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NEWSLETTER

G-20 versus the tax havens

At their meeting in London on April 1st and 2nd 2009, the 20 leading economies of the world, who together provide some 85% of the world economic production, in addition to various other important decisions, declared open war on the tax havens and states and territories which do not cooperate with the OECD, and promote unfair tax competition and the exodus of taxes. We are devoting the entire second edition of the LAVECO 2009 Newsletter to this topic, bearing in mind the widespread interest which has been generated recently among both existing and potential LAVECO clients.

First of all, this is certainly not a new idea. International organisations, headed by the OECD - which incidentally basically includes most of the G20 nations – and the European Union have been dealing with many aspects of this topic for many years. The material side can best be described on the basis of the criticism from the EU. The European Union's biggest problem with the tax havens is that these mini states have attracted and accumulated comparatively huge amounts of capital over recent decades. They have been able to do this thanks to their beneficial tax regimes, creating tax competition which the developed western countries, with their high rates of taxation, are simply unable to compete with. Even by applying the strictest laws at national level left them unable to compete with the possibilities offered by the tax havens, and a significant amount of income was transferred to the offshore territories offering more beneficial tax regimes.

This exodus of taxes can not only be witnessed in the EU, but also wherever high rates of tax are imposed, such as the United States, and even in countries like, for example, Brazil. Following the fall of the Communist Bloc, the entrepreneurs of eastern Europe also went down a similar path, with some deciding to take advantage of the possibilities on offer, and others then left with very little choice: if they wanted to remain competitive, they had to employ similar tactics.

The OECD approach the problem formally, testing the offshore jurisdictions on the basis of various criteria, and subsequently raising objections against certain countries and making certain recommendations to the "players": how they should behave, what principles they should adopt etc. The OECD certainly has more weapons in its armoury in its fight against the tax havens than the requirements of the EU. At the forefront is the attempt to create obstacles for the financing of terrorism. The requirement to stamp out money laundering is equally important. In the light of this, the most important principle for the OECD is transparency; being able to see and even illuminate exactly who is behind a structure and its dealings. Where companies are concerned, this means identifying the individuals involved in a company, as far back as the ultimate beneficial owner, where the only acceptable result can be a private individual. When opening bank accounts, it is now necessary with every institution of any repute throughout the world to name the ultimate beneficiary - private individual(s) – behind the structure. As Gordon Brown, the British prime minister, stated at the G20 meeting: the age of banking secrecy is over.

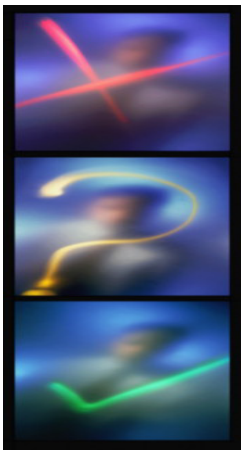
But is it really like this, and can everybody really see everything? Do the authorities really have access to every piece of information? Have we entered an era where the term anonymity will cease to exist?

As I mentioned earlier, the fight against the offshore world is nothing new, and the international organisations have been applying pressure for over a decade now. And it's true that this pressure has had its effects, and we come into contact with these on a daily basis:

1. The activities of offshore service providers and company formation agents have been very strictly regulated. Today, it can be more difficult to obtain a licence to operate as a company formation agent from the government of the Seychelles than it can to obtain a licence to deal in arms from some

European countries. Numerous technical, personal and financial requirements must be satisfied. And then when the provider finally receives a licence, the methods of accepting orders from clients are subject to stricter and stricter regulation, identifying the officers and owners of the company right back to the ultimate beneficial owner(s). This is all due to the pressure which has been applied by the OECD in this particular jurisdiction over the last 12 years. Particularly contentious in this area is the fact that if I want to operate as a company formation agent in the USA or the United Kingdom, I do not need any form of permit or government licence. I can do this through a lawyer's office, or simply as a private company. And yet the USA and the UK are champions of the fight against the offshore world.

