

THE FUTURE OF THE RULE OF LAW
IN FINANCIAL REGULATION
IN THE OVERSEAS TERRITORIES

21 November 2000

I think the topic which has been chosen for my discussions with you is intended to imply the question "what will be the rule of law which will govern financial regulation in the future?" It is a question which naturally arises in the prevailing climate of the resolve of the G7 countries in particular to impose their solutions to the perceived global ills of tax evasion and money laundering without any true dialogue with the countries upon which these solutions are to be imposed. The latter are justifiably concerned with the uncertainty of the outcome. That I think is the basis for posing the question fairly in those terms and that is the basis upon which I will proceed with the discussion.

I think I can also fairly begin by saying that speculation about the future is already being narrowed to the extent that we can now identify some changes which have taken place and perhaps some changes to come.

These are changes which are doubtless being generated by the pressure cauldron created by the various international initiatives, but which may well have emerged by consensus without those initiatives, or at least without the approach taken in them.

Cardinal among these must be that principle which prohibits the active and wilful encouragement of the criminal breach of the tax laws of another country.

The genuine concerns of the OECD and other countries to prevent such practices, were concerns which were never in principle precluded by the established norm best known to common lawyers as the principle in *Government of India v Taylor*; viz:¹ that in the absence of a treaty no country is obliged to enforce the fiscal measures of another country.

The absence of an obligation to enforce another country's tax laws did not justify the practice which enabled or encouraged the breach of those laws.

Although permitted by it, that practice was never a concomitant of the prevailing principles of sovereignty and the right of countries to determine their own fiscal regimes. Taking the most benign view one might of the past, practitioners were legally permitted to turn a blind eye to the consequences, as no offence was being committed in their own domicil of practice. Taken

¹ [1955] A.C. 491. (House of Lords).

at its worst, the practice represented "harmful tax competition" as it was indeed inimical to the revenue base of the foreign states.

Nowadays, in the more advanced financial centres, it is my understanding that the more sophisticated practitioners routinely seek to clarify the true nature of the client's transactions and will inform the client that he or she must comply with domestic tax laws and that he or she is not prepared to assist in the evasion of such laws. Moreover, in appropriate cases practitioners will require tax opinions vouchsafing compliance with the tax laws of the clients' domicile. I believe that we can all now agree that there can be little, if any, objection to the imposition of a code of practice which discourages the breach of foreign tax laws as a concomitant to the principles and obligations of international comity.

Indeed, from the point of view of an offshore jurisdiction like the Cayman Islands whose laws do not mirror the criminal tax provisions of the G7 countries, the imposition of such a code of practice may be an advisable course to adopt. I will return to this later.

On international tax matters, another principle which seems to be emerging is that States participating in the new global economy should be obliged to give information which may be required by other States for the enforcement of the criminal breaches of their tax laws.

Given the domestic concerns of countries to preserve their revenue base and the growing concerns over the facility with which capital moves around the world within the new technological economy², the emergence of this new obligation perhaps was also inevitable.³

But even if we recognise the existence of these as new obligations or "core principles"; they do not define the limits of the OECD concept of harmful tax competition or European Union concept of tax harmonisation.

What remains troublesome about these initiatives is the uncertainty over the definition of the obligations which are not at the core but at the periphery.

Such troublesome issues at the periphery include the extent of the obligation to give information for civil and administrative enforcement of tax laws; the extent of the obligation to enforce foreign withholding taxes and the assimilation of tax evasion and tax avoidance for the purposes of demanding access to confidential information.

Some of these are issues which are taken up in the OECD demands for the commitment of so-called tax havens to meet with its approval⁴ even while

² The OECD, Tax Competition and the Future of Tax Reform: Frances Homer, Head of Tax Competition Unit, Fiscal Affairs OECD January 2000.

³ The contrary argument is however equally apparent: countries encourage investment overseas in an attempt to expand their revenue base and so may be deemed obliged themselves to ensure that they obtain the necessary information to enforce it.

⁴ As expressed in the OECD invitation to "tax haven" countries to send commitment letters to its Chairman and later to endorse its form of Collective Memorandum of Understanding.

the same demands would not at this time be allowed as a matter of OECD members' domestic law, nor as between OECD members.

As we look to the future and even as we contemplate the significance of the changes which have already emerged, we will need to understand the implications of those which are only still developing.

I think the time allotted to address you can best be spent by exploring these issues in three broad contexts.

The first will be the context of the international initiatives; primarily the OECD and FATF initiatives.

The second will be the context of the interrelationships between the Overseas Territories, the United Kingdom and the European Community.

The third will be the domestic context and the likely difficulties of responding in a prevailing climate of uncertainty.

