, ECOFIN, finally reached an agreement on the EU Savings Tax Directive. The Directive is to be implemented as of 1 January 2005.

The Savings Tax Directive is not a stand alone issue but a vital part of the EU "code of good conduct" package, which also includes the abolition of harmful corporate taxation measures that distort fair competition between Member States and a directive concerning tax on royalties.

One of the main issues in connection with the introduction of the Savings Tax Directive is whether to introduce a withholding tax or exchange of information between the Member States' tax authorities. The strongest opponent against a withholding tax has been the UK, taking into consideration the UK based Euro bond market. The strongest opponent against an exchange of information has been Luxembourg supported by Belgium and Austria, all protecting their bank secrecy and financial infrastructure. The final outcome of the negotiations is a compromise.

The tax effects

274 Spitz, above n 129, 235-6.
Starting from 1 January 2005, 12 Member States\textsuperscript{275} are to automatically exchange information concerning EU resident physical persons' interest income. The exceptions are Luxembourg, Austria and Belgium, which will keep their bank secrecy regulations and these countries will instead impose a withholding tax as a main rule. Luxembourg, Austria and Belgium will, however, provide the individual account holder with an option between the withholding tax and exchange of information. The withholding tax will increase over time as follows: 15\% from 1 January 2005, 20\% from 2008 (three years after the implementation), and finally 35\% from 2011.\textsuperscript{276}

\textit{A Stumbling Block}

By insisting on retaining their banking secrecy laws, Luxembourg, Austria and Belgium are following Switzerland's course. Switzerland has repeatedly refused to comply with banking disclosure standards and has offered to pay the EU 75 percent of returns generated from a withholding tax in exchange for not having to reveal the identity of its customers.

Other non-EU member states in Europe, such as Liechtenstein, Andorra, Monaco and San Marino, must also levy a tax on EU citizens' savings and pay three-quarters of it to the home country.\textsuperscript{277}

\textsuperscript{275} Germany, France, Italy, the Netherlands, Denmark, the Republic of Ireland, United Kingdom, Greece, Portugal, Spain, Finland, Sweden
The inclusion of Switzerland and other non-EU states in the EU finance ministers' deal was a stipulation for securing the approval of Luxembourg, Austria and Belgium. The Swiss arrangement, however, is still awaiting a final approval from the EU finance committee before being implemented.278

3.2.4 U.S. Opinion on OECD's Initiative

In May 2001, under the Bush administration, Treasury Secretary Paul O'Neill made a statement on "The OECD Tax Havens" report. An excerpt is as follows: 279

The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments - like businesses - to create efficiencies. In fact, the Administration is actively working to lower tax rates for all Americans. After reducing our tax burden, we will turn our attention toward reforming our system to make it simpler and more efficient. On these principles the United States remains firm. In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities.

O'Neill made clear the U.S. would vigorously pursue genuine tax cheats and fight criminal money-laundering efforts. But he rightly saw the distinction between those

278 Ibid.
laudable goals and the less-than-laudable efforts to force low-tax countries to impose more exactions on their citizens.  

While the Clinton administration in the United States strongly supported the OECD’s efforts, Bush is taking a different instance. In response to the US administration’s objectives to the crackdown on tax havens, the OECD softened its position in late June 2001 under a compromise with the US. First, the OECD had postponed the next publication of uncooperative tax havens till the end of November 2001. Second, sanctions would not be imposed on “listed offenders” until at least April 2003. Third, the OECD would no longer try to prevent countries from keeping their low-tax systems or prevent them from offering tax breaks to foreign investors that were not available to local residents. The compromise shifts the focus to achieving an effective exchange of information with tax havens.

3.3 Tax Evasion and Money Laundering

With the FATF spearheading the combat against money laundering, countries which are concerned with maintaining themselves as lush territories for global wealth management have anti-money laundering legislation in place.

An unedited version of the relevant section of the US Criminal Code provides the following.

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280 Ibid.
Whoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity; conducts or attempts to conduct a financial transaction which in fact involves the proceeds of specified unlawful activity:

(A)

(i) with the intent to promote the carrying on of specified unlawful activity; or

(ii) with intent to engage in conduct constituting a violation of section 7201 or 7206 of the Internal Revenue Code, 1986; or

(B) Knowing that the transaction is designed in whole or in part

(i) to conceal or disguise the nature, the location, the source, the ownership or the control of the proceeds of specified unlawful activity; or

(ii) to avoid a transaction reporting requirement under state or federal law

[is guilty of the offence of money laundering].

The US Criminal Code, itself a codifying section, provides an illuminating example of a statutory provision that illustrates how anti-money laundering legislation has evolved.
The original objective of the US Congress in enacting the first anti-money laundering legislation was to assist prosecutors in securing a conviction of persons engaged in transactions involving the proceeds of drug trafficking where there was no evidence to tie them into the original (or predicate) drugs-related crime (such as production, importation or distribution). Such persons would often, prior to specific money laundering provisions, be (unsuccessfully) indicted for offences relating to the predicate drugs-related crime itself, such as

- aiding and abetting the original drugs-related offence, or
- conspiracy with others to commit the original drugs-related offence.

It was, therefore, clearly desirable to create a separate criminal offence of laundering the profits derived from drug trafficking, in order to catch and prosecute those persons who were solely involved in the movement of money earned from the unlawful production and distribution of illicit drugs.  

The original objective of the legislation was then extended to encompass not just the laundering of drug-related money, but the laundering of money derived from all crime. The US Criminal Code creates a specific offence of conducting a financial transaction that involves the proceeds of "specified criminal activity". The criminal activity specified in the Code includes not only drug-related crime, but a considerable number of other serious criminal offences. This is sometimes called "all crimes" anti-money laundering legislation, referring to the fact that the aim of the legislation is to

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criminalise persons who launder the proceeds of all serious crime, rather than just a few offences or types of offence.  

Eigen and Del Ponte assert that the objective of modern (onshore) international anti-money laundering legislation has thus been extended further to include the movement of hot as well as of dirty money. Dirty money is basically money that is derived from crime. Hot money is derived from a civil wrong which may or may not involve traditional fraud or dishonesty but which involves conduct lacking in integrity. For instance, the money may have been earned lawfully but becomes "hot" when the owner tries to disguise or hide its provenance in order unlawfully to evade taxes or exchange controls; or, alternatively, tries to disguise its provenance to frustrate lawful claims being made against those assets in, for instance, a lawsuit brought by creditors or in divorce proceedings. Hot money can be a grey area. The money may have been earned legally but it is mixed with dirty money as a result of the export methods or investment. Tax evasion and political corruption would fall in the category of hot money, which makes up a larger percentage than dirty money.

Accordingly, there is a modern extended role for anti-money laundering legislation - to combat tax evasion and other "fiscal crime". Governments in the developed high tax, industrialised (onshore) jurisdictions have realised that the same money laundering strategies implemented against drug trafficking should apply to tax evasion and fiscal crime.

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283 The two primary money laundering statutes are sections 1956 and 1957 of the U.S. Criminal Code, Title 18.
3.3.1 Eroding Bank Secrecy -- Before and After September 11

The Inland Revenue Services (IRS) sent out a clear message to tax evaders. The IRS Commissioner Charles O. Rossotti said,

"If people use these illegal offshore methods to hide their income, we will find out who they are.

If taxpayers are involved in these schemes, it is time to make things right. We urge these taxpayers to consult with a reputable, trusted tax professional for advice."286

For those Americans that abuse tax haven structures, the storm is just beginning. Since September 11, it is becoming increasingly difficult for those non-compliant taxpayers to hide. Indeed, the US government can rely on an arsenal of disclosure initiatives, and in certain cases can compel American taxpayers to turn over foreign-based documentation and information.

Lawfully, the IRS and the US Department of Justice (DOJ), as well as other US governmental agencies, have substantial powers and authority to obtain foreign-based evidence. This is true if the foreign-based evidence is located in a tax haven jurisdiction. The US government can initiate a variety of foreign-targeted discovery requests, such as "compelled consents"287 and "letters rogatory"288, as well as a

288 28 U.S.C. 1781 et seq. (1999). “The letter rogatory is a ‘medium, in effect, whereby one country, speaking through one of its courts, requests another country, acting through its own courts and by methods of court procedure peculiar thereto and entirely within the latter’s control, to assist the
As a direct result of the September tragedy 11, US law has been amended to enable the DOJ to more readily obtain foreign-based records -- even those kept in tax haven countries. On 26 October 2001 the USA Patriot Act was signed by President Bush in part to force foreign banks with US correspondents to furnish evidence and documents regarding foreign correspondent bank accounts in both criminal and civil proceedings. \(^{290}\) Further, the new law allows the DOJ to prosecute money laundering charges for many foreign criminal offences, including most foreign fiscal offences. \(^{291}\)

Additionally, since September 11, the US government has entered into tax information exchange agreements (TIEAs) with the Bahamas, the Cayman Islands, Antigua and Barbuda, Panama, and most recently the British Virgin Islands. \(^{292}\)

Pursuant to the terms of these agreements, the IRS will be allowed access to bank account information that was previously protected by bank secrecy laws, as well as beneficial ownership information relating to foreign corporations and trusts. \(^{293}\) These

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\(^{289}\) As Commissioner Rossotti stated, "simply put, the guarantee of secrecy associated with offshore banking is evaporating."

\(^{290}\) USA Patriot Act of 2001, section 315.


\(^{292}\) See Article 5, Agreement between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland, Including the Government of the Cayman Islands, for the Exchange of Information Relating to Taxes (signed 27 November 2001)
agreements will become effective beginning in 2004 for criminal tax matters and 2006 for civil tax matters.\textsuperscript{294}

The IRS has targeted US citizens and residents with unreported foreign bank and securities accounts held individually or through trusts and companies organised in tax haven jurisdictions.\textsuperscript{295} The IRS also has targeted US and foreign business organisations that promote and solicit US citizens and residents to operate offshore structures, typically in tax havens.\textsuperscript{296} These promoters usually advocate offshore schemes that illegally avoid or evade taxes and simply do not legally achieve the promised US tax savings.\textsuperscript{297}

\textit{The USA PATRIOT\textsuperscript{298} Act}

The thrust of money laundering laws was directed to that of it being a tool to combat terrorism when the "September 11 attacks" resulted in the collapse of the Twin Towers in United States in 2001. On September 14, 2001, the Department of Treasury created the Foreign Terrorist Asset Tracking Centre within the Office of Foreign Assets Control\textsuperscript{299} to act as a focal point to track, trace, and seize terrorist funds. On

\textsuperscript{294} See Article 12, Agreement between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland, including the Government of the British Virgin islands, for the Exchange of Information Relating to Taxes (signed 3 April 2002).
\textsuperscript{298} The full title of the act is "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001".
\textsuperscript{299} The function of the Office of Foreign Assets Control is to enforce economic and trade sanctions, impose restrictions on the transactions, and freeze assets based on the foreign policy initiatives and foreign policy goals of the United States against targeted foreign countries, terrorist organisations, and those groups engaged in narcotics trafficking. Its authority derives from Presidential wartime and
September 23, 2001, the President issued Executive Order 13224, which directed the Secretary of the Treasury to freeze all assets, and to take all steps necessary, to prohibit financial transactions with individuals and organisations listed in the order and this list has been updated several times. On September 28, 2001, the United Nations Security Council unanimously passed a United States sponsored resolution that called on all United Nations member states to freeze the assets of suspected terrorists in their respective countries and to take all steps necessary to disrupt the financial support flowing to these suspected terrorists and their organisations. In broad terms, Treasury Under Secretary Jimmy Gurule outlined the various lines of financial attack being pursued by the United States as follows: 300

1. Closer scrutiny of the financial activities of terrorist organisations and their supporters;
2. The identification and blocking of assets of terrorist organisations and their supporters;
3. Detailed study of the methods used by terrorists to finance their activities;
4. The implementation of measures to give additional leverage to existing laws to disrupt the financing of terrorism and to break apart terrorist organisations;
5. The identification of gaps in existing laws that terrorists may exploit and the implementation of measures to remedy these deficiencies; and
6. The promotion of closer co-operation among law enforcement and regulatory agencies both within the United States and with their counterparts in other countries.

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national emergency powers as well as the authority granted to it by specific legislation. For more see www.ustreas.gov/ofac.