2. As the newly-formed company is merely a pile of papers without a suitable bank account, the next step is the bank. Such uniform regulation has been forced upon the international banking sector as continually impedes the opening and operation of bank accounts. As a consequence, more than 95% of banks no longer wish to hear about offshore companies, let alone open accounts for them. The remaining 5% have no option but to adhere to the rules, as failure to do so leads to sanctions, with even mistakes resulting from sloppy behaviour possibly being treated as criminal activity. Wherever we go in the world to open bank accounts we are faced with the same sets of regulations, from Europe to Hong Kong and from Singapore to the Caribbean. At the time of opening the account it is necessary to clarify precisely the structure of the company, identifying the people behind the company and the bank account right back to the ultimate beneficiaries, who again typically can only be private individuals. The



banks then continually monitor the movements on the account, irrespective of whether these are incoming or outgoing. Even if they don't do it for every transaction, they then randomly request the background paperwork documenting a transaction, such as invoices and contracts.

3. The 3rd Anti-Money Laundering Directive of the European Union had to be included in the legislation of all member states and introduced into practice by December 15th 2007. According to local laws, the identification and monitoring procedures listed above now no longer apply only to the banks. Accountants, auditors, lawyers, estate agents, antique dealers and numerous other businesses have now become subject to the terms of the law. In accordance with the monitoring requirement, the service providers listed here are now required to report on their dealings, and, if they detect a suspicious transaction, should notify the government bodies set down in the law.

4. The exchange of information through international agreements has been widened. Agreements for the avoidance of double taxation already provided the tax authorities with considerable scope for the exchange of information. In recent years, however, the USA has taken the signing of Tax Information Exchange Agreements to a new level, compelling numerous small states, from where they previously had no possibility of obtaining information on their own tax-payers, to enter into such agreements.

5. The American banks play a significant role in payments made in dollars, as, thanks to the correspondent banking system, they are involved in the performance of the majority of international payments. In this way, they have unrestricted access to the details of who is making payments from where and to whom, for what and how much. In the modern computerised age, it is not too difficult to prepare reports, analyses and statistics using the details from banking transfers. In recent years the American banks, safely protected by the slogan "fight against terrorism and money laundering", have investigated, or forced the banks instigating or receiving the funds to investigate, the background of numerous transactions. Naturally, in the vast majority of cases no suspicion of money laundering was ever detected, and the transactions went through. What this did achieve, however, was to cause confusion

and sometimes panic among clients, and to put certain banks, such as Parex Bank in Latvia and the CIB bank in Hungary, in such a difficult position that they then lost a significant part of their offshore clients.

So was Gordon Brown maybe right after all, and the end is here? Will the G20 nations be able to deliver the final "coup de grâce" to the offshore market, and will the whole world be "totally globalised" from tomorrow?

I would by no means wish to dismiss the idea as an empty dream, but, with 18 years of experience behind me, I do believe that it would be extremely difficult to break down the global offshore economy at one fell swoop. I would like to list the reasons against this, and also to shed a little light on what can be expected as a result of the intervention of the G20 countries:

1. The resolutions from the G20 summit do not contain any concrete steps. The general statements of the politicians basically went something like this: "the G20 nations will bring the uncooperative tax havens under regulation." The statement immediately divides the current tax havens into two groups. The two groups – the jurisdictions showing willingness to cooperate and the jurisdictions not showing willingness to cooperate – already existed, so it looks like they still intend to use the same two categories. It is still not clear exactly what sanctions they wish to impose against the uncooperative ones. And at this point it is important to split the possible actions into two very clear parts: on the one hand we need to discuss intervention against the countries or jurisdictions providing the services, and, on the other hand, steps taken against the individuals behind the offshore structures.

2. It is relatively easy to intimidate a small, weak country as its bargaining position is not particularly strong. A bank can be fairly effectively blackmailed by the USA, with threats of closing its correspondent accounts. And "a spanner can be thrown in the works" by making the banks ask for the supporting documentation behind transactions.

