SOVEREIGN REPORT

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STOP PRESS ANNOUNCEMENT:
OECD have now extended deadline for commitments to reform to November.

US TREASURY DEALS BLOW TO OECD 'HARMFUL' TAX INITIATIVE

The new Bush administration has dealt a mighty blow to the OECD so finally there is some good news for offshore finance centres.

US Treasury Secretary Paul O'Neill confirmed that the Bush Administration intends to withdraw its support from key parts of the OECD's 'harmful tax competition'initiative. He backed the need for greater transparency and exchange of information but deliberately omitted supporting efforts to eliminate discriminatory tax regimes.

In a statement, he said he was 'troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system'. He was also concerned about the potentially unfair treatment of some non-OECD countries.

'The United States,'he said, '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 harmonise world tax systems. The US simply has no interest in stifling the competition that forces governments – like businesses – to create efficiencies.

'Where we share common goals, we will continue to work with our G7 partners to achieve these goals. The work of this particular OECD initiative, however, must be refocused on the core element that is our common goal: the need for countries to be able to obtain specific information from other countries upon request in order to prevent the illegal evasion of their tax laws by the dishonest few. In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities'.

The OECD has given 35 jurisdictions which it identified last year as 'tax havens' until 31 July to commit to reform or face sanctions.

Bruno Gibert, co-chair of the OECD's Forum on Harmful Tax Practices, said it had noted O'Neill's statement and member countries were discussing 'how to respond to these concerns in a constructive way'.

Chairman of the White House council of economic advisers, Glenn Hubbard, sought to clarify O'Neill's remarks by saying it was possible that the US would support a slimmed-down version of the OECD campaign. But such a climb-down is likely to encounter opposition from other OECD countries.

This has to be right. No nation should dictate to another what rate of tax it should set for its citizens. Many countries do not have to fund big infrastructure projects, armed forces and public transport networks. They do not need to raise the revenue required by bigger onshore countries.

The key element of the OECD initiative remains – the need for exchange of information and the need to prevent taxpayers hiding their money offshore and failing to make the proper declarations in their home countries. We do not expect any relaxation of the OECD demands in this area. At the time of writing I spoke to the OECD asking them for specific details about how they expect to be able to obtain such information i.e. would it involve a court process, would allegations of tax avoidance or evasion in the home country have to be substantially proved and what rights the OFC would have to reject the application for the information. They refused to comment or give any detail whatsoever about these matters but suggested that there was a committee meeting going on at the time I telephoned and further details may emerge after that.

Watch this space!

Howard Bilton BA(Hons)
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Chairman of The Sovereign Group

GUERNSEY

Guernsey brought the Regulation of Fiduciaries, Administration Businesses & Company Directors Law into force on 1 April. It introduces a formal structure for the licensing and supervision of all individuals, partnerships or companies offering or providing fiduciary services from or within Guernsey, Alderney and Sark by way of business.

The law introduces two categories of licence:

- a Full Fiduciary Licence which will only be available to companies and partnerships. This will permit the licence holder to offer and provide all fiduciary services;
- a Personal Fiduciary Licence which will only be available to individuals. This will permit the licensed individual to act as a company director or as a co-trustee or protector of a trust.

The essential element of the proposed regulatory structure is that those involved in the provision of fiduciary services should be 'fit and proper' persons. The criterion embraces integrity, competence and solvency.

The offering of fiduciary services without a licence will constitute a criminal offence.

Since 1984 there has been an embargo on the formation of new fiduciary businesses except where the application is from a local professional firm, a local bank or an institution found to be otherwise acceptable. There are currently 200 businesses in the Bailiwick providing fiduciary services.

SOVEREIGN COMMENT: Guernsey can justifiably claim to be better than most at avoiding bad business but up until now has not specifically regulated service providers in the jurisdiction. It is particularly good to see that the legislation will cover Sark based individuals and companies who have up until now been very active in providing 'nominee directors'.