300 Hinterseer, above note 249, 405.
The USA Patriot Act, containing more than 300 pages of new rules for combating money laundering and terrorist use of the U.S. financial system, was signed into law October 26, 2001. Effective April 24, 2002, Section 352 of the law required all U.S. financial institutions to implement a comprehensive anti-money laundering policies and procedures program. While some of the new provisions have received a great deal of media attention, many bankers remain unaware of the provisions relating to money laundering. Anti-money laundering regulations, including compliance with the Bank Secrecy Act (BSA) and Office of Foreign Asset Control (OFAC) requirements, have always been a high priority with regulators. However, in the wake of the terrorist attacks of September 11, 2001, enforcement of these regulations was increased, changes to the OFAC lists came more rapidly, and new laws were enacted to increase the responsibilities of financial institutions in preventing the use of the U.S. financial system for money laundering and terrorist funding. As a result, the risks of non-compliance with the anti-money laundering requirements and the risks of not having an effective anti-money laundering program have increased dramatically.\textsuperscript{301}

### 3.3.2 Foreign Tax Evasion and Money Laundering

Of particular interest to the offshore banking, trust and financial services industry is the issue of international (or foreign) tax evasion and its relationship to all crimes anti-money laundering legislation.

In the case of \textit{Planche v Fletcher}, it was noted that "no country takes notice of the revenue laws of another". In the leading English case of \textit{Government of India v}...

Taylor\textsuperscript{302} it was confirmed that the English courts will not entertain any action brought in England to collect taxes owed to a foreign state.

The principle that a common law jurisdiction will not allow an action to be brought in the courts by a foreign state to collect taxes owed to that foreign state is based upon the fact that each country or state is sovereign, i.e. independent. It is left to individual governments to determine with whom they wish to enter into treaties in order to assist each other in collecting taxes.\textsuperscript{303}

The above principle represents the starting point of this analysis, as it illustrates the extent of co-operation between nations in respect of the collection of foreign tax. Basically there is no co-operation unless a specific tax treaty has been signed. However, the criminal law in a number of jurisdictions as evidenced by the number of Tax Information Exchange Agreements (TIEAs) signed, has moved a long way from this rather parochial approach, towards a global responsibility. The rationale behind this movement is clear from the OECD point of view. The OECD members who represent the industrial and developed high tax jurisdictions of the world are very concerned about the amount of revenue being lost through international tax competition and arbitration. The argument calls for anti-money laundering systems to be utilised in the fight against tax-related crime.

Hence, the USA's "all crimes" anti-money laundering legislation requires the financial sector to assist combat not only the suspected laundering of money derived from criminal conduct per se, but also money derived from tax evasion. For instance:

\textsuperscript{302} Government India v Taylor [1955] AC 491, [1955] 1 All ER 292
\textsuperscript{303} Parkinson and Howarth, above n 285, 85-9.
Know Your Client ("KYC") procedures involve institutions obtaining basic information concerning each customer's tax position. Transactions that appear unusual or that, by their very nature, appear to facilitate an unlawful evasion of tax should be investigated by the institution. Suspicion of domestic tax evasion should be reported to the appropriate money laundering investigative body (the statutory duty imposed upon an institution to report suspected tax evasion overrides the contractual duty of confidentiality). The money laundering authority will generally have power to share the information it receives with other agencies, such as the revenue authorities.

3.3.3 OFCs under No Obligation to Assist in Fiscal Matters

The legality or otherwise of tax planning, though important, is of itself insufficient to demand that confidentiality be preserved in relation to tax information. While some may be uncomfortable with the argument that offshore states are under no obligation to assist onshore states in increasing onshore coffers though tax collection offshore, there is firm legal precedent for this. Even without the particular context of offshore business, the international law has always recognised that the fiscal and penal matters of one state with respect to enforcement of foreign judgements and other types of

\[304\] Ibid.
international assistance should be outside the realm of another.\textsuperscript{305} This rule has been followed rigorously in OFCs.\textsuperscript{306} It is also consistent with the rule on the legality of tax avoidance measures which refrain from imposing a duty on individual voluntarily to assist tax authorities in gaining revenue.

For example, in \textit{Stutts v Premier Benefit Capital Trust},\textsuperscript{307} a receiver appointed in the United States applied for recognition in the Cayman Islands. The applicant was the receiver of the respondent trust which was registered in the Cayman Islands but conducted its business primarily in Florida. The complaint against the trust was that it had made sales of unregistered securities and had engaged in a scheme to defraud investors. The court followed the rule closely:\textsuperscript{308}

The rule that the courts of no country execute the law of another applies not only to … crimes … but to all suits in favour of the State for the recovery of pecuniary penalties for any violation of statutes for the protection of its revenue … and to all judgements for such penalties.

Consequently, the application failed. Again, in \textit{Re Lambert and Pinto}\textsuperscript{309}, the rule of non-enforcement was considered by the Supreme Court of The Bahamas, applying to what it described as a ‘principle of international acceptance’ in the interest of ‘public
The court rejected the narrow view of the rule that it only applies where there is an attempt to enforce revenue or penal laws directly. It held that the rule applies equally to attempts at indirect enforcement: in this case, a request for information to assist in the collection of taxes.\textsuperscript{311}

In fact, the enforcement of such laws may require the offshore jurisdiction to assist in the administration of justice and to that extent it is an infringement of sovereignty.\textsuperscript{312}

On the same principles, offshore courts may refuse to enforce revenue laws which seek to expand the territorial jurisdiction of a country to tax its residents and citizens where the relevant assets are located offshore.\textsuperscript{313}

3.4 Mentality towards Money Laundering

The success of the campaign against money laundering hinges on changing the social attitudes that tend to diminish or neutralise the stigma associated with white-collar crime. In particular, two social norms are in a state of flux. The first of these concerns changing moral perceptions about what constitutes immoral conduct within the financial markets. This point of view by Stanley, argues that this transformation has been dramatic. ‘[I]t is a critique suggesting that the terminology associated with regulatory discourse neutralises “fundamental” values and suggests a version of ethical indeterminacy.’\textsuperscript{316} Within the financial markets, the rise of the so called “greed is good” mentality has narrowed the range of activities considered to be illegal.

\textsuperscript{310}\textit{Re Lambert and Pinto}, p. 16, borrowing the words of Lord Somervell in \textit{Government of India v Taylor} [1955] 1 AC 491.

\textsuperscript{311}\textit{Re Lambert and Pinto}, p. 17


\textsuperscript{313} Such as those from the US.

Meanwhile, changes in market operations, catalysed by changes in information technology, have meant that money as a concept has become a "free-floating signifier" devoid of real value: money emerges out of, and disappears into, thin air as numbers appear and disappear on a computer screen. What has not changed, however, has been attempts to control how the markets operate through highly complex and technical regulations. By their very nature, these regulations mean that violations tend to be viewed as mere infractions and not as serious anti-social behaviour worthy of condemnation through the criminal law. Four factors have reinforced this trend: 315

1) Practices that society would label "criminal", escape this label in financial markets because they either represent customary practice or they have not yet been subjected to regulation;

2) Criminal activity usually requires the identification of a victim, which is often difficult in respect of crimes committed within the financial markets;

3) Policing techniques and methodologies, while improving, tend to be inadequate so that the prosecution of an offence remains relatively rare; and

4) The transgression or circumvention of regulations may become a pleasure or desire in itself.

Hence it is argued by Stanley that, 'The investigation of criminality in financial markets travels under a number of asinine labels and the activity of the criminal becomes sanitised and neutralised because of this labelling.' 315 Concepts such as client, consumer, and victim, the traditional reference points used to define the concepts of good and bad, right and wrong, have dropped out of popular discourse to

316 Stanley, above n 314, 250.
be replaced by the terms risk, enterprise, and profit. The net effect has been for the rules and regulations that operate within the financial markets to now been seen as obstacles to be evaded as opposed to safeguards that require compliance. Therefore the argument maintains that, 'Penalty for a transgression becomes an occupational risk and not subject to the discourse of criminality.' This point of view thus accepts that, to transgress and circumvent regulations is therefore increasingly acceptable.

Secondly, in the context of money laundering, ethical indeterminacy has contributed to the emergence among white-collar workers of a professional class of workers specialising in the financing of unlawful activity through the intermediation of money laundering services. This class comprises bankers, lawyers, accountants, and other professionals who help facilitate crime by assisting in the development, implementation, and the execution of money laundering strategies. Their work has been made easier by the very way in which money operates as a medium of exchange; money eliminates the need for barter by acting as a common commodity into which goods and services can be transformed in order to purchase other goods and services. What this transposition serves to accomplish in the money laundering context is to obscure the nefarious activity associated with the underlying crime, as the money is "visible" but not the violence or other activity with which the criminally derived funds are associated. Meanwhile, the same financial, legal and accounting instruments used to launder money are also used for legal and legitimate purposes in the formal economy. What this means is that white-collar professionals may find it relatively easy to create and use instruments that they regularly use in a legal and legitimate context, but in the occasional illegal and illegitimate context. This transition from the

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37 Ibid 249.
formal to the informal economy is made all the easier by the fact that the practical
context in which such instruments are being used may be neither clearly legal nor
illegal. 319

3.5 The Influence of Soft Law

The term ‘soft law’, as cited previously, refers to the lack of justiciability of the
instruments in which the rules are enshrined, rather than to the content of the rules
themselves. An important factor which explains the role of soft law in the fight
against money laundering is the aversion to government interference that financial
institutions have often displayed. In some countries, money laundering was initially
fought, not through legislative measures, but via codes of conduct or by regulatory
measures issued by banking supervisors. The content of a number of initiatives to
curb money laundering was thus highly influenced by the financial sector itself. 320

Given the absence of a formal international legislator, it is not surprising that the
influence of soft law has been especially notable on the international level. 321 The
contribution of international soft law instruments to the fight against money
laundering is impressive. One of the earliest international initiatives undertaken in the
field of money laundering was the Recommendation No.R(80)10 adopted by the
Committee of Ministers of the Council of Europe on 27 June 1980 entitled Measures
against the transfer and safeguarding of the funds of criminal origin. 322

319 Hinterseer, above n 315, 28-9.
320 Stessens, above n 25, 15.
321 UN Economic and Social Council, Commission on Crime Prevention and Criminal Justice, “Review
of Priority Themes, Control of Proceeds of Crime – Report of the Secretary-General, E/CN.15/1993,
Vienna, 13-23 April 1993, p. 14”.
322 Stessens, above n 320, 16-7.
The crown jewel of soft law, however, is the set of the forty recommendations issued by the FATF on money laundering in 1990. The recommendations are no more and no less than recommendations: non-binding soft law. It was a deliberate choice not to cast the recommendations into the mould of a treaty. This was to avoid elaborate ratification procedures and to allow the flexible adaptation of the recommendations, as was done in 1996. Flexibility was also the motive behind the loose structure of the FATF.  

3.6 Broad Application Field of Anti-Money Laundering Legislation versus the Legality Principle

According to Dressler, there are three doctrines that balance the roles of the courts and legislatures in making criminal law:  

1. The principle of legality says that courts should not create new crimes.

2. The doctrine of void-for-vagueness says that legislatures have to explain what they mean and not leave all the work up to the courts.

3. The rule of strict construction says that if a criminal law is uncertain, it should be decided with a slant toward the defendant.

323 Ibid 17-8.
From a law enforcement point of view, the broad character of anti-money laundering legislation is necessary in order to be able to respond to the varied and shifting nature of the phenomenon of money laundering. From the defendant's viewpoint, however, the broad character of the legislation may be viewed as problematic in that the type of conduct that is prohibited may be unclear or vague. This allegedly vague character could be invoked to challenge anti-money laundering legislation as violating the legality principle. The principle not only imposes a ban on the retroactive introduction of legislation but also implies a qualitative requirement: the law should be sufficiently clear and precise that citizens can know beforehand what type of conduct is considered criminal.