3. It is also possible to intervene against the beneficial owner(s) behind a company, if it can be proven by the local legislation that tax evasion has taken place and the income has been hidden behind an offshore company. Proving this can involve an extremely complicated legal procedure according to the legislation of certain countries. The position of the state is simpler where the tax-payer has to prove his innocence in a tax matter.

Naturally, there are many things they could do, but it is debatable whether they will actually impose strict sanctions on the tax havens and those who take advantage of the tax-free possibilities. I am not going to refer to the fact that these steps significantly restrict or contravene human rights. That is pointless, as many western countries pay absolutely no attention to certain aspects of human rights. God granted us the right of freedom of establishment of an enterprise completely in vain; according to the logic of the state, I should do it where I am going to pay the most tax. Economic common sense, on the other hand, dictates exactly the opposite. In my opinion, here too compromises need to be found worldwide, as increasing the intensity of the "inquisition" could lead to an even greater slowing down of a world economy which isn't exactly prospering as it is.

And we're not talking about small change here. According to the more modest estimates, there are approximately 3 million offshore companies holding some 10 trillion dollars in cash, in certain cases in extremely sophisticated legal structures. However, the worst thing that can happen for the globalised world economy is if this capital is not used for transactions, and/or is either scared off and just "put on hold" or spent on luxuries, with the "owners" saying: "let's spend it today before they take it away tomorrow." If we look at the major stock exchanges of the world, such as New York, London, Tokyo and, say, Moscow, it becomes apparent that offshore structures are involved in more than 50% of transactions. After the slumps of recent months, is it worth risking more falls and the spread of more panic? I think our responsible politicians have to face up to this as well.

And that's just the stock exchanges. What about all the other elements of company assets? If we take the real estate market, we can probably speak about much larger sums. In reality, nobody has ever calculated the value of the real estate assets

whose ultimate owners are some offshore company, investment fund or foundation. Do you remember where the whole recession started? The balloon burst in relation to the secondary stock market created from the American real estate market. Do our responsible politicians want another trough like that one? I doubt it.

And even this pales into insignificance in comparison with the derivatives markets. Although the G20 nations also want to regulate derivative trading from now on, I can not believe that international currency trading, which goes on 24 hours a day, 7 days a week, will be prohibited. The amount traded in currency exchange transactions can reach up to 3 to 5 trillion dollars each day. An astronomical figure! And here too, a substantial amount of that can be attributed to offshore companies.

If it was so easy to do all this, then the international organisations would have done it over the last 10-12 years. It is impossible to change the world economic order from one minute to the next. Citing the tax havens as one of the causes of the recession sounds very good, but that is not going to make the world economic order change overnight. At the end of the day, it is not possible to take assets away from their owners and use them to cover state expenses because of the recession. This would be such a horrific breach of rights that it could lead to uprisings, or would, at the very least, destroy the already weakened social trust in the democratically elected political system.

While the G20 nations were meeting in London, I was on a business trip to Cyprus. I was having lunch in Larnaca with the manager of a local bank, and the topic almost inevitably turned to the G20 summit and the noises they had been making about their intentions towards the tax havens.

- Listen, László, who is going to tell me that I can't open a bank account for a company registered in Cyprus? The Cyprus company is registered in an EU member country, it pays tax, files audited accounts with the tax office, the details of the owners and shareholders are publicly available so it is transparent, and the agreements for the avoidance of double taxation also apply. So, then...

- Yes, and the euro is the official currency of your country. So if transfers are not made in US dollars, then the correspondent banks can not really affect the process. Especially if the Cyprus company's partner also has an account in the same bank, as the transfer then is really just a switch within the bank.

We continued to sit there in the April sunshine and smiled at each other. So maybe there is innovation in the offshore world after all? There always has been, and there always will be. In this life, it is the species, and within those species those individuals that are continually able to adapt to the ever-changing environment, that remain alive. LAVECO can help you in this with our 18 years' experience of change and innovation. I would be more than happy to receive any questions or comments you may have.

With kind regards

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