Many Sark residents are directors of many thousands of companies without having any idea what those companies are doing. Frequently they get appointed as directors and simultaneously sign general powers of attorney handing back all powers to hidden beneficial owners or others. The so called 'Sark Lark' has been the subject of many critical newspaper articles and official complaints and must now surely be brought to an end by these new regulations.

JERSEY FSC TO ISSUE GUIDELINES ON PUBLIC FIGURES

The Financial Services Commission is to develop and issue further general guidelines as a result of its investigations into Jersey institutions alleged to have handled money connected to former Nigerian dictator General Sani Abacha. These guidelines will address the following issues:

- the need for an established policy by each institution on the handling of accounts from public figures and their associates;
- where an institution establishes that it is dealing with a public figure or associates, it should fully understand the validity and nature of the anticipated funds;
- institutions should identify the source of wealth of public figures and the source of funds for large transactions. They should build a profile of expected account activity and monitor transactions.

The above principles apply equally where the institution accepts a public figure account from an intermediary or other introducer, even where that introducer is part of the same group. In the event that a suspicion arises in relation to a public figure, an institution should examine other accounts introduced from the same source.

The Commission said its inquiries had shown that all of the accounts so far identified as being opened by Abacha associates were opened before the 'all serious crimes' anti-money laundering legislation was in place.

At the same time the UK Financial Services Authority (FSA) has found 42 personal and corporate account relationships linked to family members and close associates of former Nigerian dictator General Sani Abacha at 23 banks in the UK following a three-month investigation. It said a total of US$1.3 billion passed through these accounts for the four years between 1996 and 2000.

The FSAidentified deficiencies in areas including: senior management oversight of account opening for high-risk customers; verification of the identity of beneficial owners of companies; introductions by existing customers; understanding the source of the customer's wealth; reporting suspicious transactions and record-keeping.

SOVEREIGN COMMENT: It has always been difficult for banks to decide whether a public figure is depositing legitimately earned money or the proceeds of corruption. Often it may have been clear that there was moral wrong-doing but this does not necessarily mean that any laws have been broken – especially when the depositor of the monies makes the laws! Banks have faced heavy criticism for handling such accounts and assisting in hiding vast sums of money on behalf of the leaders of otherwise impoverished countries. It is a welcome change to see a jurisdiction specifically legislating on this matter – particularly in view of the dire records of many leading G7 nations such as the UK and the US.

BASEL COMMITTEE PAPER ON CUSTOMER DUE DILIGENCE

The Basel Committee on Banking Supervision has issued a consultative paper, *Customer Due Diligence by Banks,* to provide guidance to banks and banking supervisors on strengthening risk management procedures in banks around the world.

Drafted by the Working Group on Cross-border Banking, the paper says banks must develop customer due diligence policies and procedures in four key areas: customer acceptance, customer identification, ongoing monitoring of high-risk accounts, and risk management.

The Committee said national supervisors, responsible for ensuring that banks have minimum standards and internal controls that allow them to know with whom they are doing business, should work with their supervised institutions to ensure that these guidelines are considered in the development of know-your-customer (KYC) practices.

Colin Powell, co-chair of the Working Group and chairman of the Offshore Group of Banking Supervisors, said: 'Supervisors should ensure that banks apply an acceptable minimum standard of customer due diligence policies and procedures to all areas, embracing domestic and overseas operations, and corporate and private banking businesses. Banks should never enter into a business relationship until the identity of the customer is satisfactorily established'.

TURKS & CAICOS BRINGS MUTUAL FUNDS LAW INTO FORCE

The Mutual Funds Ordinance to create a licensing regime for operators of mutual funds carrying on business in or from within the TCI has been brought into force.

Originally enacted in 1998, it was delayed by the need to enact regulatory legislation covering the proceeds of crime and companies management.

