OFFSHORE APOCALYPSE

THE COLLAPSE OF THE TAX HAVEN INDUSTRY – WHAT DOES THE FUTURE HOLD?

AN ORACLE

OFFSHORE APOCALYPSE

The Collapse of the Tax Haven Industry
– What Does the Future Hold?

April 2012

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The term “he” is used throughout the book for convenience only and does not reflect any gender bias.

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PART I.

FOREWORD

"Quod nimis miseri volunt, hoc facile credunt" –
"Whatever the wretched anxiously wish for, this they readily believe."
(Seneca)

1.

Adam John Hargraves and Daniel Aran Stoten were directors of the Phone Directories Company (PDC), a publisher of telephone listings on the Gold Coast in eastern Australia. Business was good, so they decided to improve their financial position by way of "tax planning." This is nothing unusual – companies do tax planning whenever they identify allowances, deductions or legal loopholes that reduce their tax liabilities. But Hargraves and Stoten intended to use the money for their own purposes. They used a common method, probably the most primitive one: With help from a Swiss consultancy, they set up a network of firms based in "tax havens" – countries that offer rock-bottom (or even zero) tax rates for non-resident corporations, coupled with a policy of refusing to disclose company data to authorities in the owners' home countries. PDC paid grossly inflated invoices to these tax haven-based companies, which then deposited the funds into offshore bank accounts. Hargraves and Stoten then accessed the money using ATMs, which allowed them to avoid transferring the money directly to their Australian bank accounts.

Hargraves and Stoten operated the scheme from 1999 to 2005, reducing PDC's tax basis by at least AUD 4.46 million (approximately $4.65 million) and cheating the Australian treasury out of AUD 2.22 million.[1] It was not long before authorities got wise to their ruse. In June 2010, the Supreme Court of Queensland sentenced both men to 6.5 years in prison for conspiring to deliberately cause a loss to a Commonwealth entity through tax fraud and abuse of offshore companies. The judge said the pair's failure to cooperate with investigators contributed to the length of their sentences.[2]

After the verdict was read, John Lawler, chief of the Australian Crime Commission (ACC), fired a salvo at the people who facilitate Hargraves and Stoten's kind of crimes – offshore company-registration agents, advisors, lawyers and the like. In a statement,[3] Lawler reminded the public that in April 2010, the Supreme Court of Victoria convicted attorney Paul John Gregory for simply advising

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[1] Joint Australian Crime Commission and Australian Taxation Office media release, "Queensland company directors receive 6 ½ years for tax fraud," 8 June 2010, http://www.crimecommission.gov.au/media/queensland-company-directors-receive-6-%C2%BD-years-tax-fraud visited on 27 June 2011.

[2] Supreme Court of Queensland, *R v. Hargraves and Stoten* (2010), QSC 188, http://www.austlii.edu.au/au/cases/qld/QSC/2010/188.html, visited on 28 June 2011.

[3] Joint ACC/ATO media release, "Queensland company directors receive 6 ½ years."

entertainment impresario Glenn Wheatley to transfer AUD 400,000 he earned from a 2003 boxing match to an offshore company.[4] Gregory was found guilty of conspiring to defraud the Australian government of AUD 194,000 and was sentenced to two years in prison.

Lawler also noted that in May 2010, the Supreme Court of Western Australia sentenced accountant Trevor Neil Thomson to three years and three months in jail[5] because he advised clients to conceal their property from tax officials by transferring it to offshore trusts. Thomson's actions helped defraud the Australian government of as much as AUD 27.68 million, prosecutors said.[6] *"The ACC is focused on disrupting the activities of principal organisers and facilitators behind these schemes,"* Lawler warned.[7]

2.

In late 2001, the United States began ramping up its efforts to identify and prosecute people who evade taxes through offshore schemes, along with the people who advise them. As a first step, the U.S. Internal Revenue Service (IRS) announced an amnesty[8] for people who had been concealing money in tax shelters,[9] offering to *"waive certain accuracy-related penalties that may apply to tax shelters and other questionable items that resulted in an underpayment of tax."*[10] In return, taxpayers had to disclose information including the names of tax-shelter "promoters" – the agencies and law firms that make money from offshore tax planning schemes.[11] By the time the 120-day amnesty ended on 23 April

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[4] Supreme Court of Victoria, *The Queen v. Paul John Gregory* (2010) VSC 121, at http://www.ato.gov.au/content/downloads/snc00220075Sentencing.pdf, visited on 27 June 2011.

[5] Because Thomson pleaded guilty and cooperated with investigators, the judge reduced his punishment to 13 months in jail.

[6] Joint ATO/ACC media release, "Operation Wickenby – Tax fraud jails Perth accountant for 13 months," 13 May 2010, http://www.ato.gov.au/corporate/PrintFriendly.aspx?ms=corporate&doc=/content/00241119.htm, visited on 27 June 2011.

[7] The investigations are part of Project Wickenby, the nickname for Australia's clampdown on offshore tax cheats (see Chapter 16). Participants in the project are the Australian Taxation Office, Australian Federal Police, Australian Crime Commission, Australian Securities and Investments Commission, and the Commonwealth Director of Public Prosecutions, with support from the Australian Transaction Reports and Analysis Centre (AUSTRAC), the Australian Government Solicitor and the Attorney General's Department. See ACC, "What is the difference between Project Wickenby and Operation Wickenby?" http://www.crimecommission.gov.au/node/108 visited on 16 January 2012.

[8] See section 26.1.

[9] "Tax shelter" refers to any method of reducing taxable income through transactions that have no valid commercial reason other than a tax advantage. Most advanced countries deem tax shelters illegal.

[10] IRS news release IR-2002-22, "Tax Shelter Disclosure Initiative Reaches Mid-Point; IRS Adds New Protection on Priviliges," 22 February 2002, http://www.irs.gov/pub/irs-news/ir-02-22.pdf, visited on 5 March 2012.

[11] The current denunciation document (which the IRS modestly calls a "Referral Form") is available at http://www.irs.gov/pub/irs-utl/referralform_reportingabusiveschemes.pdf,

2002, some 1,206 taxpayers had offered information on 1,664 fraudulent tax transactions.[12] The IRS followed up the 2001-2002 amnesty with three additional programmes. The most recent one, announced in 2012, has no deadline.[13]

The IRS has the option to refuse an amnesty application and file criminal charges against the applicant, but this happens only rarely. At this stage, the IRS' main objective is not to prosecute tax evaders, but to "smoke out" other offenders. People who enrol in the amnesty must fill out a three-page form to be scrutinised by the IRS' Criminal Investigation (CI) division. These forms have offered up a virtual treasure trove of information on tax-shelter promoters and the techniques they use. The agents thoroughly investigate the promoters' activities and gain access to other clients' particulars, which most promoters are legally obliged to keep on file). IRS agents can thereby identify tax fraudsters who might otherwise have escaped their attention.