The international initiatives

OECD

Tax competition between Sovereign states and between different polities within Sovereign states, is not a new phenomenon. Many economists,

practitioners and business people consider it beneficial. It is a process in which different markets "compete" for business and personnel.⁵

Various spokespersons on behalf of the OECD have acknowledged that tax competition can be beneficial and that the so-called "tax havens" play an important role in international finance.⁶

Notwithstanding these acknowledgements, a reasonable interpretation of the premise of the OECD Report is that tax havens are by definition "harmful".

This labeling of tax havens within an escalating programme of attack, seems to have as its objective nothing less than the moral repudiation of the legal and fiscal regimes and of the business culture of the countries under attack.

As a notable commentator puts it, it is a programme which takes sustenance from itself in that it relies in a self-referential way exclusively upon the thinking generated from within the OECD itself.⁷

This pattern goes back to 1985 when the OECD Committee on Fiscal Affairs produced its report called "Taxation and the abuse of bank secrecy." This was followed by another OECD Report on Globalization of Financial

⁵ See for example Professor Mason Gaffney and Ian Lambert: "International Tax Competition: Harmful or Beneficial? A Response to the OECD Report".

⁶ See for example Gabs Makhlouf: Director of Inland Revenue International Division, UK Treasury; Seminar on the OECD Approach to Tax Competition 3 April 2000; under auspices of European Financial Forum.

⁷ See Graham Mather; President, European Financial Forum: Tax Competition and the OECD, June 2000.

Markets and the tax treatment of income and capital. This Report recommended that the Committee on Fiscal Affairs examine and develop ways to limit the application of bank secrecy provisions.

The culmination has been in the most recent Report of 1998 - that which has generated global concerns entitled "Harmful Tax Competition; an emerging global issue" ("The 1998 Report").

Notwithstanding the lack of public input, the lack of dialogue with "tax havens" in particular and the lack of consultation even with the OECD's own Business and Industry Advisory Committee;⁸ the OECD felt able to prescribe the remedy to this perceived global illness; by recommending⁹ that countries should "review their laws and regulations and practices which govern access to banking information with a view to removing impediments to the access to such information by tax authorities".

In looking forward, it is not my main objective to criticize the lack of objectivity, transparency and dialogue which characterized the OECD process. A lot has been said about that already and others perhaps better able than I will have a lot more to say about it.

What I seek to focus upon here is the far-reaching and ill-defined nature of its proposals.

⁸ See the BIAC's Report: "A business view on Tax Competition"; July 1999.

⁹ The 1998 Report: Recommendation # 7 at page 45.

These are the factors which tend towards uncertainty and instability which are the ultimate enemies of the financial industries of the Overseas Territories.

At paragraph 14 of the *1998 Report* the OECD proposes that:

"Ideally, all Member Countries (and by extension tax havens) should permit tax authorities to have access to bank information, directly or indirectly, for all tax purposes so that tax authorities can fully discharge their revenue raising responsibilities and engage in effective exchanges of information".

Insofar as the OTs are concerned, this recommendation has taken on life in terms of the Advanced Level of Commitment which the OECD has extracted from 6 countries including Bermuda and the Cayman Islands and seeks to extract from some 35 other target countries which it has blacklisted.¹⁰

The agenda specifically on dependent or overseas territories of OECD members was clear enough from the recommendation of the OECD Fiscal Affairs Committee which encourages Member States with dependent or associated territories to promote "within the framework of their

¹⁰ The "non list" as it was sarcastically called by the target countries in response to OECD initial denials of its existence, originally contained 47 names. 6 countries were de-listed and 6 have given Advanced Level Commitments hence the published list of 35 countries.

constitutional arrangements," the implementation of the recommended measures.

The similarity between that OECD recommendation and that touching on the subject of the Overseas Territories within the European Code of Conduct on Taxation¹¹ is not coincidental and carries equally significant implications.¹²

As in the case of the European Code of Conduct, the OECD recommendations do not acknowledge a distinction between tax evasion and tax avoidance or tax planning.

This refusal to acknowledge the distinction between criminal and morally wrong conduct on the one hand and conduct which is legal, economically commendable and often desirable on the other; is a clear danger sign for the future.

From the legal and jurisprudential point of view, the implications are very far-reaching. Most fundamentally, if the prima facie showing of a crime is no longer to be required, then on what proper basis can the proposed invasion of privacy be justified? While it may be the case that some onshore countries are asking the OTs to make the same invasions of privacy as they are allowed to make in their own countries;¹³ the real issue for us will be

¹¹ Subscribed by the Finance Ministers of the European Union in December 1997.

¹² To be further discussed below.

¹³ France and some other civil law countries where the authorities have an unfettered right to information for tax collection purposes.

what should be our obligation as international "good citizens" in our dealings with other countries?

The established international standards still require that before private information is provided to foreign authorities the conduct complained of must constitute a crime.