The Ordinance and accompanying regulations provide for licensed administrators who will oversee the conduct of the fund in the interests of investors and is structured to offer three types of mutual funds licence:

- recognised funds which are constituted outside the TCI and are listed on a qualifying stock exchange can be recognised for marketing in the TCI;
- registered funds which are listed on qualifying stock exchanges or are to be marketed only to qualifying investors can be registered in the TCI;
- licensed funds that do not fit the above criteria but which will be regulated under the provisions of the Ordinance.

"Structured to offer three types of mutual funds licence"

Exemptions are granted for certain small funds with less than 15 investors, the majority of whom can appoint or remove the fund manager and funds which are marketed only to professionals. Full licences are required for other funds.

The government has also tabled a package of legislation designed to implement the recommendations of the KPMG review of financial regulation in the UK Overseas Territories. It includes a Financial Services Commission Bill to establish a new regulatory authority and amends the Companies Act to provide controls for bearer shares.

SOVEREIGN COMMENT: The new mutual funds regulations have been much delayed because TCI does little in the way of fund management business, but it still offers one of the world's most attractive corporate structures. The exempt company closely resembles the equivalent Cayman Island product at a cheaper price. The new legislation requires that bearer shares be 'immobilised' rather than abolished altogether. This means that the bearer share certificates must be lodged with a government regulated corporate service provider (CSP) who must keep full records of the beneficial owners of those shares. In effect there seems little point in a TCI company now issuing bearer shares particularly as banks and other financial institutions with which the company may wish to do business have a natural dislike of such instruments and those that use them.

US SENATE REPORT SLAMS CORRESPONDENT BANKING

US banks have become conduits for criminal proceeds and money laundering through the correspondent accounts they provide to foreign banks according to a report published by a Senate investigations subcommittee after a year-long inquiry.

The report said that correspondent banking – where banks provide services to other banks, particularly wire transfers – offers a significant gateway for rogue foreign banks and their criminal clients to carry on money laundering and other criminal activity in the US. The problem is longstanding, widespread and ongoing.

It recommends that US banks should be barred from opening correspondent accounts with foreign banks that are shell operations with no physical presence in any country and should be required to use enhanced due diligence and heightened anti-money laundering safeguards before opening correspondent accounts with foreign banks that have offshore licenses or are licensed in jurisdictions identified by the US as non-cooperative with international anti-money laundering efforts.

SOVEREIGN COMMENT: The G7 and others heavily criticise the offshore jurisdictions for being involved in money laundering but the reality is that it is very much more difficult to undertake money laundering offshore than it is to undertake it onshore. It is well-known that the onshore financial centres have much to do to bring their own standards up to those operated by the offshore financial centres. At least the US is starting to recognise this.

CAYMAN ISLANDS

The government has tabled new legislation to ensure full compliance with the anti-money laundering recommendations of the FATF and secure its removal from the FATF's list of 'non-cooperative' countries and territories.

The Companies Management Law is to be amended to extend the definition of company managers to include custodians of bearer shares and the Companies Law is to be amended to provide for the immobilisation of bearer shares.

Amendments to the Banks & Trusts Companies Law, Mutual Funds Law and Insurance Law will introduce 'fit and proper' criteria to the management of licensed entities and a Monetary Authority (Amendment)Bill will increase the operative independence of Cayman Islands Monetary Authority (CIMA). A Securities Investment Business Bill will also transfer responsibility for the Stock Exchange to CIMA and introduce a new licensing regime for brokers and investment advisors.

GRENADA

The Grenada International Financial Services Authority shut down 17 offshore banks in March in an effort to clean up its financial services sector. Prime Minister Keith Mitchell said revoking the licenses was part of 'due diligence' on the banking sector.

Grenada has taken a number of steps to strengthen the financial services sector since the Money Laundering Prevention Act 1998 was brought into force in April last year. Extradition and mutual legal assistance treaties were entered into last year with the US and a Financial Investigation Unit has been created. Amendments to the IBCAct are being drafted to put constraints on the use of bearer shares.