This requirement of foreseeability can be found in the case law of the European Court of Human Rights relating to Article 7 of the European Convention on Human Rights. Although any judgement in this matter always depends of course on the wording of the domestic law, it is questionable whether the anti-money laundering legislation can be held to violate the legality principle on the ground that it does not 'provide effective safeguards against arbitrary prosecution, conviction and punishment'. As an example, the Swiss Supreme Court has ruled that Swiss anti-money laundering legislation does not violate the legality principle, as it allows citizens to assess the consequences of their actions. The mere fact that a very substantial number of economic activities may be construed as transgressing the law does in itself not constitute a breach of the legality principle: the clarity of a definition of an offence should not be confused with narrowness. The same can be said in

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326 Ibid, para 34.
327 Ibid, para 34. 
328 Ibid, para 34.
329 Ibid, para 34.
respect of the fact that — at least under some domestic legislation — the laundering of
the proceeds of any criminal activity is regarded as criminal, which considerably
widens the application field of a law which is in the first place directed towards third
persons not involved in the predicate offence.\footnote{Stessens, above n 322, 126-8.}

3.7 The Regulatory Challenge

It has been observed by Kapstein that, "In some respects it is ironic that banking is
characterised as a global industry, for no sector of the economy is so heavily regulated
by domestic authorities."\footnote{Ethan Kapstein, \textit{Governing the Global Economy: International Finance and the State} (1996) 17.} Money launderers have the ability to simultaneously
operate in several different markets and countries. Regulators, meanwhile, have
jurisdiction over a set number of markets within a defined geographical area or state.
Criminal entrepreneurs can wire money by taking advantage of OFCs secrecy laws at
speeds limited only by the ability to communicate information from one place to
another. Regulators, however, can move only as fast as permitted by their bureaucratic
and administrative machinery and may therefore not be able to breach these countries' secrer
cy laws for years.

Technological innovation has created new opportunities for not only entrepreneurs\footnote{Part of the regulatory challenge is illustrated by the minor financial crisis that involves Sussex Futures, a derivatives trading specialist. On August 10, 1999, the Financial Services Authority in London had to intervene in the company’s affairs because on August 6, 1999, one of the company’s traders incurred losses of £750,000 in less than 30 minutes of trading. The incident illustrates the liquidity in the contemporary financial markets and how fast traders can get into both positive and negative trading positions. Vincent Boland, "Trading in UK Gilts under Scrutiny", \textit{Financial Times}, 10 August 1999.},
but also money launderers as it has helped to catalyse the globalisation and financial
markets integration processes and consequently has expanded the scope, complexity,
and rate at which financial transactions can be conducted. For money launderers, improvements in technology have made it easier for them to quickly and cheaply move financial assets around regulatory obstacles, to divert their movement through various secrecy jurisdictions, and to shuffle legal title among a number of different legal entities. The net effect has been to make it more difficult for regulators not only to track the flow of laundered money, but also to identify when, in the first place, a crime has been committed. Of course, the problems for regulators, reach far beyond the unlawful activities of individuals, as technological innovation has fundamentally transformed the very nature of the financial markets.

Associated with the processes of globalisation and integration within the financial markets has been the process of deregulation. As a process, deregulation has broken down the barriers that have traditionally separated commercial from investment banking activities and led to the formation of financial conglomerates that engage in both. As a side effect to the deregulatory process the intermediation function traditionally performed by banks is now being performed by a broader range of financial institutions like pension funds, mutual funds, and insurance companies. In turn, each such institution has its own unique characteristics to which regulators must respond.\[133\]

As in the case of international tax competition, the allocative effects of international tax arbitrage depend on the degree of substitutability—specifically, in the latter context, the substitutability of transactional forms (tax considerations aside). Some of

\[133\] Hinterseer, above n 319, 332-3.
the tax-avoidance literature identifies two broad categories of substitutable transactions noted earlier in the context of tax competition. Again, the policy relevance of the distinction between the categories lies principally in the different efficiency effects. The first category consists of those transactions that are perfect or nearly perfect substitutes in the sense that any differences in non-tax considerations are non-existent or minimal. More particularly, instances of perfect substitutability arise where equivalent cash flows associated with substitutable transactional forms are taxed inconsistently, so that repackaging lowers the associated tax burden without sacrificing the desired pattern of cash flows. Where two transactions of this type are taxed differently, the lower-taxed form may be chosen over the higher-taxed form with little or no sacrifice of non-tax attributes. These instances of "pure" tax avoidance typically involve "purely paper transactions" that attempt to arbitrage differences in tax treatment without altering the desired pattern of cash flows associated with a particular transaction.

Thus the number of participants within the financial markets increases, competition among participants has intensified. Financial institutions have expanded overseas to diversify their sources of income and to increase the scale and efficiency of their operations. In particular, financial institutions have sought to develop value-added products and services on which greater fees and commissions can be earned. They have also sought to offer these products and services within a greater range of countries and to a wider range of clients in order to create a more robust revenue

333 Brooks and Head, above n 332, 65.
334 Edgar, above n 270, 1103.
streams. At the same time, regulatory arbitrage, especially through OFCs, has been used to minimise capital costs by structuring and executing transactions through jurisdictions that have more relaxed reserve and regulatory requirements. Invariably, however, these flexible regulatory jurisdictions also have domestic laws that support financial secrecy, which complicates supervision of financial institutions.335

3.8 Tax Competition and Money Laundering

Tax systems need to cope with increasingly mobile tax bases internationally. Advances in communication technologies, ongoing developments in complex, innovative financial instruments, and the expansion of tax havens and preferential “niche” regimes designed to attract mobile capital, particularly financial capital, are creating horizontal inequities between taxpayers and producing a misallocation of capital. Governments may find themselves competing for these mobile activities, but this is different from the sort of tax competition over generally applied tax rates that has been the subject of the economics literature.336 One point of view is that, tax competition can be beneficial, both by restricting tendencies towards excessive government spending and by providing individuals with a choice between locations according to their desired level of public provision. In the absence of tax competition, tax levels would be set optimally.337 In effect, this model challenges the proposition that tax levels would necessarily be calibrated to maximize the welfare of residents or factors of production in the presence of an incentive for public officials to increase the

335 Hinterseer, above n 331, 335.
size of the public sector. Tax competition is considered to act as a constraint on such self-interested behaviour and thus is seen as efficiency enhancing. Ideally, tax levels should be driven down to the point at which the marginal cost equals the marginal benefit to taxpayers. However, this reasoning does not hold for tax competition that is non-transparent or discriminatory, or where it facilitates illegal tax abuses that enable companies or individuals to reduce their tax liability without actually moving their residence away from a jurisdiction with high public provision.

The OECD makes a useful distinction between tax competition in the form of generally applicable lower tax rates and tax regimes designed to attract foreign investors. Restricting tax competition should not and cannot mean that voters in democratic countries lose their right to determine the size of the public sector through general tax increases or reductions. But it does mean that countries should not provide windfalls for foreign investors at the expense of the ability of other countries to provide those public services which their residents desire. Such limitations are particularly appropriate because those foreign investors themselves often reside in countries providing a high level of public services and yet refuse to pay the tax price that providing such services entails.

The view that depending on the OECD for solving the tax competition problem suffers from one major drawback: Developing countries are left out and may perceive the OECD as a cartel of rich countries operating at their expense. But it is unlikely that general tax competition benefits developing countries, who need the tax revenues they give up to attract foreign investors. If all developing countries could be prevented

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338 Edgar, above n 334, 1107.
from competing in this fashion, they all could gain. In the longer run, it is considered that, the need for global standards and the fight against harmful tax competition could become part of the World Trade Organization's agenda, or even require a new "world tax organization," in which developing countries are adequately represented. It is believed that this would also solve the problem of what to do about the 15 percent of multinationals who are not headquartered in OECD member countries, a percentage that can be expected to grow if the OECD indeed moves to restrict tax competition for its multinationals.

The facilitating role played by OFCs in money laundering may be overstated. Blum, Levi, Naylor and Williams make the point in their study on OFCs prepared for the United Nations that "Money laundering can proceed very easily without bank secrecy; in fact, it may well be that launderers avoid it precisely because it acts as a red flag." In fact what may be more problematic are corporate secrecy laws and other obstacles that exist alongside bank secrecy laws, as these act as an associated set of confidentiality provisions. After all, to pierce bank secrecy laws in order to identify a company based in an OFC being used to launder money is of little help if the individuals who stand behind that company cannot be identified. In their words:

It is not that most haven countries seek drug money or any other type of assets derived from serious crime. Rather they literally cannot afford to co-operate

130 Vito Tanzi, 'Is There a Need for a World Tax Organization?' in A Razin and E Sadka (eds), The Economics of Globalization: Policy Perspectives From Public Economist (1999)
133 Ibid.
134 Ibid 28.
too closely. ... It is popular to decry the operation of such financial havens, and it is certainly true that they can have a harmful effect, particularly in terms of facilitating tax evasion and secondarily as places that foster money laundering. It is however necessary to show some understanding of their positions, their economic vulnerability and their lack of alternative resources. In the field of drug control, the major consuming countries are willing to research and finance alternative development programmes for producing countries. Therefore, it should be possible to imagine alternative economic development solutions for such financial havens, developed in conjunction with the world business community.

Certainly, the developed countries, along with all other countries that are keen to ensure that the global economic system operates in a manner whereby abusive financial practices are minimised, have legitimate concerns about the questionable activities facilitated by OFCs. These concerns are all the more important to address given the contemporary interconnectedness of the financial markets and the problem can be spread quickly throughout the financial system. Certainly, without international organisations like the FATF, OECD, and FSF to push reform, the policies facilitated by OFCs would tend to proliferate rather than be curtailed. From an OFC perspective, however, the crux of the problem is that the financial services industry is an industry that can be mobilised in support of sustainable development. In particular, financial services are a growth industry, a skilled industry, an industry that supports the transfer of skills and technology, and an industry that is not premised on
the exploitation of the environment. In this respect, further comments by Oxfam are of note. Widespread concern about the offshore problem has given rise to a number of international initiatives. ... These initiatives are useful up to a point, but they primarily reflect the concerns of Northern governments. They lack a development perspective and can also be accused of being unbalanced. The issue of financial havens goes beyond the ‘offshore’ activity of small island states to ‘onshore’ activity in major economics such as the City of London and New York.

Consequently, Oxfam advocates an integrated global approach. Such an approach would help to address the “unfreedoms” discussed by Amartya Sen and would involve the provision of technical and other assistance to help OFCs diversify away from dependence on financial services, especially secrecy services. The FATF, FSF, and OECD have recognised the need for such assistance. The important point is that to address the issues posed by OFCs, development issues such as training, resourcing and technology, need to be taken into account.

Alldridge asserts that the events of 11 September 2001 provided the impetus for a further shift in the focus of money laundering control to consider the means by which terrorism is financed. The expression ‘laundering’ was continually applied to the

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345 Oxfam, above n 1, 2.
346 Amartya Sen, a Nobel Laureate in economics has stated economic development to be about the removal of “unfreedoms”, which includes the unfreedoms associated with tyranny, poverty, corruption, and other obstacles that contribute to social deprivation. Amartya Sen, *Development as Freedom* (2001)
3.
347 Hinterseer, above n 335, 232-3.
means by which terrorist organisations were financed. The use of the pejorative expression was doubtless deliberate. The analytical truth is that funding for terrorism is either itself from the profits of crime, in which case it is covered already, or it is not, in which case the seizure of money intended for terrorist use, when no action has been taken towards its deployment, smacks of 'thought-crime' and does not fall within traditionally accepted notions of laundering, because the money is clear in the first place. Similarly, the introduction of closer monitoring of suspected bank accounts by financial information orders had already been put in place, so far as concerns the accounts of persons suspected of involvement in terrorism. Somehow, however, the more widespread introduction of these laws was presented as being a necessary response to the attacks. In this case the legislation probably would have occurred anyway, and the attacks simply provided a convenient issue by reference to which to overcome any opposition on civil liberties grounds.

3.9 Conclusion

In this chapter, the issues of tax competition, tax arbitrage and money laundering were examined as two of the policy drivers of the OECD, FATF and FSF. Tax evasion and money laundering law as a problematic issue, is a creature and has become the motor of international co-operation in financial surveillance. The development of money laundering law has been driven by international organisations, and it has blurred or removed many distinctions that previously were considered sacred. Banking secrecy has been broken down and far greater international co-operation put in place. The US has been one of the driving forces behind many of the initiatives in the

348 'G7 approves plan to choke terror funds', The Guardian, 26 September 2001
349 Allridge, above n 260, 23.
internationalisation of criminal law. The denial of certification involves foreign assistance sanctions and a mandatory US vote against multilateral development bank loans. The US holds greater sway at the OECD, the World Bank and the IMF than at the United Nations; developments in international efforts against laundering which come from the former are more likely to bear a US imprimatur than those from the latter. The principal moving forces have been the IMF, the World Bank, and, in particular, the FATF. Because of its jurisdiction over markets, the European Union has been a central player. Money Laundering law is a microcosm within which the reconfiguration of national sovereignty and criminal justice is taking place.