In 2010, CI began to sharpen its focus on the offshore sector. This should be cause for despair among tax-haven abusers: Since its foundation in 1919, CI's conviction rate for federal tax prosecutions has consistently topped 90% – higher than any other federal law enforcement agency.[14] Since 2009, CI has initiated more than 4,000 criminal investigations per year; more than 80% of the people who were convicted went to prison.[15]

Doubters should ask Harry Abrahamsen, the New Jersey businessman who got mixed up in a tax-evasion scheme run by UBS, Switzerland's largest bank. CI's special agents revealed that Abrahamsen had failed to tell the IRS about more than $1 million he had been keeping in two UBS accounts. It is unlikely that reporting the funds would have substantially improved Abrahamsen's situation: A good deal of the money was proceeds from tax fraud. In 2000, Abrahamsen transferred his UBS deposits to accounts held by Primrose Properties, a Panamanian shell company he founded with the assistance of a Swiss private banker and lawyer. This fictitious company name allowed him to conceal income and interest payments from the IRS. In addition, Abrahamsen reduced the tax base of his U.S. resident company, SJT Imaging Inc., by paying false or inflated invoices to a Swiss company for printing services at more than fair market value. This allowed him to add $1.3 million to his

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visited on 18 October 2009.

[12] IRS news release, "Tax Shelter Disclosure Initiative Benefits the IRS in Fighting Abuse," IR-2002-99, 16 September 2002, http://www.irs.gov/pub/irs-news/ir-02-99.pdf, visited on 18 October 2009.

[13] See section 26.1.

[14] IRS, "The History of IRS Criminal Investigation (CI)," last updated 12 October 2010, http://www.irs.gov/compliance/enforcement/article/0,,id=107469,00.html, visited on 27 June 2011.

[15] IRS, "Three Fiscal Years Trends in Investigations – Criminal Investigations," last updated 4 November 2011,
http://www.irs.gov/compliance/enforcement/article/0,,id=107484,00.html
visited on 7 March 2012.

UBS accounts, according to the U.S. Department of Justice.[16]

On 24 May 2011, Abrahamsen pleaded guilty and was sentenced to three years' probation, including 12 months' home confinement with electronic monitoring. Abrahamsen also had to pay back taxes, interest and penalties totalling more than $600,000 and a penalty in excess of $300,000. Furthermore, Lucille Abrahamsen Jackson, his daughter, admitted to concealing more than $750,000 in a Swiss bank account. She was sentenced to probation for filing a false tax return in 2005.[17] In the grand scheme of things, the Abrahamsens got off fairly lightly – they could easily have ended up in the penitentiary.

U.S. prosecutors have been trying to target the people who facilitate crimes like Abrahamsen's for decades, but only recently has the legal environment supported such efforts. A key ruling was *U.S. v. Popkin* (1990),[18] where Atlanta lawyer Gerald Popkin was charged with "corrupt or forcible interference" with U.S. tax laws after he knowingly helped a client create a normal domestic corporation for the purpose of shielding foreign-earned income from U.S. taxes. Unbeknownst to Popkin, the client was actually part of a government sting operation.

At first glance, the U.S. government's case against Popkin may seem petty: His fee for the transaction amounted to a mere $1,755, and as far as he knew, his client intended to pay tax on his corporation's future income. Furthermore, the company never even operated. Still, the sole act of assisting in the formation of a company for purposes of tax evasion was enough for a jury to find Popkin guilty of infringing tax laws. In July 1990 he was sentenced to a year and a day in prison and was instructed to pay $6,755 in restitution.[19] Perhaps the only consolation for Popkin was that the

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[16] U.S. Department of Justice press release, "New Jersey UBS Client Sentenced for Failing to Report More Than $1 Million in Swiss Bank Account," 24 May 2011, http://www.justice.gov/opa/pr/2011/May/11-tax-669.html, visited on 27 June 2011.

[17] ibid

[18] United States Court of Appeals, Eleventh Circuit, *United States v. Gerald M. Popkin,* 943 F.2d 1535, 9 October 1991, available at http://openjurist.org/943/f2d/1535/united-states-v-m-popkin, visited on 28 June 2011.

[19] Gerald Popkin was charged in a three-count indictment in January 1990. Counts I and II of the indictment are related to defendant's actions in preparing his client Stephen Musick's tax returns for 1983 and 1984. The defendant was acquitted on these counts but was convicted on count III, which charged the defendant under 26 U.S.C. § 7212(a), alleging that Popkin had corruptly obstructed and impeded and endeavoured to obstruct and impede the due administration of Title 26, United States Code, by preparing the tax returns described in Counts I and II and by creating a California corporation expressly so that Musick could disguise the character of illegally earned income and repatriate it from a foreign bank. Popkin appealed to the Eleventh Circuit Court of Appeals, to no avail: The court affirmed his conviction, even though there was no corrupt solicitation, no threatened or actual violence against an employee, and the scheme simply involved one individual's evasion of taxes. The Popkin case has often been criticised as an abuse of an *omnibus clause* in the Internal Revenue Code (IRC). Prosecutors probably chose this route because the U.S. had no laws against money laundering at the time Popkin committed his offence; such laws would have allowed prosecutors to press charges fairly easily.

sting operation took place in 1985, and federal money laundering laws did not come on the books until 1986.

Since *Popkin,* U.S. prosecutors have galvanised their efforts to punish people who facilitate tax fraud. They are even going after foreign promoters suspected of helping American citizens dodge taxes. In July 2010, a federal grand jury charged Felix M. Mathis, a partner of Swiss law firm Froriep Renggli LLP, with "conspiring to defraud the United States and structuring the importation of currency into this country."[20] A warrant was later issued for his arrest.

Mathis, a member of the bar in both Switzerland and New York, was indicted in connection with his role as an adviser to Andrew Silva, an American physician who pleaded guilty to conspiracy to defraud the U.S. in February 2010. Prosecutors say Mathis helped Silva conceal money he had inherited in 1997 at a Swiss affiliate of HSBC through the Liechtenstein-based Pentruvoi Trust.[21] In September 2009, HSBC informed Silva it was closing his account. Like many Swiss banks, HSBC was under pressure to get rid of its American clients due to stepped-up enforcement of U.S. tax evasion laws. HSBC did not want to report Silva's details to the IRS – an act that would have violated Swiss rules.[22] Silva needed a new hiding place for his cash.

What happened next might have been taken from a spy novel. According to prosecutors, Mathis advised Silva not to wire his Swiss funds to the U.S. because it would leave a paper trail. Instead, Mathis told Silva to mail himself the cash in instalments of less than $10,000 (that is, below the threshold of U.S. customs reporting obligations) using several different Swiss post offices to mail the letters. Silva and Mathis communicated with each other through code words: For example, if Silva wanted to discuss the Swiss accounts with Mathis, he sent a letter asking to "meet for coffee." All in all, Silva sent $235,000 by mail, and also transported cash in person when returning from trips to Switzerland.

Silva was caught and charged. In February 2010, he was fortunate enough to get just two years' probation, including four months' home detention; he could have received 25 years in prison

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[20] DoJ press release, "Swiss Lawyer Indicted for Helping to Hide Swiss Bank Accounts and Monies Returned to U.S. Clients," 15 July 2010, http://www.justice.gov/opa/pr/2010/July/10-crt-815.html, visited on 5 March 2012. Mathis is also charged with "Klein conspiracy," which relates to allegations of tax fraud. The general federal conspiracy statute has two clauses: The first makes it a crime for two or more persons to conspire to commit an offense against the United States by violating a specific statute or statutes, and the second clause makes it a crime for two or more persons to agree *"to defraud the United States, or any agency thereof in any manner or for any purpose…"* Criminal No.: 1:10-CR-260; Count 1: 18U.S.C. § 371 (Conspiracy); Count 2: 31 U.S.C. § 5324(c)(3), (d)(2) (Structuring); and Count 3: 31 U.S.C. § 5324(c)(3), (d)(2) (Structuring).