SOVEREIGN COMMENT: Grenada was previously one of the easiest countries in which to set up an offshore bank although how they managed to attract customers to deal with those banks is something of a mystery. It is becoming increasingly difficult for non-banks to start a bank anywhere in the world. Most jurisdictions have legislation which allows for the relatively easy incorporation of a bank but in practice the licensing authorities exercise their discretion and turn down applications from non-financial institutions. The move by Grenada to shut down those operators is welcome.

SINGAPORE

A Banking (Amendment) Bill to strengthen prudential safeguards and corporate governance, facilitate risk-focused supervision, provide banks with greater operational flexibility and update regulations, was published.

The key changes in the Bill include: revision of ownership rules for local banks following the lifting of the aggregate foreign shareholding limit; introduction of flexibility for Monetary Authority of Singapore (MAS) to prescribe institution-specific capital adequacy requirements; reduction of paid-up capital requirements for local banking subsidiaries; redefinition of capital for foreign banks; and revision of banking secrecy provisions.

The MAS has also released public consultation papers on a Securities & Futures Act to consolidate existing legislation and introduce a modular, single licensing regime for securities and futures intermediaries, and a Financial Advisers Act to govern advisory activities in respect of a range of investment products, and the distribution and marketing of life insurance policies and unit trusts.

LEBANON

The Lebanon has brought in new anti-money laundering legislation. It was one of the 15 jurisdictions identified as 'non-cooperative' in the fight against money laundering by the FATFlast June.

'In particular', said the FATF, 'Lebanon maintained a strict banking secrecy regime which affected access to the relevant information both by administrative and investigative authorities. International cooperation was compromised as well'.

The new law criminalises the laundering of the proceeds of crime specifically in relation to narcotics offences, organised crime, terrorist acts, arms trafficking, embezzlement/other specified frauds and counterfeiting of money or official documents. It also provides for a seven-year maximum prison sentence and confiscation of tainted assets.

The Lebanon Central Bank has also promulgated regulations on the control of financial and banking operation for fighting money laundering which addresses issues relating to the check of the client's identity and the obligation to control suspicious operations.

SOVEREIGN COMMENT: Up until now Lebanon had almost impregnable banking secrecy. These new laws erode that secrecy somewhat.

HONG KONG APPOINTS NEW HEAD OF CIVIL SERVICE

Donald Tsang was appointed as chief secretary of the civil service following the abrupt resignation of Anson Chan in January. It is the most significant government appointment since the return to Chinese rule in 1997.

Financial secretary since 1995, Tsang is credited with leading Hong Kong through the Asian financial crisis and helping to revitalise the economy with his 1999 Budget. He is replaced as financial secretary by a candidate from outside the civil service, investment banker Antony Leung who was formerly chairman of JP Morgan Asia-Pacific.

Hong Kong has reached agreement to enter into a mutual legal assistance treaty (MLAT) with Switzerland as part of efforts to clamp down on money laundering. The agreement enables Switzerland and Hong Kong to share information and evidence in suspected criminal cases, and to transfer prisoners. They are also able to request that assets be frozen and transferred between the two financial centres.

Swiss justice minister Ruth Metzler said the MLAT, the first between Switzerland and an Asian country, would lead to much closer cooperation in the fight against financial crime and would serve as a model for future agreements between Switzerland and other Asian states. Negotiations are currently in progress with the Philippines and Singapore.

A Banking (Amendment) Bill to upgrade Hong Kong supervisory regime in line with industry developments, particular in relation to electronic banking, was published in March. It is designed to enhance the Hong Kong Monetary Authority's (HKMA) oversight of places of business of authorised institutions.

The Bill updates the definition of 'manager' and introduce requirements for authorised institutions to notify the HKMA of the appointment of managers and to maintain adequate systems of control to ensure that such managers are fit and proper.