On a legislative level, international harmonisation of anti-money laundering legislation is an absolute prerequisite for success in the fight against money laundering. This holds not only for criminal legislation, but also in the context of preventive legislation, where the argument for effectiveness is reinforced by an economic argument, namely the desirability of imposing the same type of anti-money laundering measures on financial institutions in different countries with a view to an international levelling of the playing field. On an operational level, the globalisation of money laundering makes it necessary to establish effective international co-operation mechanisms which allow national authorities to co-operate in the prevention and prosecution of money laundering and in international 'proceeds-
At the heart of the matter lies the issue of sovereignty. While this concept undeniably allows every state to draft its legislation according to its own will, it might also be argued that a corollary of this concept is that no state should assist citizens of another state in the violation of the laws of their home countries.

On the assumption that broad international coordination of corporate income tax systems is not feasible, or even desirable, in the short to the medium term, the obvious policy inquiry is the consideration of more limited forms of coordination that could be adopted as a response to international tax competition and international tax arbitrage. Such responses should be target-efficient in the sense that they address the defined policy problem presented by these two processes. It is argued in this section that the OECD and EU proposals to address international tax competition, as well as some proposals in the literature, can be criticised as over-inclusive, both in their definition of the policy problem presented by this process and in the proposed responses to the perceived problem. In contrast, the limited responses to international tax arbitrage that have been adopted to date are generally under-inclusive in each of these two respects.

In suggesting possible responses to international tax competition and international tax arbitrage, it is accepted that the conditions do not exist for radical reform of the current allocation of taxing jurisdiction and the division of revenue from cross-border transactions. Indeed, it is not clear that the status quo needs to be disturbed to any

355 Stessel, above n 328, 94-5.
significant extent, at least in the development of an effective response to international
tax competition and international tax arbitrage.\textsuperscript{356}

An element of the status quo is the role of low-tax jurisdictions as facilitators of tax-
driven choices of investment location and the transactional form for such investment. As described in the existing literature, these jurisdictions may be either tax havens offering a general low-tax environment or jurisdictions that have a high-tax environment but offer low-tax treatment for selected investments. Commentators have consistently recognized the need to block access to these low-tax jurisdictions. To date, that goal has been pursued through a combination of the application of CFC regimes, thin capitalization regimes, and anti-avoidance rules and doctrines found in domestic law and tax treaties.\textsuperscript{357}

The challenges brought about by the supranational directives in regards to tax competition and money laundering have been analysed in this chapter in the global perspective and which now lead on to the shift in focus to the current issues of confidentiality and exchange of information between independent sovereign states including the OFCs.

\textsuperscript{356} Edgar, above n 328, 1133.

Chapter 4: Offshore Confidentiality and Exchange of Information

4.1 Introduction

Chapter 3 analysed the regulatory and soft law response to the increase in harmful tax competition and money laundering. It addressed harmful tax practices and money laundering. This chapter focuses on the corollary issues of confidentiality and exchange of information and how OFCs are expected to respond.

Confidentiality is an important common denominator in all of the various subjects of offshore law. Yet it has become an important subject of its own, grounded in a body of unique legal principles. Indeed, so frequent has been litigation on confidentiality in offshore law, that a definable body of jurisprudence now exists. Its intricate parameters and limits may be identified through case law, legislation, treaties, and statements of public policy.

This chapter analyses the challenges to confidentiality which reflect the transnational nature of offshore banking. Accordingly, mutual legal assistance, worldwide restraint orders and the tensions posed by conflicting national interests, particularly when assessed in the light of comity. Not far from that, is the issue of sovereignty and issues of private international law.
Confidentiality in OFCs operates within a new paradigm. Disclosure initiatives, anti-money laundering regulations, emerging rules on the enforcement of foreign tax laws, tax-avoidance and now issues of terrorism have forced reforms to the law of confidentiality. Thus, the international and public policy issues which seek to erode and undermine confidentiality in offshore jurisdictions are analysed. So too are the areas of the FATF’s concerns on money laundering and the OECD’s allegation of ‘unfair tax competition’ raised in Chapter Two.\(^{358}\)

Both organisations have produced ‘blacklists’\(^{359}\) of uncooperative jurisdictions in their efforts to secure commitments. A raft of anti-money laundering statutes and practitioner guidance regulations have come into force. This requires clients purchasing offshore companies to provide sufficient information for verification of the identity, source of funds and nature of business to satisfy due diligence and know your client (KYC) requirements.\(^{360}\)

Onshore courts such as that of US and UK, often display hostility to the efforts of offshore courts (such as the Bahamas and Cook Islands) to protect confidentiality.\(^{361}\) On
the other hand, offshore courts seem preoccupied in protecting confidentiality save in
blatant cases of criminal wrongdoing. Indeed, it would appear that onshore courts are
prepared to jettison well-established principles in conflict of laws to extend their reach
into offshore jurisdictions. Consequently, the sovereignty of nations and their legal
systems is becoming increasingly insecure.

There is concern that onshore courts and international bodies are attempting to distort the
application of well-known legal rules in offshore jurisdictions in order to defeat
confidentiality. For example, questions of tax, trust law and human rights are approached
differently where offshore jurisdictions are involved in order to effect disclosure of
financial information. Further, the respect paid to confidentiality in onshore jurisdictions
as evident in blocking laws and informational privacy law contrasts greatly with the
approach to confidentiality in offshore jurisdictions. Antoine asserts that it is tempting to
conclude that these differences have more to do with public policy concerns rather than
strict legal logic. 362

Despite the judicial and other assaults, confidentiality in offshore law continues to be
instrumental in shaping offshore finance. The claim that crime is generally protected or
even dominant in offshore centres is analyzed and exposed as erroneous although it is
conceded that confidentiality can be abused and the limits must be set for it. Indeed, it is
argued that if the integrity of confidentiality is to be maintained, it will be necessary to

claiming the Andersons were connected with an alleged $50 million fraudulent investment scheme. In the
course of the proceedings the existence of the trust surfaced and the judge ordered the Andersons to
repatriate $1.3 million of trust funds to the U.S.

362 Antoine, above n 358, viii.
define more clearly the boundary between criminal activity and merely undesirable activity (from the perspective of onshore jurisdictions), such as tax avoidance and privacy interests. 363

What differentiated legal from illegal activity is the intention with which an act is committed. This concept lies at the heart of the actus rea and mens rea distinction made by the criminal law, and is useful to highlight a dichotomy that concerns the use of financial secrecy services. Although secrecy may be the badge of fraud and financial secrecy services may be used to shelter unlawful activity, such services are also used by businesses for legal and legitimate purposes. In other words, the same legal, financial, and accounting instruments that shield informal economic activity also contribute to the growth and evolution of the formal economy. When the use of financial secrecy services supports the pursuit of questionable business practices, when the abuse of such services creates economic hardship, and when such services support graft and corruption, in other words, when secrecy is used as a badge of fraud, action needs to be taken. However, it is argued that the regulatory apparatus imposed by the state must be able to differentiate legal use from illegal abuse of financial secrecy services in a manner that does not impose significant compliance costs and competitive disadvantage on those who provide and use such services in a legal and legitimate manner. 364

363 Ibid.
There is a plethora of compliance requirements being imposed by governments to control money laundering and the concern expressed by the private sector regarding the associated compliance costs. These compliance requirements are considerable and have been imposed in an expanding manner on financial institutions and service providers in related industries because they are seen to be in the optimal position to ascertain whether money launderers and criminals are abusing the economic system. Financial institutions certainly recognise the need to prevent abusive financial practices. The challenge for the regulators, however, is to implement an effective, but economical prevention and detection system. In particular, Hinterseer argues that this system ought to be able to differentiate suspicions from legitimate transactions without unduly burdening financial institutions with regulatory requirements and compliance costs, and without alienating clients from their relationships with the financial institutions with whom they do business. The counterpart to this challenge is, namely the challenges associated with regulating the development and implementation of such a system from the perspective of regulatory agencies.

Certain countries attach particularly great importance to the exchange of information. That is the case in particular with the United States and Canada, but also of European countries, which may base this administrative co-operation, not only on bilateral conventions, but also on directives under European Community law, or even on a multilateral convention signed within the framework of the Council of Europe. Germany,

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\[366\] Hinterseer, above n 347, 283-284.
Belgium, Canada, Denmark, France and the Netherlands in particular have agreed with each other on automatic exchange of information. 367

On the other hand, Switzerland maintains a reserved attitude vis-à-vis the exchange of information on the basis of taxation conventions, limiting this to the information required for application of the conventions, except in the convention it concluded in 1996 with the United States, which allows the transmission of information needed for prevention of tax fraud offences and similar acts, without being limited by banking secrecy. However, by virtue of the domestic law authorising international legal aid, the Swiss police authorities may forward information, without being limited by professional secrecy rules, when the object of the foreign proceedings giving rise to the request for information has been characterised as tax fraud. 368

4.2 Swiss Concept of Offshore Confidentiality

The statutory model, being the model of offshore confidentiality familiar worldwide today, was conceptualised by the Swiss. They are also responsible for the birth of the OFCs. As the Swiss model remains the archetype of the offshore financial centre, its laws will be outlined in order to examine the main features of offshore confidentiality. 369

Although Switzerland is more closely identified with banking confidentiality laws, the

368 Ibid.
369 Switzerland is still a world leader in offshore business. Europe accounts for 60% of offshore banking business, while Switzerland claims 35% of the share of offshore business on its own. Further, approximately one third of the world’s private wealth is invested offshore; ‘The Race for Riches’ (1993) 3 The Banker 42.
duty of confidentiality is not confined to the banking sector. Rather, it is but one aspect of a general right to financial privacy under the Swiss Civil Code (1907 Switzerland).

Specifically, the obligation of banking confidentiality arises from three legal principles:

1. the right to personal privacy;
2. the contractual relationship between customer and banks;\(^{370}\) and
3. specific statutory provisions governing banking confidentiality.\(^{371}\)

In addition, penal and administrative sanctions apply to breaches of banking confidentiality. Most notably, the Swiss Banking Law, article 47 makes breach of banking confidentiality a crime.\(^{372}\)

The Swiss concept of confidentiality has been imported into offshore countries. In the majority of offshore jurisdictions, the confidentiality obligation has been codified.\(^{373}\) The enactment of such legislation serves to extend the obligation of confidentiality from being merely contractual to being statutory and may be enforced by both criminal and civil sanctions. In addition, third parties outside the relationship of banker and client may be liable for breaches of this duty of confidentiality. In the few offshore countries where

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\(^{370}\) Swiss Civil Code, Art 398. The agent is obligated, in general, to use the same care as the employee under an employment contract. Affirmed by the Swiss Federal Tribunal in 1937: 63 Arrêts du Tribunal Fédéral Swiss II 242, 16 September 1937.


\(^{372}\) ibid, Breaches of privacy under art 28 also qualify as a tort.

\(^{373}\) By statutes as the Confidential Relationships (Preservation) Law 1979, rev’d 1999 (Cayman Islands) (CR(P)L), the Confidential Relationships Act 1985 (St Kitts), the Bank and Financial Institutions Act 1995 (Belize), Offshore Banking Act 1996 (Belize) and the International Business Companies Act 1996 (Belize), the Confidential Relationships Preservation (International Finance) Act 1996, No 17 of St Vincent and the Grenadines and the Banks and Trust Companies Regulation Act 2000 (Bahamas), recently revised from the 1980 statute.
confidentiality has not been upgraded by codification under separate confidentiality statutes, such as in the British Virgin Islands, St Lucia and Barbados, it should still be viewed differently from its pedigree. This is because in an offshore financial context, as a legal principle or policy, confidentiality, whatever its trappings, assumes a peculiar and more important focus and thrust which is clearly lacking elsewhere.\textsuperscript{374}

Thus, typically, when it concerns a duty of confidentiality in offshore matters, it is this extended concept which is being addressed. As the majority of offshore countries have also inherited common law principles on bank confidentiality, the offshore confidentiality concept is a good example of the hybrid nature of offshore legal concepts. The common law and civil law foundations of the confidentiality principle have been merged to create a strong statutory model with an important policy focus. This is a unique legal phenomenon.