[21] DoJ, "Swiss Lawyer Indicted for Helping to Hide Swiss Bank Accounts." See also United States District Court for the Eastern District of Virginia, *United States v. Felix M. Mathis,* criminal no. 1:10-CR-260, available at Worldwide Tax Daily, "Attorney Indicted for Involvement in Scheme to Conceal Transfer of U.S. Funds to Evade Tax," 15 July 2010 (2010 WTD 137-49).

[22] See section 16.2.

and a fine of as much as $1.25 million. Naturally, he had to repay the taxes due. He also had to disclose all details about the conspiracy and cooperate with the U.S. authorities – leading directly to the charges against his erstwhile attorney, Mathis.

Luckily for Mathis, Switzerland is unlikely to extradite its own citizens in connection with the kinds of charges that the U.S. has filed against him. But for the time being, Mathis is advised not to travel to any country that has an extradition treaty with the U.S. – in other words, he basically cannot travel.

HSBC's role in the Silva conspiracy remains to be clarified. The bank denies involvement in tax evasion. However, HSBC has a branch network in the U.S., which may make it easier for federal prosecutors to target it.

Methods of eliminating such tax evasion schemes are spelled out in a "six-point execution list" drawn up by a group of non-governmental organisations dedicated to tax justice.[23] Once governments integrate this list into national law, HSBC and other big banks will not have to worry about losing clients who are engaged in tax fraud and money laundering to the competition. Since all banks will be playing by the same rules, these clients will have nowhere else to go.

3.

Throughout this book the reader will come across case studies by the Egmont Group, an international network of financial intelligence units (FIUs) – national authorities who investigate suspicious financial transactions.[24] These come from a collection of 100 real (albeit anonymised) stories that the Egmont Group has compiled to warn offshorers that their crimes have been identified and are subject to prosecution. The cases are presented in boxes; they should provide a respite from the academic language in some other parts of the book. Take the following case for example:[25]

[23] See Chapter 11.

[24] See section 21.4.

[25] Egmont Group, "FIU 's in action: 100 cases from the Egmont Group," Case no. 64, http://www.egmontgroup.org/library/cases, visited on 10 October 2010.

A European FIU received an anonymous disclosure about Josie, which claimed that Josie was committing large-scale tax evasion. The FIU decided to undertake a preliminary investigation into Josie's finances to determine whether the allegation was true.

The FIU established that Josie had opened a bank account several years ago. She had told the bank at the time that she was a representative of an offshore company and that she was acting on its behalf. The FIU discovered that in addition to Josie's claimed connection to this offshore company, at that time she had also controlled a company that had been trading but had not been registered with the authorities. It appeared that the cover story of the links with the offshore company had allowed Josie to obtain a company account without alerting suspicion.

According to the FIU's investigation, Josie had arranged contracts with various Eastern European companies. These contracts stated that Josie's company was to undertake construction work and supply equipment. When using Josie's services, the foreign companies transferred their payments to the offshore company's bank account, thus avoiding any record of taxable activity taking place within the jurisdiction.

A significant number of Eastern European companies had credited Josie's bank account over the years, as by not paying tax she had been able to reduce her costs and thus offer a cheaper service than legitimate suppliers. The FIU calculated that Josie had received over US$ 250,000, although Josie had already taken the majority of this money out of the account. Armed with the knowledge that Josie had operated a non-registered company, the FIU surmised that it would be interesting to look at her tax declarations. It came as no surprise that Josie had failed to declare any income and had never paid taxes on her earnings.

At time of writing an in-depth investigation into the extent of the criminality was ongoing although a prosecution on tax evasion and money laundering charges seemed likely.

4.

Would-be tax evaders might think that countries with less-developed law enforcement systems will turn a blind eye to offshore offences. They would be wrong. Emerging-market governments are taking an increasingly proactive stance against the offshorers who rob them of tax revenue and the promoters who make their crimes possible.

In October 2010, Romanian police arrested László György Kiss, a notorious enabler of offshore tax-evasion schemes.[26] Kiss was accused of masterminding a scheme to embezzle and launder money

[26] See section 24.2.

from Petrom Service SA, a Romanian energy services company. Prosecutors also suspect that the ultimate beneficiary of the plan was Romanian media mogul Sorin Ovidiu Vantu.[27] The arrangement that Kiss concocted was not so different from the schemes that Western companies use to channel oil and other commodities to Europe – schemes that were thought to be legal and rock solid.

The Petrom Service affair was just one of thousands of offshore schemes that Kiss had engineered for clients who wanted to get rich by avoiding taxes. He had been conducting his illicit enterprise quite openly at his Bucharest firm, Lamark Tax Planning Consult SRL. He even authored a book on how business people could profit from his offshore techniques.

As Kiss can attest, offshore promoters should fear not only the law, but the media as well. Before his arrest, Kiss unwittingly granted an interview to undercover reporters from the Organized Crime and Corruption Reporting Project (OCCRP),[28] a group of investigative journalists from across Eastern Europe. Posing as businessmen who wanted to conceal proceeds from an oil deal, the journalists secretly recorded Kiss explaining how they could evade taxes without raising suspicion. The reporters then presented Kiss' plan to Romanian authorities and inquired about its legality. It was bad timing for Kiss, who was already under investigation in relation to the Petrom Service deal. He was behind bars a few weeks later.

The power of the press is also evident in the collapse of Kiss' New Zealand-based partner, Ian Taylor. On 3 June 2011, Taylor notified his clients that he was shutting down all operations in New Zealand and the island of Vanuatu under pressure from authorities.[29] The decision came after Fairfax Media, an Auckland-based news group, conducted a 16-month investigation into the Taylor family's offshore dealings, with an exposé coming out just days before Taylor announced he was closing shop. "*I fully understand that you will be frustrated and angry at this situation, as I am also,*" Taylor told his clients in an e-mail published by the local media. "*We have spent the last 10 years building a good reputation, good client base and a good business, and it is all gone due to some irresponsible media and a government department that was embarrassed by that media and looked to blame someone.*"[30]

The Taylors are accused of setting up Bristoll Export Ltd., which authorities suspect of moving proceeds from a $245 million Russian tax-fraud scheme into Swiss bank accounts in 2007-2008. A lawyer

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[27] Mihai Munteanu, "Kiss: Police Arrest Kiss," Organized Crime and Corruption Reporting Project (OCCRP), 20 November 2010, http://www.reportingproject.net/offshore/index.php/kiss-the-downfall-and-arrest-of-kiss, visited on 29 June 2011.

[28] OCCRP, "Crime Goes Offshore," 20 November 2010, http://www.reportingproject.net/offshore/index.php/offshore-havens-enable-crime, visited on 16 January 2012.

[29] Michael Field, "'Shell' operation shuts after crime links exposed," Fairfax Media Ltd., 7 June 2011, at http://www.stuff.co.nz/auckland/local-news/5107131/Shell-operation-shuts-after-crime-links-exposed, visited on 30 June 2011.

[30] ibid

who was looking into the affair died in Russian police custody.[31] In addition, the U.S. Department of Justice accuses the Taylors of incorporating companies that helped launder as much as $50 million from the Mexican Sinaloa drug cartel to Wachovia Bank in America.[32] In his e-mail, Taylor complained of heavy-handed treatment by New Zealand officials: *"We are forced to cease fighting the Companies Office from striking off companies. Even our top level lawyers are afraid to stand by us because they fear what the government may do to them, despite the fact that we are the victims,"* the press quoted him as saying.[33]

New Zealand's clampdown against the Taylors comes at a time when the country is trying to promote itself as a new kind of "offshore centre" – a credible place with reliable laws and a good system of exchanging data with other countries. New Zealand officials who read this book should painstakingly consider what sort of business they want to attract. The consequences of New Zealand turning itself into a tax haven could be devastating for its reputation.