LABUAN PUBLISHES FINANCIAL SECTOR MASTERPLAN

Bank Negara, the Malaysian central bank, has published a Financial Sector Masterplan setting out its long-term blueprint for the financial sector, including the International Offshore Financial Centre (IOFC) in Labuan. It makes recommendations in three main areas:

- to promote and diversify further the financial players and activities in the IOFC;
- to promote the development of Islamic banking and insurance business;
- to develop and strengthen the capital market, e-commerce and the ancillary activities.

The Masterplan proposes a review of existing rules and regulations to facilitate expansion in the scope of core business. Measures under active consideration are: incorporation or registration of other types of offshore companies by both non-residents and residents; change the domicile status of trust companies to that of offshore companies to facilitate their dealings and encourage foreign trust companies to be based in Labuan; develop the IOFC as an active reinsurance and captive insurance centre, including rent-a-captive business; rationalise the roles of offshore banks to fully complement their activities with the domestic financial market; facilitate the setting up treasury centres for multinational corporations and financial institutions.

The Masterplan also addresses regulatory policy and the supervisory framework. The necessary supervisory structures have been set up within the Labuan Offshore Financial Services Authority to conduct on-site inspection and anti-money laundering legislation is now being finalised.

The Islamic banking, finance and insurance business already established in Malaysia, it says, provides a platform from which Labuan can be developed with a strategic focus on Islamic products and services. It proposes to develop an International Islamic Financial Market and set up a Syariah Advisory Council for financial markets.

SOVEREIGN COMMENT: Labuan has had some success in attracting business from financial institutions who wish to invest into Malaysia or to utilise the Malaysian tax treaty network for investing in treaty partners. Labuan has had little success in attracting other business but clearly sees its Islamic links as being a selling point.

ENGLAND & WALES: TRUSTEE'S DUTY OF CARE

The UK Court of Appeal upheld the decision of the High Court *(Sovereign Report – Issue 5, page 5)* that the test for breach of trust by a trustee should be objective. 'This', it said, 'was more in line with the test applied to cases of professional negligence and would only involve looking at the ultimate decision rather than every event leading up to it'.

In *Wight & Another v Olswang,* the respondent was co-trustee of a fund with an absolute discretion in relation to the continued retention of trust holdings. In April 1991 the trustees sold some of the holdings. Most of the remainder were sold in 1992 and 1993. The appellants, beneficiaries of the trust, submitted that by reason of alleged breaches of duty, the trustees lost opportunities to sell the remaining shares at higher prices in May and September 1991.

The High Court held that, irrespective of breaches of trust during the decision-making process, beneficiaries of a trust would have to establish that the decision was one that no reasonable trustee could have made.

The appellants contended that the test for breach of trust should be subjective. The court should ask whether, if a particular breach of trust had not occurred, would a different result have been obtained.

The respondent argued that the claim should be objective. The beneficiaries would have to show that no reasonable trustee, with similar knowledge and experience and in a similar position, could have acted in the same way. The Court of Appeal agreed, dismissing the appeal.

SOVEREIGN COMMENT: From a trustees point of view this is welcome news. Trustees cannot be expected to time a sale of stock to achieve the highest possible price. Clearly stock prices move up as well as down and it is easy to see when a sale would have best been completed with the benefit of hindsight. If at the time of sale a reasonable man would have concluded that it was clearly not the correct time to sell a stock then the trustees should be liable but not otherwise.

ENGLAND & WALES: FOREIGN CONFISCATION ORDER

The House of Lords ruled that the High Court had power to grant a restraint order prohibiting a person from dealing with realisable property in enforcing an order for the confiscation of the proceeds of crime made in a designated foreign state, even if the confiscation order had been made before that state had been designated.

"Court had power to grant a restraint order... even if the confiscation order had been made before that state had been designated"

In *Montgomery & Another v Government of the United States of America,* the Lords upheld a Court of Appeal decision to reinstate restraint and disclosure orders made in 1997 under the Criminal Justice Act 1988 against the appellants Kathleen Montgomery and her husband Lee Edwin Montgomery in support of confiscation orders made by a US Federal District Court against Mrs Montgomery and her former husband Larry Barnette following his 1984 conviction for fraud upon the US government.