The term 'offshore' has become synonymous with jurisdictions enforcing such rigid confidentiality laws. The increased demand for financial confidentiality laws has

\textsuperscript{374} Indeed, the Confidential Relationships Preservation (International Finance) Act 1996, s 3(1) of St Vincent and the Grenadines specifically states that the 'public policy of the state is to protect and preserve ... confidentiality'. Although in these countries there are no separate confidentiality statutes there are confidentiality provisions in individual legislation such as the Banks and Trust Companies Act 1990, am'd (BVI), the International Trusts Act 1999 (St Lucia), s 61, the Registered agents and trustee Licensees Act 1999 (St Lucia), s 25 (however, the duty here is not general but is directed at the Director, his agent or an agent of the Financial Centre Corporation - the regulatory authority) and the Banks Act 1999 (St Lucia), s 19. The original s 24 of the Banks and Trust Companies Act 1990 (BVI) had a provision stipulating that all information disclosed to the Inspector, Registrar or Director of Financial Services was 'absolutely privileged'. The new s 24, however, provides for 'gateways' to disclosure enable foreign regulatory authorities to obtain information in strictly defined circumstances.
corresponded to the marked expansion in the number of foreign owned banks operating in such secrecy havens. 375

4.3 Three Arguments about the Financial Secrecy Laws

Given the scrutiny financial secrecy laws and services have recently come under, both those commercial participants who trade in, and those governments that use such services to promote economic development, have drawn on various arguments that support the existence of such laws. Here, three arguments are noted. First financial secrecy laws are said to protect private assets from wrongful expropriation by public authorities. 376

Wherever a minority is subject to persecution by the majority, as exemplified by the Jews in Nazi Germany, this rationale finds justification. In fact, this type of argument was recently advanced by USA House Representative Ron Paul in his criticism of the International Counter Money Laundering and Foreign Anticorruption Act 2000. 377 This act gives significant discretionary powers to the Secretary of the Treasury to take action against other countries, foreign financial institutions, and classes of financial transaction that are identified to be a "primary money laundering concern". As Representative Paul observes in criticism of the act. 378

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375 Antoine, above 363, 23-25.

158
Bank secrecy itself is not necessarily indicative of a crime ... Bank secrecy is an important way for individuals to protect themselves — and possibly have the resources to save themselves and their loved ones. Enacting this bill into law in the 1930s would have been the equivalent of a death sentence to Jews in the Nazi era just as it would threaten those persecuted individuals now relying on bank secrecy.

The treatment of a minority within a given geo-political area is a domestic political issue upon which most international participants are encouraged to remain silent. Northern Ireland and the activities of the Irish Republican Army are an example. Depending on the individual’s position, money laundering services either help to support a legitimate partisan struggle against a foreign oppressor, or to finance a terrorist organisation that relies on various criminal activities to support its operations. Similarly, take the example of tax avoidance and evasion. Many claim that financial secrecy laws provide a useful and important means by which financial assets may be sheltered from unfair taxation. The tax-evader is merely a “revolution for free enterprise” who refuses to abide by inefficient government regulation. Contemporary international consensus that harmful tax practices need to be addressed has created further pressure to do away with “bank secrecy statutes as a factor in international finance”. This consensus is typified by the fact that in the USA consideration is being given to classifying tax offences as money laundering predicate offences. 379 The point remains, however, that financial secrecy laws have from

time to time helped individuals protect their wealth and assets from unjust expropriation by repressive regimes.

Second, financial confidentiality merely forms part of the professional relationship between a banker and his/her client and should be accorded the same rights and privileges associated with other professional relationships like doctor-patient and lawyer-client. The traditional rationale used to justify the existence of privacy rights that attach to these relationships concerns the need to protect the private affairs of the individual from unwarranted third party scrutiny.

Medical privacy is a manifestation of the highly personal nature of health related issues. Legal privilege, meanwhile, is not only a corollary of the rights of counsel and protection against self-incrimination, but also a reflection of the adversarial nature of the judicial system. Similarly, banker-client confidentiality is premised on the highly personal nature of each individual’s financial affairs and the right of the individual to use his/her financial resources in a manner he/she deems to be appropriate.

It is of note, however, that the sanctity of each of these relationships is subject to exceptions. The relationship of lawyer-client is subject to a requirement that the relationship should not be used to shield unlawful activity; a requirement which certainly should also be applied to the banker-client relationship. The purpose of such confidential relationships after all is to protect the intimate details of the individual’s activities from

38 Campbell, above n 376, vii.
unwarranted examination and not to enable an individual to pursue activities that will deliberately cause harm to others.

A balance needs to be struck between the right of the individual to pursue his / her affairs in private and the right of the state to investigate suspected criminal activity. Consequently, the individual’s right to deploy his / her financial resources as he / she deems appropriate should be protected from unwarranted third party scrutiny so long as the particular activity pursue is legal. The basis of the relationship between a banker and his / her client is one of contractual confidentiality, but there are exceptions, as overriding legal obligation and express or implied consent by the client.\textsuperscript{381} The money laundering provisions that have been put in place over recent years have radically altered the relationship between banker and client because they do represent such an overriding obligation. The reporting provisions have the effect, under certain conditions, of creating for the banker an entirely different relationship with his / her client, no longer as confidant, but as police informant.\textsuperscript{382}

Third, financial secrecy can be regarded as a fundamental right. Civil libertarians might argue that just as an individual’s sexual preferences and religion orientations should be protected from discrimination, an individual’s financial affairs ought to be protected from unwarranted third party scrutiny. Hinterseer argues that according to the principle of self-determination, an individual ought to be free to exercise his/her free will to pursue his/her own conception of the “good life” free from intrusion by third parties on the condition

\textsuperscript{381} And compare Peter W Schrotth, ‘Bank confidentiality and the war on money laundering in the United States’ (1994) 42 American Journal of Comparative Law 369-91.

\textsuperscript{382} Alltridge, above n 352, 270.
that the individual's actions do not cause harm to others. Moreover, the nature of the
"good life" pursued by an individual is a highly personal and unique conception, about
which third parties ought not to comment. To pursue the "good life", however, takes
more than free will; resources and money are also required. The right of the individual to
conduct his/her financial affairs in private is therefore fundamental. Pursuit of the "good
life", does not entitle an individual to engage in activities that will cause harm to others.
The right to the state to monitor various activities pursued by the individual is therefore
theoretically acceptable. Financial secrecy is neither a fundamental, nor absolute, right.
However, the balance that is struck between the need of the majority and the needs of the
individual ought to be struck in a manner such that unwarranted intrusion by third parties
is prevented or at least minimised. At the same time, where such intrusion does occur,
safeguards need to be implemented to ensure that individual rights are adequately
protected. 383

Privacy is a basic human right and civilised society – as well as commerce – would be
rendered impossible without it. The word 'privacy' like 'property' connotes what is
peculiarly an individual's own. The common law utterly rejects the idea that the citizen
belongs to the state. No clearer expression of that rejection was even seen than when
Britain and the Commonwealth stood against what Winston Churchill described as a
'monstrous tyranny' founded upon the opposite principle. The German Socialist
dictatorship completely subordinated the individual and the private to the demands of the

383 Hinterseer, above n 366, 286-8.
state and its state police, had neither restraint from warrants nor any respect for business, bankers', lawyers' or family confidences. 384

Seen from this legal and historical perspective, demands that foreign governments should be able to invade the privacy of the subject in Commonwealth countries becomes troublesome indeed. It is a serious concern that basic legal protections and rights have already been eroded by tax collection imperatives in OECD countries. It is a troubling notion to both offshore financial centres and their investors that foreign government officials should be able to extract information concerning the private financial affairs of families or companies without a local warrant showing good cause and without notice to persons affected. 385

According to Wheelwright, in Australia, a taxpayer's right to privacy is more properly described as a statutory duty on government officers not to disclose information about taxpayers except in very limited circumstances. This is described in the Charter 386 as a commitment by the ATO to respect a taxpayer's privacy and to keep a taxpayer's information confidential in accordance with the law. The need to assure privacy is important for taxpayers, given the increased use of modern technology in tax assessment

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384 Terence & Deborah Dwyer, above n 268, 336.
385 Ibid.
386 The Taxpayers' Charter is a document developed by the Australian Taxation Office (ATO) in consultation with tax professionals and the community over more than two years. It lists taxpayers' rights and obligations, and standards of service which can be expected from the ATO. Detailed information on the matters covered by the Charter is provided in 15 explanatory booklets available from all ATO offices (or through the ATO website at http://www.ato.gov.au) eg, "Treating you fairly and reasonably", "Your privacy and the confidentiality of your tax affairs", "Your honesty and the tax system".

163
and collection, although taxpayers are not protected from the Commissioner's access to premises and information under ss263 and 264.387

The British document called the "taxpayer's charter" is not a charter of rights. Indeed, nowhere in the document is any statement of rights (in the legal sense) mentioned. This is despite the emotive content of the term "rights" in this context, especially when linked with the term "charter". It is central to the understanding of the operation of tax laws in the United Kingdom that there appear to be no such things as "taxpayer' rights". This phrase will not be found in any Act of Parliament or other formal document. The Bill of Rights, like Magna Carta and the Petition of Right were concerned about the status of Parliament against the king.388 When Parliament became, in this sense, king,389 it adopted the same approach as kings did - the assumption of an untrammelled power to choose how to tax. The taxpayer's only rights were the rights of property affected by a tax charge, and the right to appeal against or secure a review of any tax charge.

At the present, there is no right of individual privacy -- rather a right, and duty, of governmental privacy. The taxpayer cannot demand to see any records held by government about her or him, but the government can demand information from a taxpayer. The taxpayer has no reserved rights at the legal level of family life or property, nor any protection against retrospective, disproportionate, discriminatory or taxes

388 The English Bill of Rights 1689, The Magna Carta (1215) and The Petition of Right (1628)
389 Technically, the sovereign authority is not the Queen in Parliament. However, as was illustrated with the 1996 Queen's Speech, the royal element is purely nominal. Traditionally, the Queen opens the annual session of Parliament by reading out a speech laying down the workload for the session. In 1996, the Queen did so in the customary manner, but the Prime Minister changed some of the items later that day in debate in Parliament.
otherwise perceived by a taxpayer as unfair taxes. Such remedies as there are at the political or administrative levels only: those of the revenue adjudicator, the ombudsman, and the member of Parliament.

4.4 Benefits of the Financial Secrecy Laws

Financial secrecy laws and services also provide certain beneficial, essential and, most importantly, legal economic benefits. The first benefit is that financial secrecy services like privacy laws enable economic actors to conduct their activities free from unwarranted scrutiny. According to Schneider, this has several advantages. First, transactions can be structured in a manner that avoids unwarranted scrutiny by competitors and other interested third parties. Second, sensitive information can be stored in a place where third party requests for release of the information will be difficult, if not impossible, to achieve. Third, transactions can be arranged that might otherwise be extremely difficult or considerably more expensive to complete. Thus, a company is able to pursue its affairs in private, free from unwarranted third party scrutiny.

A second benefit derived by economic actors concerns tax planning. Taxes are popular to no one, and individuals and corporations are willing to go to great lengths to minimise their tax liabilities.

390 The Human Rights Bill will grant some of these rights formally for the first time in United Kingdom law.
To minimise tax burdens, the use of offshore financial centres is useful. Their use has certainly given rise to aggressive practices, and contemporary concern about the financial activities being conducted within and through these jurisdictions as noted earlier, can be justified. Offshore financial centres enable companies to structure transactions to reduce and defer taxes, which therefore frees up capital to grow their business, improve efficiency, and create employment. Of course, offshore financial centres can be used to shelter financial structures that are abusive. As Levi notes, however, “The bulk of the financial transactions undertaken in offshore financial centres arises from the lawful activities of multinationals seeking to minimise taxation worldwide and to optimise the distribution of their profits.”

The use of money laundering type instruments and services is not illegal per se, but can be used either for legitimate legal business purposes or for illegal money laundering purposes; the difference depends on the intentions with which such instruments and services are used. The danger of course is that money laundering type services used in a legitimate manner may come to be abused and used to facilitate economic activity associated with money gained from illegal sources.

The financial industry, like any industry, seeks to create a safe economic environment, to act in a lawful manner, and to create a strong public reputation for service, trust and accountability. Undoubtedly financial secrecy services have performed an important role in most financial atrocities and criminal endeavours perpetrated since World War Two.

and continue to shelter a number of abusive practices. Financial secrecy laws have a long and legitimate history and the three earlier discussed rationales all have merit to a greater or lesser degree.