5.

Anyone who serves as a nominee director for a shell company that is *de facto* owned and operated in Italy may want to take a hard look at a ruling the Italian Supreme Court handed down in February 2012.[34] The judgment broke new ground in cross-border tax jurisprudence by affirming that the legal representatives of a Luxembourg-based offshore firm could be held liable for the crime of omitted tax return in Italy, where the firm actually operated. This view is almost a novelty, at least in Europe: Until now, persons who have acted as legal representatives for offshore entities have rarely faced prosecution for aiding and abetting mere tax evasion. It is also surprising that a country like Italy, where tax evasion is a national pastime second only to football, would go after foreigners with such determination.

"Fiduciary companies, financial intermediaries, advisors and counsels of foreign companies of Italian groups when acting as members of the board of the said foreign companies should carefully assess whether such companies fall within the definition of sham companies i.e. società esterovestite, in order to identify the potential Italian tax liabilities of the company and avoid potential criminal tax consequences which may derive personally to them from the failure to fulfill such obligations," write Bernadette Acili and Domenico Gioia of

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[31] Michael Field, "Web of Intrigue," *Sunday Star-Times,* 29 May 2011, available at http://www.stuff.co.nz/national/crime/5070730/Web-of-intrigue, visited on 1 July 2011.

[32] Michael Field, "NZ Firms Linked to Money Laundering," *Sunday Star-Times*, 29 May 2011, available at http://www.stuff.co.nz/national/5069771/NZ-firms-linked-to-money-laundering, visited on 30 June 2011.

[33] ibid

[34] Corte di Cassazione n 7739 2012.

the Paul Hastings LLP law firm.[35]

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If the reader disagrees with the quote from Seneca at the beginning of this chapter, the following pages will be of little value to him. He may wish to stop reading right here. One can only hope that the above stories will persuade him to get rid of his offshore company – the sooner the better. If he is not yet convinced, this book offers a cornucopia of other examples that will plainly demonstrate how authorities are coordinating efforts to clamp down on tax-haven abuse. Anyone who has engaged in offshore abuses will reap the consequences, most likely before the applicable statute of limitations expires. Tax planning through offshore companies may result in imprisonment in the U.S., Australia, and even in less-developed countries. If an offshorer is fortunate enough to have an amnesty programme available in his jurisdiction, he may be able to liberate himself from criminal prosecution after he has paid up his back taxes and related charges.

Most countries have not aggressively gone after people who abuse offshore regimes because their foreign partners are often reluctant to cooperate. But there can be little doubt that enforcement officials are starting to cooperate more closely and will prosecute cross-border tax crimes more rigorously. The Organisation for Economic Cooperation and Development (OECD) intends to work towards a legal framework that aims to close loopholes and illegal tax evasion.

This will be reinforced by the FIUs that exist in virtually every country – even in tax havens.[36] These agencies are already working with one another to combat tax evasion and money laundering. As the Egmont Group's case studies show, they are yielding results.

Anonymity is a thing of the past. Money laundering regulations oblige nominees (the frontmen who pose as directors, managers, and shareholders of offshore companies on paper) and financial-service providers to disclose information about the real owners of

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[35] Bernadette Acili and Domenico Gioia (Paul Hastings LLP), "Italy: Tax Avoidance: Criminal Liability for a Foreign Company's Management," 21 March 2012, http://www.mondaq.com/x/169450/Corporate+Tax/Tax+Avoidance+Criminal+Liability+For+A+Foreign+ Companys+Management&email_access=on, visited on 25 March 2012.

[36] All tax havens have FIUs, but people who invest through offshore companies often do not know they exist. Naturally, tax-haven governments do not advertise them: No offshorer would be willing to put his money in an offshore regime that is committed to exposing his involvement in money laundering. Tax havens had no choice but to establish FIUs and to start cooperating with international agencies: Had they refused, they would have been excluded from international banking correspondence. They have been compelled to accept the recommendations of the Financial Action Task Force (FATF), which oblige tax havens to provide information to FIUs in capital-exporting countries upon request. Tax havens have also had to implement anti-money laundering laws. Nonetheless, offshore-company registration providers in tax-haven jurisdictions are reluctant to alert authorities to money laundering activities – they would effectively be denouncing themselves.

offshore companies. Financial institutions know that offshore business is the single-most important vehicle for money laundering worldwide. They are often the first to notify authorities about suspicious offshore transactions.

As the reader will learn, some countries are already using money-laundering laws to prosecute tax crimes, meaning tax offences will become “more criminalised” in many jurisdictions. This should be a frightening prospect for offshore company owners.

1. INTRODUCTION

"The avoidance of taxes is the only intellectual pursuit that carries any reward"
(John Maynard Keynes)

"In this world nothing can be said to be certain, except death and taxes"
(Benjamin Franklin[37])

This book is dedicated to anyone who is involved in the offshore industry. First and foremost, it seeks to reach business owners and other laymen who allow themselves to be advised – or, perhaps more accurately, duped – by offshore-industry professionals. The real-life anecdotes in the Foreword encapsulate the authors' main message: If the reader, however reluctantly, reconsiders the wisdom of planning taxes through offshore schemes, he can avoid a world of trouble. This may be a tough pill to swallow. It may not be easy for someone who has been profiting from the offshore industry to learn that he has no choice but to enrol in a tax amnesty programme – if available – or to conduct a self-audit, saddling himself with untold back taxes plus hefty interest.

The authors hope that offshore business owners and their relatives will not be the only ones who find these lessons compelling. Lawyers, tax advisors, offshore-company registration agents, accountants and certain employees of financial institutions – collectively known as "promoters" or "enablers" in the offshore world – can benefit from this book. The book may also prove useful for company managers who pay invoices issued by offshore companies or otherwise maintain contractual relations with them.

While we offer examples from around the world, our primary focus is on anti-tax haven enforcement by the U.S. and the IRS. America presents somewhat of a paradox: On the one hand, it is the biggest tax haven in the world; on the other hand, it passionately combats tax-haven abuse – primarily by its own taxpayers. (We will explain how this unfortunate situation developed.) Washington's efforts significantly influence the work of the Organisation for

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[37] Several famous authors have uttered lines to this effect. The first was Daniel Defoe in *The Political History of the Devil* (1726): "Things as certain as death and taxes, can be more firmly believed."

Benjamin Franklin (1706-90) used the form we are currently more familiar with, in a letter to Jean-Baptiste Leroy (1789), which was re-printed in *The Works of Benjamin Franklin* (1817): "In this world nothing can be said to be certain, except death and taxes."

Another thought on the theme of death and taxes is Margaret Mitchell's line from her book *Gone With the Wind* (1936): "Death, taxes and childbirth! There's never any convenient time for any of them."

http://www.phrases.org.uk/meanings/death-and-taxes.html, visited on 20 February 2011.

Economic Cooperation and Development (OECD), an institution dedicated to cracking down on abusive tax practices. The struggle against tax havens does not end in the OECD member states: Developing nations such as the BRIC countries (Brazil, Russia, India and China) are also joining the fight – particularly the latter two. These fast-growing emerging markets understand the failures of the developed world, which has allowed its taxpayers to reduce their tax bases through more or less dodgy schemes.