In 1998, on the application of the Montgomery's, the High Court discharged the orders on the grounds that the Act could not be used in aid of US confiscation orders made before the Act was applied to the US. The power to make restraint orders in aid of US confiscation orders was conferred upon the High Court with effect from 1 August 1994 by the Criminal Justice Act 1988 (Designated Countries & Territories) Order.

The US government appealed. The Court of Appeal reversed the decision of the High Court and reinstated the orders. It held that the 1988 Act expressly provided that these powers could not be used in connection with English domestic proceedings instituted before the commencement of the Act. But that provision was omitted in the Act as applied to external confiscation orders.

ITALY

A court in Modena adjourned the trial of Luciano Pavarotti on charges of tax evasion until September. The opera singer is accused of failing to declare earnings of £13m between 1989 and 1995. He faces a maximum penalty of three years in prison if convicted.

Pavarotti, who denies the charges, has argued that in financial terms he was resident in Monte Carlo at the time and paid taxes on his earnings in the various countries where he worked.

But the Italian tax authorities insist that Modena, where his family is based and where he owns properties and controls investments and companies, was the centre of his business and personal affairs *(Sovereign Report – Issue 7, page 5).*

SOVEREIGN COMMENT: To legally maintain Monagasque residency an individual must actually reside in Monaco for at least 90 days during the year. Other tax shelters such as Malta, Cyprus, Gibraltar, etc have no minimum stay requirement to maintain legal and tax residency. It should be noted that the fact that you are tax resident in one country does not mean that you are not tax resident in another at the same time and subject to tax in both.

GUERNSEY

The Royal Court held that a trustee need only provide full and accurate information as to the state and amount of a trust property to beneficiaries whose interest in that trust had become vested by the date of commencement of the Trusts (Guernsey) Law 1989.

In *the matter of The Peter Acatos No 2 Settlement,* the respondent, a Guernsey-registered trust company, in its capacity as trustee of the settlement – under which the applicant was a member of the class of discretionary beneficiaries – applied to the Court for directions as to the extent of its duty under the Law in respect of requests made for information.

The Law provides that a trustee shall provide full and accurate information as to the state and amount of the trust property but, in the case of pre-1989 trusts, only for the benefit of a beneficiary whose interest in the trust property becomes vested before the commencement of the Law.

The Peter Acatos No 2 Settlement was created many years before the Law but none of the beneficiaries' interests in the trust property had become vested before its date of commencement.

ISLE OF MAN

The government announced a 2% cut in the rates of income and corporate taxation as part of the 2001 Budget. The reductions are a first instalment of the tax strategy approved by Tynwald last October *(Sovereign Report – Issue 6, page 6).*

Under the Budget proposals, the standard rate for both corporate and income tax will be reduced from 14% to 12% – with the top rate reduced from 20% to 18% – with effect from April 6 this year. Other Budget measures included an effective zero tax rate for fund managers.

The Isle of Man was one of 35 'tax havens' listed by the OECD Forum of harmful Tax Practices in June but secured its removal from the list last December after making unilateral commitments to eliminate harmful tax practices by 31 December 2005.

Jersey senator Frank Walker condemned the Isle of Man's unilateral approach to the OECD and said Jersey may have to 'react' to the tax cuts. He said Jersey would liaise closely with Guernsey as any short-term tax advantage gained by one over the other would be 'long-term folly'. A document on possible tax changes is in preparation.

SOVEREIGN COMMENT: The long term aim of the Isle of Man government is to introduce an uniform, but low, rate of tax for all companies and structure in the Isle of Man and do away with exempt and other zero tax structures. It is thought that the applicable rate of tax would be 10%.

BERMUDA

The Proceeds of Crime Act is to be amended to introduce the concept of dual criminality for crimes which would constitute an indictable offence under Bermuda law. The amendment will also apply to tax fraud but only if the foreign law criminal violation also meets the standard of indictable tax fraud as defined under Bermuda law.