According to Hinterseer, two important questions therefore arise. First, how to define the caveats that qualify the individual's right to privacy in financial matters. Second, how to construct the various legal requirements that will help to ensure that unlawful activity can be detected, investigated, and prosecuted in a manner that is efficient and economical, but which does not unduly compromise individual rights and freedoms. These questions concern how to strike an appropriate balance between the individual's interest in using his/her financial resources pursuant to the principle of self-determination, and society's interest in preventing abusive financial practices pursuant to the principle of social welfare. To strike this balance, governments do not necessarily need to implement onerous laws. Financial institutions and other economic actors have a legitimate concern to minimise costs and compliance burdens associated with regulation. It is expected of financial institutions and others to be supportive of money laundering legislation to the extent that it promotes transparency, stability, and a level playing field within financial markets. In this respect, the Wolfsberg Anti-Money Laundering Principles are pertinent. However, resistance would naturally rise to transforming into a criminal offence activity that was previously considered both profitable and legal.

The challenge for the legislator is therefore to control the abuse of financial services without penalising those who would use the same services in a legitimate and legal
manner. However, legislators have created a situation whereby financial institutions may be unduly penalised precisely because they have complied with their legal obligations mandated by the criminal law. This situation has arisen because inadequate consideration has been given to how the criminal and civil law currently interface. 394

Accordingly to Bentley, for the taxpayer, it is important to determine the limits on the powers of the tax authorities to gather information. Due process demands that taxpayers should be aware of the requirement to provide information, that they should have the capacity to provide the information, that they should be given a reasonable time to do so, and that there should be a presumption that they are acting honestly unless they act otherwise. It is often a requirement that the taxpayer must be informed before a tax authority can request information about the taxpayer from a third party. Taxpayers should also have the right of access to information held about them by the tax authorities. Under the basic right to privacy there should be limits on the scope of the tax authorities’ information gathering powers. Collection of tax does not require the provision of unlimited information. Even where there is possible tax evasion, the tax authority should restrict the information it gathers to what is relevant to the bona fide assessment to tax. It is not a valid argument to say that tax collection outweighs all rights to privacy as a matter of public interest. 395

The gathering of information from taxpayers is predicated upon the tax authorities treating the information as confidential. Bentley asserts that, it is a question of balancing

394 Hinterseer, above n.383, 288-290.
the competing interests of the tax authorities to gather the information necessary for them to collect the right amount of tax, with the interest of individuals in maintaining their right to privacy. Tax systems should contain stringent secrecy provisions to ensure that basic privacy requirements are observed. The right to confidentiality of information should be supported by rules governing precisely how, when and where information relating to a taxpayer can be used, for example, in criminal proceedings. The rules should cover the passing of information within the tax authority, to and from other government and quasi-government departments, and to the courts and other judicial or quasi-judicial bodies. The rules should be particularly clear on levels of authorisation and the reasons required before confidential information is released to third parties.\footnote{Ibid.}

4.5 Political and Economic Motives for Attacking Offshore Laws

If criminal activity is not the true focus of offshore activity, and if it is demonstrable that offshore laws do not exist either to promote or conceal such activity, then why such an offensive has been launched against the offshore sector? The argument as previously discussed by Antoine, is that the real issue, concerns the loss of revenue, particularly but not solely, fiscal revenue flowing from onshore economies and filtering offshore. The revenue, albeit in savings which filters from onshore countries, results in the economic developing of many offshore countries, several of which can be labelled as developing countries.\footnote{This can be viewed as a kind of ‘balancing effect’} The fear on the part of onshore countries of the loss of revenue as a direct result of offshore activity is not one to be dismissed. Already, non-offshore jurisdictions
within the European Union are beginning to experience an increase in loss of revenue as a result of offshore business, as noted in the recent Boston Consulting Report 2003. European unification has improved European citizens' ability to relocate their assets to other European countries and many investors are choosing to invest in European offshore jurisdictions such as Ireland and in Asia such as Singapore and Hong Kong. The enrichment of offshore coffers at the expense of those onshore provides a powerful economic and political motive for the legal offensive aimed at the offshore sector. This factor cannot be ignored when the question of the acceptable limits of offshore activity and law are to be addressed.

The above point of view is underscored by a discussion on tax reform by the UK Revenue in 1982. It was pointed out by the UK Revenue Board that the UK was losing £100 million annually in revenue due to the growing use of tax havens for tax avoidance purposes and the problems associated with the accumulation therein of profits and investment income. This prompted the then Secretary of the Institute of Directors' Taxation Committee to respond.

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399 'Greengrocers Plight', The Financial Mail (South Africa), 16 April 1996, 6.
400 Singapore is managing about US$2.2 trillion offshore assets. Figure provided by Pulses, a monthly publication of Singapore Exchange Limited, dated November 2003.
401 The total trade value of Hong Kong's offshore trade was HK$1,425 billion in 2000. Figure provided by Hong Kong Trade Development Council (2000)
The UK tax authorities have no business to set themselves up as the 'fiscal policeman' of the world. Such fiscal imperialism can only provoke retaliation by other governments jealous of their sovereignty. The proposal is unacceptable on grounds of both economic and constitutional principle and is impracticable.

The real concern of onshore countries in relation to offshore activity is often actual financial loss rather than high or moral principle. While it is clearly within the right of any country to safeguard economic and political interests, this element must be recognised for what it is and should not be allowed to cloud the relevant legal issues, such as the validity of the offshore interests by attacking offshore law and policy. The argument thus follows, that all things being equal, offshore states have a similar right to safeguard their economic and political interests by upholding them. This is an important argument in the difficult issues relating to comity, taxation and the confidentiality principle. It is central to the question of legitimacy.

4.6 Offshore Responses to Erosion of the Confidentiality Principle

Developments restricting the application of the confidentiality principle have occurred under offshore law largely as a result of onshore influences. This includes statutory developments as well as the increasing recognition by the offshore courts that it is both desirable and appropriate to restrict the principle in certain circumstances. This means
that the extent of the duty of offshore confidentiality, notwithstanding its pretence at a statutory certainty, is constantly being redefined, even by offshore courts.404

However, it can be seen that OFCs come to the international arena at great risk. It is argued that the erosion of the confidentiality principle has the potential to prejudice their economic interest. The cost of co-operation in such efforts may be increased competition in the offshore marketplace, where the stakes are already high. OFCs are painfully aware that any moves against confidentiality could trigger an exodus from their offshore industry to other more secretive, and consequently more attractive, jurisdictions. Hence, this is a serious obstacle to mutual assistance efforts. In recent times, a refusal to cooperate has invited ‘blacklisting’ or even sanctions from the OECD.405 Thus, a fine balance must be struck between co-operation and competition. That balance swings in favour of disclosure where criminal, but not civil matters are involved. Indeed, at an emergency meeting of the CARICOM Heads of Government held in The Bahamas in October 2001, the Finance Minister of The Bahamas had occasion to underline that while The Bahamas had co-operated extensively in the fight against crime and, more recently, against terrorism, they had to be careful to preserve confidentiality for non-criminal and civil matters.406

The highly competitive nature of OFCs points to the unlikelihood of the repeal of their much prized and guarded confidentiality laws. In fact, since anti-secrecy initiatives by the

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404 Antoine, above n 375, 81.
405 This is a contentious issue.
406 CARICOM is the Caribbean Community -- a regional entity. The remarks were made on October 2001; BBC Caribbean News.
international community initially targeted the major offshore jurisdictions, for example, Switzerland and the Cayman Islands, other OFCs perhaps saw this intervention as a golden opportunity to gain a larger share of the industry. Consequently, the large majority of OFCs have been less enthusiastic about far-reaching inroads into confidentiality. The threat of sanctions by the OECD has undoubtedly tempered this reluctance. However, despite the fact that the OECD seems to seek to generalise all aspects of offshore confidentiality with a broad brush of tax arbitraging, its mandate is essentially confined to taxation harmonisation.

The advent of greater harmonisation of taxation laws in the European Union has catapulted this issue forward. The extent to which harmonisation will affect competitiveness to the benefit of non-European Union offshore financial jurisdictions at the expense of European offshore countries, such as Ireland and Luxembourg, is yet to be seen. Already, the UK is showing signs of capital flight as a direct result of the European Union. As the world of business becomes even more transnational, movements of finance becomes swifter. Investors are always willing to relocate to get a better deal and, given the inherent mobility of offshore finance, the threat to offshore industries as a result of what may be viewed, from the perspective of investors, as unfavourable changes is both imminent and real.

407 Antoine, above n 404, 82.
408 Ibid 82.
409 See "Greengrocers Flight", The Financial Mail (South Africa), 16 April 1996, 6, which reports that British investors are choosing to put their assets in low tax jurisdictions within the European Union, such as Dublin and Luxembourg.
OFCs are ever mindful of the tensions between confidentiality and disclosure in the interest of cooperating with international efforts at disclosure. Their position is that the surrender of financial information must be within clearly defined boundaries. The laws and policies on disclosure and the compromises toward disclosure made in international legal assistance agreements reflect this. Courts too must be aware of such policy considerations. Nevertheless, the very existence of such disclosure mechanisms is further evidence of the realisation by offshore countries that appropriate limits must be set for the confidentiality principle.

4.7 Methods to Obtain Information under International Cooperative Efforts

There are three main methods by which an onshore country may attempt to obtain information from offshore countries for use in trials or legal investigations. These are:

1) letters rogatory or letters of requests;

2) unilateral methods, such as the subpoena or summons; and

3) international treaties and other statutory instruments on legal assistance.\(^\text{410}\)

Of these, the first two may be viewed as more traditional methods.

Of the three methods, it is the use of unilateral methods which is most likely to raise controversial legal issues. Further, conflicts of laws may arise. The use of unilateral

\(^{410}\) Antoine, above n 408, 85.
methods, for example, is likely to raise contentious legal issues relating to comity, i.e. the respect by one country for the laws of another and sovereignty. This was the problem which arose in the Cayman Islands and The Bahamas. The USA subpoenaed and threatened banks which had branches in these jurisdictions with contempt for their refusal to surrender bank information. These refusals were a result of the banks’ compliance with offshore confidentiality laws. This expanded territorial jurisdiction was seen as a violation of sovereignty.

In relation to the summons process, a major problem may be that there is no basis for jurisdiction over persons or corporations domiciled outside the onshore country. Consequently, if a person refuses to appear, he or she cannot be sanctioned unless he or she enters the onshore jurisdiction or is a citizen of that state.

While the use of letters rogatory is less controversial, it is likely to be difficult in application as they can be time-consuming and complicated. Also, the success may depend on offshore legislation which is too limited in scope to be of any real assistance.

Mutual legal assistance instruments are less invasive than unilateral mechanisms. They balance the needs of law enforcement with those of sovereignty and the national interests

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413 Antoine, above n 410, 86.
414 A letter rogatory is a process which invokes the legal process by means of a formal request issued by a judge in one country to the judiciary in a foreign country. The request requires the sanction of the foreign court in order to prevent the violation of that country’s sovereignty. Letters rogatory may further involve the diplomatic process.
of the requested country. Indeed, this was the very reason why the Cayman Islands moved toward such treaties.

Mutual assistance in criminal matters is the process by which states, through designated regulatory and judicial bodies, seek and provide assistance for use in criminal prosecutions from the other states. Mutual legal assistance often has two components: first, assistance in the provision of evidence and, secondly, assistance in the tracing and restraining of the proceeds of crime. More recently, a third element, that of confiscating the proceeds of a crime, has been introduced in offshore jurisdictions. International legal assistance has a greater reach than mutual legal assistance in that it is not confined to criminal matters and need not depend on reciprocity.

The reach of international legal assistance vehicles, both in form and substance, may be much greater than the traditional methods such as the letter rogatory. First, they go well beyond the judicial process. For example, such instruments may permit disclosure in relation to requests in investigatory proceedings such as the grand jury proceeding, as opposed to limiting it to judicial proceedings. Mutual legal assistance mechanism may also encompass more varied matters of substance, when they are in treaty form. Nevertheless, it is possible to broaden the range of possible offences under letters rogatory by dispensing with dual criminality requirements and allowing the process to be used for unfamiliar forms of crime.

415 Antoine, above n 413, 86.
416 Note that international legal assistance is used here to denote a process which can encompass both mutual legal assistance and other forms of assistance such as letters rogatory.
Jurisdictional problems also plague the letters rogatory and mutual legal assistance processes. For example, while it is probable that an English court will now order disclosure where documents located in England are sought, it is less likely to heed requests for assistance where an English branch or parent of a bank is targeted for documents located offshore. The rule in *Libyan Arab Foreign Bank v Bankers Trust Co*\(^\text{417}\) that the proper law is the situs of the bank account, still obtains, and should continue to protect offshore banks with onshore associations. Continuing jurisdictional and procedural difficulties lead to increased efforts at treaty formation through which offshore countries are obliged to heed the terms of the instrument and ignore traditional and legalistic hurdles. Mutual legal assistance treaties represent:\(^\text{418}\)

A step forward in international relations in that they offer rules and procedures that greatly simplify previous practices and offer an alternative to questionable techniques such as the kidnapping of information in foreign countries and attempting to enforce USA subpoenas in foreign jurisdictions.