No matter what the reader's background may be, and regardless of whether he agrees with the book's message or not, he will soon experience significant changes in the way state authorities deal with tax havens and the businesses registered there. Specifically, he can expect increasingly stringent tax audits, criminal investigations, and punishments, as recounted in the Foreword.

People who work in the offshore-company registration industry may not agree. In recent decades, the offshore lobby has published a veritable throng of booklets and pamphlets extolling the benefits of owning companies in tax havens. A large number of these publications discuss how business people can plan their taxes through offshore regimes – which, they allege, is absolutely legal. In the age of the Internet, these booklets have been replaced by websites, a development that has further encouraged tax planning through tax havens. There are also periodicals that specialise in this subject, as well as newspaper articles and conferences.

The reader would be well advised that this promotional literature cannot provide a fair analysis. Its publishers have a direct interest in supporting the offshore industry because that is where they make their living as lawyers, advisors or nominees. Most of this (dis)information ignores an inconvenient truth: Traditional tax-planning options are disappearing as some of the best-known offshore jurisdictions succumb to international pressure to reform their laws. Specifically, they have been watering down bank secrecy, the glue that keeps offshore structures together, and have agreed to begin exchanging tax information with governments whose citizens operate on their territory. As investigative techniques develop and intergovernmental cooperation strengthens, authorities will become all the more successful in uncovering abusive practices. The consultancies that promote offshore structures and tax haven-related investment will collapse, hastening the downfall of company-registration agencies in offshore locations.

Legal tax planning will remain possible. The key to successful and lawful tax planning is "substance" – that is, companies based in tax havens and the transactions they conduct must have some commercial rationale other than the owners' desire for a lower tax bill. Entrepreneurs who want continue planning taxes will have to dismantle their "substance-free" offshore structures and replace them more robust "onshore" structures. This means they will have to effectively manage their firms in the countries where they are registered.

The problem is, establishing substance in a foreign country is a very expensive and time-intensive process. Tax planning can only be safe if it has been successfully tested against the increasingly comprehensive, up-to-date anti-avoidance legislation and related court rulings. Business that lack sufficient capital will probably be shut out from legal tax-planning opportunities in the future.

This book will substantiate this message. It will detail the efforts that the OECD, the Financial Action Task Force (FATF) and other international institutions are undertaking to combat tax havens. It will outline new legislative initiatives by the European Union and the U.S., and will review court rulings handed down in numerous countries. We will also discuss the advanced methods of criminology that expose a great number of tricks employed by offshore practitioners. (The simplest way for authorities to combat offshore tax planning is to seize the databases of offshore-company registration agencies.) Readers will discover that in the overwhelming majority of cases, tax havens do not offer a legal way for them to avoid taxes in their home countries.

We will then review the methods through which companies might continue tax planning through legal, albeit much costlier, means.

WHY THIS BOOK WAS WRITTEN

1. Amnesty Awareness

Tax evasion has broad appeal to companies in countries where taxes and social contributions are particularly burdensome. Company owners sometimes try to lighten the load by paying fictitious or inflated invoices to offshore firms, which allows the owners to book expenses that reduce their domestic tax bases. They may also register their workers as employees of an offshore company to try to lower the cost of employment. Once a taxpayer moves his assets offshore, it is very difficult for him to legally re-integrate them into the domestic economy. He can always conduct a self-audit that reviews his liabilities – but this is a painful process that most people would just as soon avoid.

Numerous governments have addressed this problem by introducing amnesty programmes. When a state offers an amnesty, it tacitly acknowledges that (i) its unreasonably high tax rates have "forced" people to evade taxes, and (ii) the state is (or was) not able to properly enforce its tax laws. In a typical amnesty programme, authorities forgive the wrongdoing of those who have used tax havens. In return, the wrongdoers (which, depending on the jurisdiction, may include perpetrators of serious tax crimes) have to pay tax on their offshore wealth typically at rates ranging from 2% to 40%. If a taxpayer enters an amnesty programme, the local

promoters who helped him set up the company might also escape punishment. But this is not always the case: U.S. authorities can prosecute promoters of tax-avoidance schemes using information they receive from programme participants.

A successful amnesty programme will encourage voluntary reporting of taxable wealth held offshore. The taxpayers should be granted a one-time redemption of all untaxed funds, regardless of whether they are held domestically or abroad. Major assets that have previously escaped taxation could be regularised at a special tax rate that should not exceed 5% (10% in highly developed countries). The rate could even be reduced to 2.5%, provided that the taxpayer invests his regularised wealth in the domestic real estate market. That would boost the domestic construction and property industries while simultaneously saving public funds. The programme would be even more attractive if it were open to companies as well as individuals.

In less-developed countries, it is crucial for amnesties to offer the one-time redemption of funds. Very few emerging-market companies have enough cash on hand to pay 5% of the wealth that they want to regularise. In most cases, the firms have already used the assets that escaped offshore to finance their domestic ventures and improve their competitiveness. (This typically occurs through borrowing or capital contributions from the offshore company.) Alternatively, the taxpayer may have already invested his offshore "savings" in real estate.

There are two major stumbling blocks that may hamper an amnesty programme's success. The first is weak tax morale: If taxpayers are not afraid of the state due to ineffective law enforcement, an amnesty programme may fail even if its terms are entirely reasonable. The second obstacle is the black economy: If a UBO can continue to profit from under-the-table business without major repercussions, why would he expose his company to greater tax liabilities?

For this reason, the success of any amnesty programme is closely linked to tax reform. If authorities fail to cut taxes, no amnesty can be popular: Upon entering the programme, a company's tax burden would rise so dramatically that it would lose market position to competitors who continue to engage in tax evasion. Radical cuts in major taxes may stem the growth of the black economy and hamper capital flight. They may also make the country more attractive to foreign direct investment. This book addresses the question of why and how countries should overhaul their tax structures and implement a tax burden that people consider fair (and are willing to pay).

As we shall see, the only economically successful amnesty programmes were the ones offered by Argentina[38] and Italy.[39]

[38] Argentina has implemented the most successful amnesty programme in the world (at least from the perspective of this book's authors). As Argentine President Cristina Fernández de Kirchner told Dow Jones on 1 September 2009, the Argentine state was not over-zealous and did not seek to achieve unrealistic goals. The

Whether they were successful from an ethical perspective is an open question: Opponents say amnesties reward dishonest taxpayers and create a disincentive for people to pay on time. But since an amnesty is voluntary, opponents have a hard time mounting legal challenges against it.

In countries where no amnesty programme exists, people who engage in tax haven-related business would be well-advised to conduct a self-audit. This is a good idea even if the belated payment of tax does not save the taxpayer from criminal prosecution. Any effort to regularise untaxed income and property may induce authorities to consider more lenient punishment.

2. Dose of Reality

It is not the author's intention to frighten the reader; however, the discussion in the following pages may do just that. Those who see the reality of their offshore business should logically think over the consequences of owning such a company – even though it looked advantageous at the outset. They will eventually have to acknowledge that the conditions for offshore business have deteriorated.