The Taxes Management Act is also to be amended to extend the scope of indictable offences to include criminal tax fraud. The definition of indictable tax fraud under Bermuda law follows the Swiss standard in that it only applies where there are substantial amount of taxes involved and where the fraudulent act is in writing, deliberate or wilful and designed to falsify material written records.

NON-OECD COUNTRIES SET UP NEW TAX AND INVESTMENT GROUP

A new multilateral body, the International Tax & Investment Organisation (ITIO), has been formed by the non-OECD members of the OECD-Commonwealth Joint Working Group on Harmful Tax Competition.

It aims to strengthen international cooperation between small and developing economies (SDEs) in tax and investment matters, assist SDEs to interface with international organisations to achieve this end and consider the development implications of international tax and investment initiatives.

Founded by Antigua, Barbados, British Virgin Islands, Cook Islands, Dominica, Malaysia and Vanuatu, the ITIO has already been joined by a further five jurisdictions – Anguilla, Bahamas, Cayman Islands, St Kitts & Nevis and Turks & Caicos.

The ITIO is currently preparing a first draft of a tax policy statement which might serve as the basis for a commitment letter for its members to the OECD.

Although the ITIO will help members deal with the OECD initiative, there are other global initiatives affecting international tax and investment policies which it believes need to be addressed from a global perspective, such as e-commerce and manufacturing.

Membership is open to any country or jurisdiction that is interested in pursuing cooperation on international tax and investment matters and exploring the development implications of tax and investment issues. International organisations sharing the ITIO's interests may be given observer status and it also intends to seek private sector input into its activities.

Meanwhile the OECD-Commonwealth process *(Sovereign Report – Issue 7, page 6)* is effectively on hold until the OECD countries respond to 17 questions submitted by the non-OECD countries at a meeting in Paris on 1 March in relation to its 1998 report on 'Harmful Tax Competition'and last year's framework for a Collective Memorandum of Understanding on Eliminating Harmful Tax Practices.

The Commonwealth countries said that in order to continue work on the development of a politically acceptable commitment process they must be in a position to understand the scope of the commitment sought by the OECD in its interpretation of the three broad principles of transparency, non-discrimination and effective exchange of information.

The OECD has not yet finalised its written response. It said it first needed the approval of all its members.

JERSEY THREATENS UK WITH LEGAL ACTION OVER BUDGET DELAY

The UK government finally allowed Jersey's 1997 Budget provisions to go to the Privy Council for Royal Assent after a two-year delay. The move followed the threat of legal action by the Jersey government.

The cause of the dispute was the inclusion of so-called 'designer tax' measures for international companies and followed the UK's signing of the OECD's report on 'harmful' taxation: which addressed preferential tax regimes in both OECD countries and non-member countries and their dependencies.

The Home Office said: 'The issue was whether the UK should, through giving royal assent, condone a predatory tax measure'.

Last autumn the Jersey authorities informed the UK that if it did not consent to the law within three months, the matter would be taken before the States with a view to seeking approval for appropriate legal action.

The Home Office said it had released the BIll because the delay was causing uncertainty about Jersey's tax system. Refusing Royal Assent would have meant Jersey having to invalidate the measures, which were in force pending approval from the UK.

SOVEREIGN COMMENT: Designer tax rates have been particularly heavily criticised in the OECD report. These are structures which are able to elect their own rate of tax and choose a rate with a specific purpose in mind. An OECD requirement is that such rates are abolished or rolled back but this requirement may be removed due to the new USA position on this matter.