Nevertheless, even treaties may have difficulty overcoming procedural and jurisdictional obstacles in order to defeat the offshore confidentiality principle.\(^\text{419}\)

### 4.8 The FATF Challenge – Meeting the Standards


\(^{419}\) Antoine, above n 415, 85-7.
According to Antoine, no single entity has been as instrumental in defining the way forward in the fight against money laundering and international financial crime than the FATF. The work of the FATF has pointed several deficiencies in the world’s financial institutions which exacerbated and even encouraged money laundering. This has led to the formulation of strict new standards. They are the standards which offshore financial centres are required to meet. Not surprisingly, many of these involve offshore confidentiality.420

Much progress has been made by OFCs in bringing their laws up to FATF standard, hence the relatively young statutes which exist.421 Many jurisdictions have been removed from the list of ‘non-cooperative’ countries such as the Cayman Islands, The Bahamas and Panama.422

The FATF’s primary emphasis as has been seen, is on adequate control, regulation and supervision. Both the prevention and detection of money laundering are to be targeted as well as appropriate punishment. In these objectives, legal as well as practical impediments to efficient anti-money laundering regimes are to be examined. The latter includes, for example, obstacles which restrict supervisory and investigatory powers of judicial and administrative authorities, or the absence of such powers. Thus, the concern

420 Ibid 151.
421 ‘We are pleased to have the good name of The Bahamas restored, But we will continue to pay close attention to evolving international standards to ensure continued compliance’ said Wend Warren, CEO and Executive Director of The Bahamas Financial Securities Board, “Bahamas Special Report – The Third Pillar” (Jeremy Hetherington-Cole, Bahamas, 2001).
422 See Appendix U for the 2004 list of NCCIs.
of the FATF too includes the presence of a satisfactory environment to prevent money laundering.423

4.8.1 Loopholes in Financial Regulation

Inadequate or ineffective regulation and supervision of financial institutions involve lax requirements for the licensing of offshore companies and other entities. Unsatisfactory conditions begin with few or no requirements for assessing the backgrounds or identity of managers and beneficial owners. This is exacerbated by secrecy or confidentiality rules thereafter, including the existence of anonymous accounts. These perceived deficiencies create a danger that such entities can be operated by criminals.424

In addition, requirements to keep (for a reasonable time, such as five years) records verifying the identity of clients and beneficial owners, are often lacking. This is worsened, in most OFCs by the lack of information about transactions made and the often deliberate legal or practical obstacles to the means of obtaining such information.

Significantly, the FATF singled out the rules for professional secrecy and banking secrecy for negative comment. While noting that such rules can be based on valid grounds, they should not pre-empt supervisory responsibilities and investigative powers of the administrative and judicial authorities in the fight against money laundering. More particular was the concern that such secrecy or confidentiality obligations could not be

423 Antoine, above n 420, 151-2.
424 Ibid 152.
lifted by authorities in criminal investigations relating to money laundering, a concern which is not justified, according to Antoine.

The lack of routine confidential reporting requirements based on a standard of suspicious reporting was also noted. Such requirements should be supplemented by adequate provision for competent authorities to receive reports and should be mandatory.\textsuperscript{425}

Other regulatory issues identified by the FATF include the impediments posed by commercial law. Such laws, in particular, laws on company formation and trust laws, have the ability to hinder the prevention, detection and punishment of criminal activities. Shell corporations and nominees, for example, may be used to launder the proceeds from crime.\textsuperscript{426} These problems are compounded by confidentiality obligations and the inability to identify beneficial owners and beneficiaries.\textsuperscript{427}

4.8.2 Obstacles to International Co-operation

The several restrictions on the transmission of information to foreign authorities seeking legal assistance is perhaps the main concern of the FATF in the area of international co-operation. Identified as legitimate restrictions are the following: reciprocity in exchanges, confidentiality requirements on the part of the requesting authority, the need for clear rationales for the information requested and the status of the requesting authority. The need for administrative authorities with efficient powers for exchanges of information

\textsuperscript{425} See Appendix G, FATF 40 Recommendations, particularly Recommendations 14-19.
\textsuperscript{426} See Appendix G, FATF 40 Recommendations, particularly Recommendations 10-13.
\textsuperscript{427} Antoine, above n 424, 151-2.
with foreign authorities is also an important concern of the FATF. Other restrictions may be considered 'abusive'. In particular, the refusal of co-operation on the ground only that the substance of the request relates to tax matters, especially where tax evasion is involved, is viewed as a 'detrimental practice' for international co-operation against money laundering.

Significantly, the FATF also highlighted administrative and practical hurdles in its discourse on international co-operation. Long delays and 'obvious unwillingness to respond constructively to mutual legal assistance requests', for example, were viewed as detrimental practices. So, too, was the failure to provide administrative and judicial authorities with the necessary resources to conduct investigations, not only for mutual legal assistance, but in all anti-money laundering proceedings.

4.9 Comity Principle and Confidentiality

According to Antoine, efforts toward disclosure at the expense of offshore confidentiality laws may involve conflict of laws. The question of sovereignty with respect to confidentiality is paramount, and has been highlighted by offshore courts in responding to the OECD challenges to the OFC.

428 See Appendix G, FATF 40 Recommendations, particularly Recommendations 36-40.
429 Indonesia and Myanmar were highlighted as countries which have not made adequate progress in eliminating money laundering, Financial Action Task Force, Annual Review of Non-Cooperative Countries or Territories (Paris: FATF, 2003).
430 Antoine, above n 427, 151-3.
It is argued by Antoine that the OECD and its member states are violating international
taw, according to the Articles of the Draft Declaration on Rights and Duties of States
(1949) by The International Law Commission of the UN.\textsuperscript{431}

1. Article 1: Every State has the right to independence and hence to exercise freely,
without dictation by any other State, all its legal powers, including the choice of
its own form of government.

2. Article 2: Every State has the right to exercise jurisdiction over its territory and
over all persons and things therein, subject to the immunities recognised by
international law.

3. Article 3: Every State has the duty to refrain from intervention in the internal or
external affairs of any other State.

4. Article 14: Every State has the duty to conduct its relations with other States in
accordance with international law and with the principle that the sovereignty of
each State is subject to the supremacy of international law.

Under Article 1 of the Statute of The International Court of Justice, the International
Court of Justice has jurisdiction to hear a complaint from one or more of the 35 nations
under attack from the OECD and its member states. The Articles of the Draft Declaration
on Rights and Duties of States have effect in international law, under Article 38 of The
International Court of Justice Statute.\textsuperscript{432}

\textsuperscript{431} Draft Declaration on Rights and Duties of States (1949) art 1-3, 14.
See also Paul Baxendale-Walker, ‘Defending Gibraltar And Developing Britain’s Offshore Territories: In
The comity principle is an extension of the principle on territorial sovereignty. It sets the standard for resolving conflicting jurisdictional issues which may arise. In its legal sense, comity is:

- the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or other persons who are under the protection of its laws.

It is ‘the degree of deference that a domestic forum must pay to the act of a foreign government not otherwise binding on the forum’.

The key principle underlined in the comity rule is the recognition that states have sovereign interests which need to be reconciled. The principle recognises each of these conflicting interests as legitimate but acknowledges the necessity for one state to succumb to the other’s interest if their interest is recognised as greater. Where a potential jurisdictional conflict exists, a court should look beyond the *lex fori* and consider a...
foreign state's interest. Comity is seen as essential in preserving international harmony and good relations between states.

As the confidentiality principle is grounded in the national interest of the offshore state, conflicts arise in areas where both onshore and offshore states assert jurisdiction to proscribe and enforce rules of law. Offshore states have an interest both in the sovereignty of their legal systems and the stability of their economies which are threatened by attempts to undermine confidentiality laws. The contrasting attitudes toward confidentiality between offshore jurisdictions and the major onshore countries may lead not only to political conflict, but to conflict of laws. It is argued that there is a delicate balance to be struck between the utility of confidentiality laws in an offshore state which uniformly denies access to information in favour of preserving that country’s economy, and the requests for information from onshore jurisdictions in an attempt to detect and prevent undesirable activity facilitated by such confidentiality practices.

In 1967 the Social and Economic Council of the United Nations founded what is today its Ad Hoc Group of Experts. The group is composed of 25 members, experts, and tax administrators from 15 developing and 10 developed countries. As the UN group evolved, it was given various tasks such as guidelines for tax treaties, proposals for

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435 Hilton v Guyot 159 USA 113 (1895).
436 Oetzen v Central Leather Co 246 USA 297, 304 (1918).
437 Antoine, above n 430, 273-8.
international cooperation to combat tax evasion and avoidance, and international cooperation to reduce incompatibilities between tax systems.\textsuperscript{438}

The United Nations, like the International Monetary Fund, has criticized the workings of the OECD and FATF, arguing -- in the spirit of national sovereignty -- as an apparent defence of members of the UN General Assembly against intrusions by external agencies that have no jurisdiction in law. The Ad Hoc Group recognized the need for legal legitimacy in all state-to-state and agency-to-state relations in the international arena. Morris asserts that, however, such rhetoric may provide little solace to the OFCs since it appears to be public relations “spin”. The intent of the Ad Hoc Group is apparent: It states “the inability to obtain information from tax haven countries and tax information not available within its jurisdiction impedes the efforts of many tax administrations to deal effectively with the cases of tax avoidance and tax evasion.” It has opted for a series of bilateral treaties which link the developing world with the developed world; with the former giving up its tax information, whilst the latter developed countries offer assistance to developing countries to enable them to carry out exchanges of information procedures to control harmful tax competition. This is apparently taken to be a fair exchange.\textsuperscript{439}

According to Antoine, the conflict of laws typically arises where banks, companies or individuals are called upon by onshore states to produce documents or other information concerning offshore business.\textsuperscript{440} This is in situations where compliance may invite


\textsuperscript{439} Morris, above n 411.

\textsuperscript{440} Antoine, above n 437, 275-8.
criminal or civil sanctions under strict offshore confidentiality laws. Where, simultaneously, offshore states seek to protect their confidentiality laws and onshore states, their legal interests in disclosure, the result is a 'jurisdictional deadlock'. The subject of disclosure proceedings must then make a choice whether to obey the offshore or onshore law forum. The dilemma is made even more acute as such entities or individuals also face potential legal sanctions such as contempt actions from onshore courts for failure to produce compelled information.

The question to be resolved, therefore, is which law is to be followed, that of the offshore jurisdiction protecting confidentiality, or the onshore country compelling disclosure? This is the fundamental issue posed in the following analysis, a challenge which has raised complex issues of international law and political sovereignty. The subject involves both a jurisdictional issue based on geographical territorial limits and one of conflict of laws in relation to the substantive content of such laws. These two questions are inextricably linked. An artificial separation of the two issues is made here merely for purposes of clarity.

The dilemma posed by the comity question has been caused mainly by the deliberate extraterritoriality initiatives of onshore states. Equally problematic is the conflict which arises from the polarisation of offshore and onshore attitudes toward disclosure and the limits of confidentiality laws. This goes beyond matters of mere jurisdiction, tending toward a dichotomy in philosophical attitudes on the nature and importance of financial confidentiality and, by implication, the sovereignty and legitimacy of laws which uphold
it. This polarisation is most evident in relation to tax matters. Offshore and onshore states do not always share the same views on the matter of classification of criminal offences or litigation techniques. Consequently, offshore states are unlikely to view as appropriate, onshore countries’ unilateral attempts to thwart confidentiality for such purposes.

Disclosure initiatives raise questions as to the extent to which a jurisdiction can compel openness about banking information in another country where confidentiality laws are in effect. The outcome of this question, centred around comity, hinges on the legitimacy of offshore confidentiality. Some countries, particularly the USA, follow a ‘wide approach’ to confidentiality. They pursue disclosure aggressively, even where conflicts of law are apparent. While offshore jurisdictions do not deny that there are circumstances where confidentiality is inappropriate, typically they adopt a ‘narrow approach’. These differences in perspective have evolved into a situation where those onshore countries pursue a unilateral solution to perceived problems. 441

It is not apparent that onshore courts have properly considered offshore interests in their determinations under the comity principle. The facts that confidentiality is one of the pillars of the offshore industry, and that the offshore industry is essential to the economic and political survival of such nations, is largely ignored. As have been previously noted, offshore nations which make breaches of bank confidentiality statutory and/or criminal offences, are typically countries with limited natural resources, dependent on finance and

441 Ibid.
banking. Their domestic law has been tailored aggressively to encourage the formation and operation of businesses within their territories, it is therefore logical that they should protect their economic well-being in the same way that other countries, including the USA, protect their economies.