Decades ago, tax haven governments introduced "secrecy laws" to prevent foreign authorities from obtaining information about their citizens who had moved assets offshore. Secrecy laws are one of the cornerstones of the offshore industry: They keep tax evaders safe from prosecution in their home countries. It is no wonder that the gross value of assets kept in tax havens may reach into the trillions of dollars.[40] But today, pressure from wealthy nations has

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programme allowed individuals to be discharged from tax liability by paying an 8% tax or, exceptionally, a 1% tax, provided that they invested their regularised income into Argentine real estate or movable property. Without the amnesty programme, they would have been obliged to pay a 35% tax, plus late-payment interest and penalties. Companies that entered the amnesty programme had the opportunity to pay 30% of the normal tax that would otherwise have been due. About 200,000 individual and corporate taxpayers took part in the programme; the state managed to recoup some ARS 33 billion ($8.3 billion) in tax revenue. See Mike Godfrey, "Argentina's Tax Amnesty Raises USD8.3bn In Revenue," Tax-News.com, 4 September 2009, available at http://www.lowtax.net/asp/story/front/Argentinas_Tax_Amnesty_Raises_USD83bn_In_Revenue____38889.html, visited on 16 January 2012.

[39] In 2009, Italy declared its third tax amnesty since 2001, the so-called Scudo III ("shield" or "protection"), which imposed a 5% penalty on undeclared foreign savings. (The amnesty has since been extended, but the penalties have been raised as high as 7%.) The programme was truly successful from an economic perspective: As much as $137 billion has been repatriated, generating $7 billion in tax revenues – far surpassing the government's expectations. However, the amnesty has been criticised as unethical because it allowed the legalisation of funds from criminal sources (not only tax evasion). *"Parliament is aiding and abetting bands of criminals,"* opposition Italian Values party leader Antionio di Pietro told Bloomberg in October 2009, a clear reference to the Mafia. See Steve Scherer, "Italy Tax Amnesty Poised to Pass; Opposition Says It Aids Mafia," Bloomberg, 1 October 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aMijLhTnaPuM, visited on 16 January 2012.

[40] In 2000, an IMF study estimated the total value of on-balance sheet cross-

forced the most ardent supporters of secrecy – including Switzerland – to back down. Offshore tax dodgers can no longer feel secure that their secrets will not be exposed.

Surely, taxpayers – or ultimate beneficial owners (UBOs), as this book will refer to them[41] – have long been aware that offshore "tax planning" is not entirely legal. People who do business with tax haven-registered firms must also sense that something is amiss: Sober minds can surely identify the danger in signing a contract with a company whose official address is nothing but a post office box on a Caribbean island, in an Alpine hamlet in Liechtenstein, or even a city in a developed jurisdiction such as Hong Kong, Luxembourg, the U.S., the Netherlands or Switzerland. Intelligent people are certainly also aware that a company with no proper management cannot sign a virtually unlimited number of contracts and issue countless invoices to anybody for anything. Nor does it seem feasible that a legitimate firm could share the same office space with several thousand other firms.

Anyone who invests through a tax haven-registered entity must know that the firm is based on fictitious paperwork – especially given that all contracts, invoices and other documents are produced in the company's normal office in the UBO's home country (albeit with the offshore company's letterhead). This is also the place where business partners meet with the company's managers.

The idea that it is possible to create an artificial company whose profit is not subject to any tax anywhere (save an annual maintenance fee of $1,000-$2,000 payable to the company-registration agent) is a pipe dream. Any taxpayer of sound mind must realise it is simply too good to be true. He must also know that such a setup is exceedingly vulnerable: One does not require a law degree to understand that simulated contracts and forged invoices constitute tax fraud and falsification of corporate documents. Forgery of official documents also occurs whenever an offshore

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border assets parked in offshore financial centres at $4.6 trillion (as of June 1999). Caribbean basin countries hosted $900 billion of the total (not including Bermuda or Panama, which did not provide data). Asian tax havens had $1 trillion, while London, Japan and the United States absorbed $2.7 trillion dollars of tax haven-related business. The financial infrastructure of the latter jurisdictions was used to transfer and manage the funds derived from tax havens. See Ahmed Zoromé, "Concept of Offshore Financial Centers: In Search of an Operational Definition," IMF Working Paper, April 2007, p. 25, footnote 24,

http://www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf, visited on 28 February 2012.

According to a 2011 report by the U.S. Public Interest Research Group (USPIRG), offshore tax havens added $434 to the average U.S. taxpayer's tax bill in 2010. See Benjamin Davis, Elizabeth Ridlington, Gary Kalman and Jeffrey Musto (U.S. PIRG Education Fund), "Tax Shell Game: How Much Did Offshore Tax Havens Cost You In 2010?" April 2011, available at

http://cdn.publicinterestnetwork.org/assets/6199a01e45e44ebdea96ad519a6f0642/Tax-Shell-Game-web-vUS.pdf. See also U.S. PIRG press release, "Washington, D.C.: Off-Shore Tax Havens Cost U.S. Taxpayers $434 a Year," 18 April 2011, http://www.uspirg.org/news-releases/tax-and-budget/tax-and-budget-news/washington-d.c.-off-shore-tax-havens-cost-u.s.-taxpayers-434-a-year All sites visited on 16 January 2012.

[41] See the definition of UBO in section 2.3.

company's "nominee director" signs blanket declarations in advance, which the UBO can then backdate as he pleases. The moment the UBO moves his funds offshore, he becomes involved in the crime of money laundering. So might any of his relatives whose daily lives are financed by the tax haven-registered business (provided that they are aware of the criminal source of the funds).

In developed countries, authorities can easily detect abusive practices by UBOs of tax haven-based companies. This is not yet the case in many developing nations. Authorities here rarely investigate tax haven abuse proactively, chiefly because their main targets would be politicians and members of the economic elite. Hence the average UBO pays little attention to the risks of doing business in tax havens. But in some emerging markets, especially India and China, it may be high time for them to change their ways…

Offshore-company promoters are supported by an outstanding marketing campaign. Its success is evident in the fact that the people who participate in offshore schemes come from the educated and affluent sectors of society. This is why there are millions of offshore companies that account for more than half of worldwide capital turnover, virtually free of tax.

One particularly persuasive ploy that offshore-company registration agencies use is the idea that the European Union's fundamental freedoms support their right to exploit tax havens such as Cyprus, Malta or Luxembourg. The agencies claim that the EU´s Merger Directive[42] can be invoked to avoid capital gains tax following the exchange of shares between two companies incorporated in the EU or the European Economic Area.[43] They fail to emphasise that the Merger Directive has a built-in anti-abuse provision (Article 11). Promoters also tout the EU Parent-Subsidiary Directive as a means of eliminating tax on dividends through offshore companies. They neglect to mention that Article 1(2) of the Directive explicitly authorises member states to prevent such abuses. In other words, if a tax advantage is the sole purpose of a merger, or if such a transaction is wholly artificial, then the benefits of the Parent-Subsidiary Directive may not apply (depending on domestic law).

Most offshore companies are compelled to operate in the UBO's country of residence because most tax havens enforce "ring-fencing" laws that prohibit offshore firms from conducting business on their

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[42] *Official Journal of the European Communities,* EU Directive 90/434/EEC of 23 July 1990 on a common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, 20 August 1990, L 225/1, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31990L0434:en:HTML, visited on 22 January 2012.

[43] See European Court of Justice, *Leur-Bloem v. Inspecteur der Belastingdienst*, C-28/95 (1997) ECR I-4161, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61995J0028:EN:HTML, visited on 28 February 2012. (This case is fully discussed in section 14.1.1.6.)

territory. If an offshore company were to actually operate in the tax haven where it is registered, it would be subject to domestic taxes, which can be fairly steep. This would defeat the entire purpose of establishing "tax planning" arrangements through an offshore company, which is for the UBO to dodge taxes in the country where he keeps his "physical" offices.