US TREASURY SECRETARY STATEMENT ON OECD'S "HARMFUL TAX COMPETITION" INITIATIVE

The Clinton administration, in its final Budget request, proposed money for implementing the anti-tax haven provisions of the OECD's 'harmful tax competition' initiative but the Bush administration had failed to clarify policy direction since taking office in January. On 10 May US Treasury Secretary Paul O'Neill made the following statement:

'Recently, I have had cause to re-evaluate the United States' participation in the Organisation for Economic Cooperation & Development's working group that targets 'harmful tax practices'. Following up on the thoughts I shared with my G7 counterparts at recent meetings, I want to make clear what is important to the United States and what is not.

'Although the OECD has accomplished many great things over the years, I share many of the serious concerns that have been expressed recently about the direction of the OECD initiative. I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system. I also am concerned about the potentially unfair treatment of some non-OECD countries. 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 harmonise 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.

'When I took my oath of office as Secretary in January, I pledged faithfully to execute the laws of the United States. In its current form as established by Congress, the US tax code generally taxes income on a worldwide basis. We have an obligation to enforce our tax laws as written because failing to do so undermines the confidence of honest taxpaying Americans in the fairness of our tax system. We cannot turn a blind eye toward tax cheating in any form.

"The United States does not support efforts to dictate to any country what its own tax rates or tax systems should be, and will not participate in any initiative to harmonise world tax systems"

'That means pursuing those who illegally evade taxes by hiding income in offshore accounts. In today's world of instant information on the Internet, offshore bank accounts are no longer an obscure perk of the very rich. Just type in 'offshore brokerage account' in any Internet search engine. The number of sites offering easy, affordable, secret offshore brokerage accounts for investing in US stocks is astonishing.

'As one Internet site advertising offshore brokerage accounts in Dominica boasts, 'US stocks, bonds, options, currencies and mutual funds are frequently bought through offshore companies because they are not liable to US capital gains taxes'. Consider just how unfair this is to law abiding US investors who invest in US stocks and pay taxes. The tax evading US investor, investing in the very same US stocks through a secret offshore account, does not.

"The work of this particular OECD initiative must be refocused on the core element that is our common goal: the need for countries to be able to obtain specific information from other countries"

'Anyone who doubts that the US needs information from offshore tax havens in order to prosecute tax evaders need look no further than the case of John Mathewson. Mathewson ran a bank in the Cayman Islands. When shut down in 1995, Mathewson had over 1,000 customers and, according to Mathewson, 95% of his customers were US citizens. With Mathewson's cooperation, the IRS obtained tax evasion convictions on, and collected substantial back taxes from, over 20 of Mathewson's clients. These cases were made possible because of Mathewson's extraordinary cooperation. Without it – and without any tax information exchange agreement with the Cayman Islands – this large-scale illegal tax evasion would have gone unpunished.

'To enforce our tax laws, we must have a multi-prong strategy. If the United States believes that a particular US taxpayer is illegally evading the US tax laws through the use of offshore entities or secret bank accounts, the United States must make every effort on our own to obtain the necessary information to enforce the US tax laws. In addition, the United States has negotiated individual treaties or agreements with over 60 countries so it can obtain needed information in cases of tax evasion. Finally, in appropriate circumstances, organisations like the OECD can be used to build a framework for exchanging specific and limited information necessary for the prosecution of illegal activity. We do – and will – guard against over-broad information exchanges in which foreign governments seek information for improper purposes or without proper safeguards. We cannot tolerate those who cheat on their US taxes by hiding behind a cloak of secrecy.

'Where we share common goals, we will continue to work with our G7 partners to achieve these goals. The work of this particular OECD initiative, however, must be refocused on the core element that is our common goal: the need for countries to be able to obtain specific information from other countries upon request in order to prevent the illegal evasion of their tax laws by the dishonest few. In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities'.

INFORMATION

MORE INFORMATION

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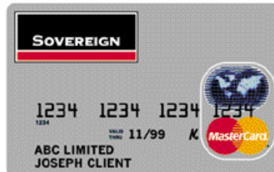

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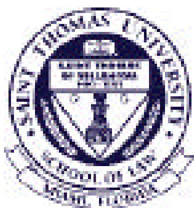

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