Onshore courts, primarily USA courts, explicitly recognise their objective in undermining confidentiality as part of their wider economic and political interest in obtaining tax revenue and law enforcement. Yet, mention, in the literature is hardly even made of offshore states' equally important, or perhaps greater, interest in upholding confidentiality as a means of protecting the offshore financial sector, the primary means of economic development. This is the major difficulty with the comity principle applied in offshore law.

Nevertheless, there is no common front on the part of the major onshore countries on the question of anti-confidentiality policy, for as yet there is no consensus as to the degree of intervention which is permissible by the country desiring information. The wide USA approach is not in line with other onshore countries, 'such as the UK'. The difference can be traced in part, perhaps, to the economic and political losses which the USA suffered as a result of offshore investment. This has been reflected in legal policy which often

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443 Antoine, above n 440, 273-5.
appears to be self-centred in terms of the comity question. Consequently, there is no uniform standard on the extent to which the confidentiality principle should be protected where conflicts of laws issues are at stake.

The UK, by its lack of TIEAs, has not been an interventionist as the USA in challenging foreign confidentiality laws, preferring to preserve principles of comity between nations and adhering to a restrictive view with regard to territorial jurisdiction. To some extent, the UK is compromised by the involvement of many of its dependencies in the offshore business. Further, in the UK, there has been opposition from within to proposed expansion of powers of inspection in relation to banking documents for purposes of fiscal offences. This is even in the pursuance of international measures against crime. In contrast, the policy of the USA to utilise unilateral measures, such as the subpoena and grand jury proceedings against confidentiality, constantly to extend its jurisdiction and to assert the supremacy of its domestic interests beyond its shores has engendered much resentment, even from other onshore countries. This has resulted in a position of ‘extreme isolation ... from most other countries’.

It is argued that offshore states are under no moral or legal obligation to assist onshore states in their law enforcement efforts in fiscal matters. The counterview that the fact that

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446 Antoine, above n 443, 274-7.

447 The Bankers Association argued that the extension of the Criminal Justice (International Co-operation) Act 1990 (UK) to fiscal matters might have adverse consequences for London. See Note [1990] British Tax Review 1.


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fiscal matters form the bulk of the subject matter of disclosure requests is not helpful to onshore cases.

Hence it is one view that the confidentiality principle must sometimes be sacrificed to a greater interest in disclosure when competing interests are balanced. This is so, for example, where serious international criminal matters are an issue, an opinion shared by offshore courts. However on the other hand, seeking an appropriate balance does not mean a carte blanche denial of the confidentiality interest in all circumstances where there are conflicts of laws, as sometimes appears to be the present judicial practice. Rather, offshore jurisdictions must be given the opportunity to define the limits of their confidentiality laws fairly. It is therefore argued that they should not be forced into surrendering to greater political and economic powers disguised as legal interests. A just appreciation of the comity principle allows such an exercise by ensuring the consideration of the interests of both onshore and offshore states. It is only within such a construct that the extent to which the offshore confidentiality principle is justifiable, can be truly appraised.

4.10 OECD's Attitude Towards Bank Secrecy

450 Antoine, above n 446, 273-8.
The OECD Report on *Improving Access to Bank Information for Tax Purposes*\(^{451}\) ("The Bank Information Report") was prepared by the OECD Committee on Fiscal Affairs and unanimously approved by all 29 OECD member countries. The Bank Information Report noted a perceived imbalance between the ability of taxpayers (individuals and companies) to operate in the increasingly borderless world of globalisation, and the contrasting inability of tax collectors who are still required to operate along strict national boundaries. Accordingly, The Bank of Information Report suggested that this imbalance should be addressed by "enhanced international co-operation for the effective application of tax laws." To that end it established an ideal, namely that all OECD member countries should permit access to bank information, directly or indirectly, for all tax purposes, so that tax authorities could discharge their revenue-raising responsibilities and engage in "effective exchange of information" with their partners.\(^{452}\)

The OECD argument is invidious: it is essentially "why should you object to anybody accessing your personal information unless you have something to hide?". The hidden danger in this argument is that it entirely ignores that privacy is a 'right'; that it has been painstakingly evolved, fought for, and preserved for centuries, often in the face of quite intrusive forces; and that there is nothing to be ashamed of in simply wanting to remain 'private'.\(^{453}\)


\(^{452}\) Bennett, above n 255, 25.

\(^{453}\) Ibid.
Post the September 11 attacks, both the USA (Kerry & Levin / Grassley Bills) and the G-7 (06.10.01) have moved to further tighten AML (Anti-money laundering) legislation to undermine the financial supports of international terrorism.454

The USA has consistently maintained the position that it is not prepared to agree to the automatic exchange of information. Whilst the USA is not prepared to countenance automatic information exchange they are prepared to have "on request" tax information exchange agreements with the whole of the EU, negotiated on a bilateral basis. Importantly the USA will agree to exchange information in relation to alleged non-disclosure of income or tax fraud.455

4.11 OECD and the Confidentiality Principle

The OECD ‘Harmful Tax Practices’ report claims that harmful tax competition is achieved by the operation of tax regimes which facilitate and even encourage the reduction of tax burdens imposed by high tax countries. This ‘tax competition’ it is alleged, distorts trade and investment and erodes national tax bases. There is, therefore, a need for greater convergences in tax systems to enable a more ‘level playing field’. The report explored three themes; transparency, exchange of information and non-discrimination. Two of these relate directly to offshore confidentiality.456

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454 Ibid 30.
456 Antoine, above n 450, 314-6.
The OECD complained that mobile capital and labour were being attracted away from countries with high taxes to those with low taxes. This, in turn, undermined the process of tax collection in such high tax countries. The report did not ostensibly criticise the concept of competition in fiscal affairs itself and even acknowledged that some tax competition could be beneficial. However, the question of ‘harm’ is raised in relation to what OECD regards as ‘poaching’ the tax base that ‘rightly’ belongs to another country in the context where a preferential tax regime is being offered to overseas individuals and businesses by the ‘poacher’, the offshore financial jurisdiction.

The OECD asserts that money laundering is encouraged by OFCs and, therefore, cross-border information on tax and other activities should be exchanged. Offshore jurisdictions have no natural inclination to exchange information with high tax countries in order to improve compliance. Accordingly, it is argued that money laundering is a more compelling rationale for such an objective. The initial justification for the attack on OFCs was, therefore, on this ground. As offshore jurisdictions have continually complied with demands for better money laundering controls, the focus has shifted to extending information flows and to the construction of a legislative architecture, for the purpose of enforcing tax laws, this clearly has important implications for confidentiality generally.

457 In the OECD Report 2000, the OECD retracted on its challenge to tax neutral or tax-free regimes. The OECD Report 2000 states that the OECD project is not intended to promote the ‘harmonisation’ of income taxes or structures, nor is it about ‘dictating to any country what should be the appropriate level of tax rates’.

458 Antoine, above n 456, 314-6...

459 For example, under mutual legal assistance treaties.

460 Antoine, above n 458, 314-6.
Excessive bank secrecy is viewed as not only encouraging money laundering but also contributing to a lack of transparency in financial information, undermining onshore tax compliance and law enforcement efforts. The offshore trust and international business company, came in for particular criticism because of their capacity to hide the identity of the beneficial owner of assets. The OECD urges the maintenance of records of such beneficial owners and the exchange of relevant information and other data requested by onshore countries in the enforcement of their laws and tax policies, initially for criminal tax matters only. This includes provisions for the routine exchange of information by way of treaties. 461

4.12 Conclusion

The analysis in this chapter has demonstrated that if current trends continue, the OFCs will have little choice, in the face of such focused and antagonistic display of global hegemony, but, as appears to be happening, to realign their legal regimes toward the model suggested by the OECD. 462 In particular, this means broadening the avenues of disclosure. The policy objectives articulated in these initiatives have already begun to shape the direction of new fiscal policies, both in offshore jurisdictions and high tax

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461 Ibid.
462 The Model Agreement on Exchange of Information on Tax Matters (the Model Agreement) was developed within a specially created working group, the “Global Forum Working Group on Effective Exchange of Information.” This group, which was co-chaired by Malta and the Netherlands, consisted of representatives from Aruba, Australia, Bermuda, Kingdom of Bahrain, Canada, Cayman Islands, Cyprus, France, Ireland, Isle of Man, Italy, Japan, Malta, Mauritius, Norway, Netherlands, Netherlands Antilles, the Republic of the Seychelles, the Slovak Republic, San Marino, the United Kingdom, and the United States. The Model Agreement is available on the OECD website at http://www.oecd.org/ctp. The Model Agreement seeks to promote international co-operation in tax matters through exchange of information. In its introduction, the Model Agreement notes that it is important for as many financial centres as possible throughout the world to meet the standard of tax information exchange and it encourages all economies to co-operate in this endeavour.
onshore countries. This does not mean, however, a capitulation to all of the demands made by the OECD. Rather, a more balanced approach is needed to work out rational principles of fairness in what is today a changed commercial law environment heavily reliant on globalisation.

In the following chapter, an analysis of the initial hostile and dictatorial tone of the OECD has been tempered somewhat because of the responses by offshore jurisdictions themselves and certain commentators from USA, UK, and Australia.\textsuperscript{463} The Commonwealth Secretariat, and even the British Press, in its role of exposing some of the hypocrisies relating to the money-laundering accusations, have also helped to balance the discussion.

The commitment required by OFC's in regards to "transparency" has also highlighted many examples of stifling hypocrisies.\textsuperscript{464}

1. beneficial ownership of companies and partnerships to be registered with the government, but UK company law prohibits the disclosure on share registers of beneficial ownership;

2. settlers and beneficiaries of trusts to be registered with the government, but the creation of trusts is completely secret in the UK;


\textsuperscript{464} Baxendale-Walker, above n 432 'OECD Demands and International Law'.

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3. trusts to draw up accounts in accordance with internationally accepted accounting standards and publicly filed, but not in the UK where there is no legislation governing trust accounts;

4. free government access to bank information of enterprises, individuals and trusts, but this is denied in the UK by the Data Protection Act and banking confidentiality laws, which can only be overridden by a Court order;

5. abolition of the ability for investors to negotiate the tax rate to be applied, but thousands living in the UK benefit from negotiated "forward tax agreement";

6. abolition of share warrants to bearer, but not if issued by an English incorporated company under section 188 Companies Act 1985.

Hence, the High Consultations on OECD Harmful Tax Competition Initiative paved a way forward, relying more on co-operation and dialogue. A working party was established comprising members of offshore jurisdictions, the Commonwealth Secretariat, international financial institutions, and the OECD to work out some of these more contentious issues.

Even so, the appetite for offshore financial services and, in particular, tax migration structures continues to steadily increase. Offshore clients are often sophisticated and determined and are unlikely to surrender their right to more efficient investment opportunities easily. The road points to compromise and accommodation of the several
conflicting interests between such investors, their host countries and powerful onshore nations.\textsuperscript{465}

It has been argued in this Chapter that the power of national legislators is eroding, even in the field of criminal law, which most of them still regard as their chasse gardée. Given the fact that the territorial range of domestic criminal law is by definition limited, the clout of municipal legislators is also limited. An effective response to transnational crime phenomena such as money laundering therefore requires that legislation regarding law enforcement is, at least in part, taken over on a higher, international level. The traditional approach to this is has been by the negotiation of bilateral or multilateral treaties. This is, however, a cumbersome way of working which often involves lengthy negotiations and difficult ratification procedures. Its effectiveness is especially doubtful in view of the fact that the actual implementation of what states agree on an international level, still depends on the willingness of those states to implement it domestically.

It is not surprisingly therefore that international law enforcement is increasingly based on other types of international instruments such as non-binding recommendations (e.g. the FATF recommendations) or by supranational binding instruments (e.g. the European Money Laundering Directive). Although resorting to this type of international instrument sometimes obfuscates the penal aspects of the law, these aspects are nevertheless present. From the analysis in this chapter, it is to be expected that the future development of international law enforcement will move increasingly away from the traditional inter-

\textsuperscript{465} Antoixe, above n 461.
government type of conventions and will use other types of international soft law instruments. 466