A few tax havens allow – or even require – businesses to maintain a local presence. For example, Cyprus, Luxembourg, Malta, the Netherlands, Singapore, Switzerland, United Arab Emirates (UAE) and Uruguay have all concluded double tax treaties (DTTs) with other countries. In a standard DTT, a company's effective place of management prevails over the place of incorporation for the purposes of determining tax residence; therefore, offshore companies that are not effectively managed in these tax havens are not considered to be resident there. And most UBOs do not manage their companies in these tax havens because the operating costs would be too high.

Since place of effective management determines tax residency, tax haven-related schemes can hardly withstand legal challenges in the UBO's home country, regardless of whether his business operates offshore or onshore. The UBO will not be able to defend himself by saying he does not effectively manage his business in his home country. If he tried this tactic, he would be undermined by his business partners, nominees, the company-registration agent(s) and the employees of the bank where the business accounts are kept. All of these people will uniformly testify that the company in question belongs to the UBO and that it does not operate in the tax haven where it is registered. They will declare that they do not take part in the effective management of the company, even though they operate it on paper; they will even claim they did not take part in the company at all. They have a direct interest in denying involvement; otherwise, they will become entangled in a criminal procedure and will not be able to avoid responsibility for aiding and abetting tax fraud and money laundering. They also do not want to risk being charged with the falsification of company documents or subornation of forgery.

The conclusion is that taxpayers who become entangled in offshore tax-avoidance schemes cannot avoid committing the crime of tax evasion and a number of related offences. The statute of limitations on these related offences may be much longer than those that apply to the tax offences themselves. And once a criminal procedure is initiated, the taxpayer will lose his reputation in the business community.

3. Highlighting the threat of criminal organisations

Engaging in tax haven-related transactions is never a one-man job. A taxpayer begins by approaching lawyers and advisors in his home country who specialise in tax haven-related schemes. They are

usually contractors for company-registration agencies that operate in tax havens; annual maintenance fees are also paid through them. The taxpayer also needs to find "nominees" in the tax havens to serve as the owners and directors of his offshore company on paper; usually, these people are also retained by the company-registration agencies. Such nominees can only participate through fictitious contracts. They do not operate the business; their sole function is to sign the papers given to them.

Most UBOs work with advisors in their countries of residence who speak their language, are familiar with local laws and have established business contacts. (Some UBOs approach the company-registration agencies in tax havens directly – but this is rare.)

So, at least three people are needed to run a tax-haven company – the UBO, the offshore consultant (promoter) in the UBO's country of residence, and the company-registration agent based in the tax haven (not to mention the nominees). The number three is important: In some jurisdictions, the legal category of "criminal organisation"[44] applies to cases where at least three people holding different positions conspire to commit significant crimes, durably, with a gainful purpose and in collaboration with each other. Naturally, the punishment for a crime committed by a criminal organisation is harsher than if the same crime were committed by one offender singlehandedly.

To make matters worse, people who evade taxes through offshore schemes may be charged with a combination of tax fraud, money laundering and other related crimes.[45] Such a "compound crime" may trigger extra-harsh punishment.[46]

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People who invest via tax havens may feel the pressure mounting. International organisations like the G20 are working on recommendations that would oblige member states to automatically exchange information on people who invest through tax-haven entities – possibly even retroactively.

In February 2012, the Financial Action Task Force (FATF) issued a recommendation for states to include tax crimes as a predicate

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[44] In the U.S., criminal agreements are often referred to as "conspiracy" (which again has various forms). This book uses the more European terms of "criminal organisation" or "accomplices."

[45] The case may be further complicated by charges of VAT fraud. A variety of services performed by companies based in tax havens are often taxable in the UBO's home country because that is where these services are actually rendered, and therefore, the company should have charged VAT.

[46] Most countries' laws provide severe punishment for tax evasion, but it is an entirely different question as to how these laws are enforced. Courts are hesitant to hand down long prison sentences or big fines, even in countries that are OECD members. This approach is not surprising because the infringement of tax laws through tax havens is frequently not treated as a crime. Authorities therefore have not initiated criminal proceedings, even in cases where the unpaid tax has been clearly identified.

offence for money laundering. All FATF member states will have to integrate this recommendation into their domestic legislations in some form or another. This means people who commit tax crimes may be implicated in money laundering – even in countries like the U.S., where tax evasion is not yet considered a predicate offence.

In the U.S., the Foreign Account Tax Compliance Act (FATCA), passed in 2009, will require foreign financial enterprises to disclose U.S. interests in their institutions from 1 January 2013. A large number of European banks are already trying to get rid of their U.S.-based clients – who previously were their most prized customers.

Australia has taken a similar path. In April 2010, the Australian Taxation Office asked the biggest financial enterprises in the country to provide information on the bank accounts of Australian resident taxpayers (both individuals and companies). Following the U.S. model, Australia is determined to investigate the wealth that has been invested offshore and has escaped taxation at home.

It will be many years before the statute of limitations runs out on current acts of tax evasion and money laundering through tax havens. As a result of the above-mentioned efforts of international agencies, it is very likely that automatic information exchange will be implemented in due course, even if local authorities are sluggish about providing the data. It is then up to authorities in capital-exporting countries to decide whether to use this information, and if so, how.

4. New tax laws, new growth

Many emerging markets do not have the economic infrastructure to attract significant investment over the long term. A competitive tax system could make them significantly more attractive. It is particularly important to reduce the burden on employment; this would make it possible to create jobs at companies that can serve as a supply base for multinationals. These countries would then have an opportunity to whiten their economies, and escaped wealth could be repatriated.[47]

It is every country's goal to adopt a system where taxpayers prefer to pay taxes rather than evade them. This can only be

[47] Some tax havens are seeking to preserve their foreign clients by remaking themselves as "competitive low-tax regimes," with corporate tax rates not exceeding 10% (on average). Cyprus applies a 10% rate and Gibraltar introduced a 10% corporate tax rate in 2011. If Central and Eastern European (CEE) countries were to introduce such tax rates, they could become attractive destinations for investment because they also offer the benefit of a cheap and well-educated work force. Countries like Liechtenstein, where labour costs are substantially higher, might find it hard to compete.

Governments that wish to implement these reforms must also conclude double tax treaties (DTTs) with capital-exporting nations that allow for the full exchange of tax information (e.g. Hong Kong's DTT with Belgium). Such agreements are vital; without them, investors in low-tax jurisdictions might be forced to pay taxes in both the jurisdiction and their home state.

achieved if there is no significant difference between the cost of paying taxes and the cost of evading them, particularly in countries with weak tax morale. According to model calculations based on interviews with 10,000 company managers in 80 countries, cheating and corruption cannot be eliminated unless fair taxes are applied.[48] Unfortunately, the economic environment in developing countries often invites tax evasion. Companies simply cannot survive unless they are able to shirk part of their tax burden. Since their competitors are also massively engaged in tax evasion, they have no other choice but to do likewise.

In countries where economic operators pay just a small part of their taxes, it is logical to ask why the state does not reduce taxes to tolerable levels. Such a measure would be unlikely to cause a budget deficit because tax receipts do not increase when nominal tax rates are higher. Indeed, the tax cuts may even bolster state revenues since taxpayers, aware of the heavy punishment they risk, will be less apt to break the law. With fewer tax evaders, a smaller, but well-paid staff of tax authorities would be able to work more efficiently to combat tax evaders who are unwilling to pay even the reduced taxes.

It would also be important for states to guarantee these deep tax cuts for at least four years. This is because tax-evasion schemes are unlikely to be eliminated for at least one or two years after the reforms go into effect. Once someone has legalised his venture, it will become impossible for him to return to the black economy in the short term since regularised funds cannot be quickly re-concealed. However, if a businessman who has "gone legal" is then slapped with tax hikes that dramatically raise his production costs, it will be difficult for him to compete against business rivals who continue to dodge taxes.

Within the EU, Slovakia has been particularly proactive, setting income tax, corporate tax, and VAT at 19%,[49] and making dividend income tax-free. Romania went further by introducing income and corporate taxes at 16%. Neighbouring Hungary has adopted a 10% tax on corporations whose annual profits are less than HUF 500 million (approximately $2.5 million), a 19% tax for companies whose profits exceed this threshold, and a 16% flat income tax. Bulgaria went so far as to introduce income and corporate taxes at 10%.

Some countries outside the EU also levy corporate taxes at no more than 10%. Serbia's corporate tax does not exceed this level, and its income taxes are no more than 20%. Meanwhile, neighbouring Montenegro has introduced a 9% tax on corporate profits, a 12% flat income tax and 17% VAT. Initially, the Adriatic

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[48] Sacit Hadi Akdede, "Corruption and Tax Evasion," Adnan Menderes University (2006); Eric M. Uslaner, "Tax Evasion, Corruption, and the Social Contract in Transition," University of Maryland-College Park, 2007; and Douglas A. Hibbs and Violeta Piculescu, "Institutions, Corruption and Tax Evasion in the Unofficial Economy," Göteborg University (2005).

[49] Slovakia raised its standard VAT rate to 20% on 1 January 2011.

nation's leaders expected tax revenues to fall, at least in the short term. But this was not the case: Privatisation, foreign direct investment and a streamlined tax system combined forces to spur economic growth and broaden the tax base. These reforms helped to improve Montenegro's image from that of a statelet mired in the black economy to a country with competitive tax laws.

Tax rates unquestionably affect a country's competitiveness. The World Economic Forum (WEF) publishes an annual Global Competitiveness Report that ranks countries' economic competitiveness based on surveys of business executives and other data. In the 2010-2011 edition,[50] Southern European countries fared poorly in the question on how taxes affect investment and labour: Out of 139 countries, Greece came in 99th, Spain was 112th, Portugal ranked 123rd and Italy was 133rd.[51] Top-ranked countries are as follows:

1 Bahrain	6.1
2 Hong Kong SAR	6.0
3 Singapore	5.6
4 Oman	5.6
5 United Arab Emirates	5.5
6 Kuwait	5.5
7 Luxembourg	5.4
8 Mauritius	5.4
9 Saudi Arabia	5.3
10 Switzerland	5.0
11 Qatar	4.8
12 Cyprus	4.7
13 Botswana	4.6

Rankings for average tax burdens – including income tax, social charges on employment and other taxes – are as follows:[52]

1 Timor-Leste	0.2
2 Namibia	9.6
3 Qatar	11.3
4 United Arab Emirates	14.1
5 Saudi Arabia	14.5
6 Bahrain	15.0
7 Georgia	15.3

[50] World Economic Forum, "The Global Competitiveness Report 2010–2011," (2010) http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf, visited on 16 January 2012. Rankings for 2010-2011 were based on a weighted average of data from 2009 and 2010, except as noted.

[51] Extent and effect of taxation: What impact does the level of taxes in your country have on incentives to work or invest? (1 = significantly limits incentives to work or invest; 7 = has no impact on incentives to work or invest); 2009-2010 weighted average. "Global Competitiveness Report 2010-2011," p. 431.

[52] The variable shown is a combination of profit tax (percentage of profits), labour tax and contributions (percentage of profits), and other taxes (percentage of profits) for 2009. "Global Competitiveness Report 2010-2011," p. 432.

8	Kuwait	15.5
9	Zambia	16.1
10	FYR Macedonia	16.4
11	Botswana	17.1
12	Lesotho	18.5
24	Singapore	27.8

Countries that received top honours for spending public money efficiently are:[53]

1	Singapore	6.1
2	Rwanda	5.8
3	Qatar	5.7
4	Oman	5.6
5	Tunisia	5.3
6	Saudi Arabia	5.2
7	United Arab Emirates	5.2
8	Bahrain	5.1
9	Switzerland	5.0
10	Gambia	5.0
11	Hong Kong SAR	5.0
12	Sweden	4.9
13	Luxembourg	4.8
14	Finland	4.7
15	Botswana	4.7

Notably, Italy is 108th and Greece is 128th on this list.

The above data suggest that a shift of emphasis in taxation policy impacts individual behaviour. It invites people who are deeply involved in offshore tax planning to change their conduct and abandon the misuse of foreign jurisdictions. This presents a grave challenge for the offshore-company registration industry: Once countries that want to compete for foreign direct investment replace the tax-shelter model with comprehensive tax cuts, the offshore-registration agencies will lose their *raison d'être*. Moreover, these low-tax countries will be cooperating with OECD and other international agencies. Company-registration agents in tax havens will have to either start providing services that facilitate genuine business activity or cease to exist.

• • •

This book seeks to explain the complex subject of tax haven-related abuses simply and concisely. We deliberately try to avoid using excessive "legalese" and academic jargon in our discussion of court

[53] Wastefulness of government spending: How would you rate the composition of public spending in your country? (1 = extremely wasteful; 7 = highly efficient in providing necessary goods and services); 2009–2010 weighted average. "Global Competitiveness Report 2010-2011," p. 373.

cases and other texts in order to make this information accessible to the broadest audience possible. It reaches out to UBOs of companies that are registered in tax havens, who may not be experts in the intricacies of international tax law.[54] The book may equip them with the knowledge they need to assess the risks associated with such enterprises, to explore the possibility of legalising their businesses, or to decide whether to abandon their tax-haven companies entirely.

There will also be extensive discussions of court cases. They may be useful for lawyers and advisors of UBOs who would like to deepen their knowledge of the topic. Civil servants and state officials may also discover lessons in foreign court rulings that will help them improve the application and enforcement of laws in their own countries.

The presentation of certain cases will inevitably be lengthy: The authors consider it important to cover a broad range of details. The topic of tax havens has countless ramifications and can hardly be outlined comprehensively, even in hundreds of pages. We welcome any feedback at this book's dedicated website – www.offshoreapocalypse.info – or via email at help@anoracle.info

This introduction must conclude with a warning: The offshore era is drawing to a close. Developed countries, along with an increasing number of emerging markets, are stepping up their surveillance of offshore tax avoidance and prosecuting offenders. International agencies are becoming increasingly active, and more tax information is being exchanged. People who abuse tax havens face punishment for tax offences whose statute of limitations may exceed 10 years. The time has passed when UBOs could benefit from a company that is mechanically registered in a tax haven without living, breathing local managers. These developments mean the offshore-company registration industry is also on its last legs.

The message is clear: "Game over!"

(....)

[54] With minor exceptions, tax laws are not "international." According to Roy Rohatgi, *"International tax law refers to the principles derived from public international law that deal with tax conflicts involving cross-border transactions."* Roy Rohatgi, Basic International Taxation: Volume 1: Principles, second edition (2007), p. 14.

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