If we accept the premise that the core principles have changed to include a requirement to give information to interdict criminal tax evasion,¹⁴ one might even also accept the proposition that the dual criminality rule should not apply and so countries should provide assistance even if such conduct would not constitute a crime under their laws. Even in that scenario, the minimum requirement would still be the commission of a criminal breach of the tax laws of the requesting country.

That, however, is still far removed from what the OECD proposes by its refusal to acknowledge the distinction between tax evasion and tax avoidance.

The agenda here seems quite straightforward: it would remove any legal threshold to be crossed by tax authorities in order to gain access to information. Paradoxically, such unfettered access at the international level would not reflect the safeguards which, often because of constitutional

¹⁴ At common, this is enunciated law this is by the House of Lords decision In Re the State of Norway No2 [1990] 1 A.C. 723.

entrenchment, would remain inviolate at the domestic level within some OECD countries. The consequences of that paradox seem obvious enough. Doing business in or through offshore centres would become less attractive for clients from some OECD States as the same safeguards would not exist as would exist within their own States.

The lack of attractiveness here would not simply be one of confidentiality, although that would be an important factor. Another important area of the concern, as I understand it, is that of practicality. For example, a perfectly legitimate offshore transaction, structured for tax planning purposes, would become subject to the scrutiny of interested domiciliary tax authorities. Those involved in the transaction would naturally be concerned whether the transaction will be regarded as falling on the right or wrong side of the tax evasion/tax avoidance line. The resultant uncertainty and delay in the determination of the true status of the transaction - on which side of the line it falls - would likely serve to make the transaction impracticable. Thus, the general uncertainty whether transactions would be regarded as acceptable tax planning or disallowed as being abusive tax practices would become an effective disincentive.

Looked at in that way, it appears that the broad OECD agenda is intended to eliminate the advantages of international tax competition all together. If it succeeds, no so-called tax haven jurisdiction could benefit from its low tax

regime as a base for the structuring of international transactions because total transparency would allow the domiciliary tax authorities the right to examine, approve or disapprove the transaction. To the extent that tax planning is an element of the transaction through the offshore jurisdiction, the element so relegated to the scrutiny of domiciliary tax authorities would lose its attraction due to the unpredictable outcome of that scrutiny.

Given the likely consequences, a clear problem for the future to be addressed by offshore jurisdictions such as the OTs is whether they should be required to allow this sort of uncategorised access to information for tax purposes; ie: without reference to the standard of a prima facie showing of criminal conduct.

There are also the well recognised concerns about the potential for “fishing”.¹⁵

The civil or administrative basis for international access to tax information is not one which is readily given to governance by the rule of law. As there would be no need to reference an existing breach of the tax laws, the request could be entirely open-ended and unspecified. For such a basis to be rationalised, it must proceed upon a presumption that all offshore transactions are illegitimate until proven legitimate. That must be the

¹⁵ As discussed extensively for instance, in *First American Bank v Zayed* 2000 CILR 57, 75 - 80.

presumption upon which tax authorities can demand the right to approve or disapprove of them. It is a presumption which will have peculiar application to offshore jurisdictions or "tax havens". And the justification it seems would be simply because they have been deemed "harmful" by the OECD itself- as places where no "substantial activity" occurs and where by definition transactions are effected only for evasion or "abusive avoidance" of taxes.

The magnitude of the implications here is not to be underestimated. As the BIAC to the OECD observed in its first response to the 1998 Report:

"In our view, multinationals should have the right to structure their international business activities in the most cost effective manner possible, including the minimization of their global tax costs as one of the cost components incurred in the conduct of their business. During the period of growth of the global economy, taxation differentials among countries and subdivisions of countries were the order of the day, and in planning corporate expansion, location decisions were based on many factors, including tax costs, but tax costs were only one factor dictating the location decision - [(others included the availability of professional services, access to capital markets, geographic location, stable government - generally the

countries' ability to service successfully geographically mobile business activities)]. The Report's recommendations, if implemented in whole or in part, would constitute the beginning of the rebirth of artificially imposed restrictions on this flexibility, turning the clock back many years."

Notwithstanding such concerns, no real moral argument can be presented and none has been fully articulated by the OECD. On the contrary, "tax havens" pose no threat to global financial stability. The Report of the Financial Stability Forum of the IMF makes this clear. 16¹⁶

Moreover, the OECD has itself acknowledged that its member states have consistently over recent years experienced increases in the collection of their tax revenues in absolute terms.¹⁷

Nor has there been any attempt at a sustainable argument to show the extent to which so-called "tax havens" enable the illegal evasion of taxes.

Instead, in the OECD Report, we see a liberal intermingling of the tax evasion and money laundering issues. The FATF estimates that "hundreds of billions of ill-gotten dollars" are laundered annually and draws the conclusion that "it is reasonable to assume that a large portion of laundered

¹⁶ Dated March 2000. This is notwithstanding its later report in which the FSF described varying levels of regulatory short-comings within the offshore jurisdictions.

¹⁷ The BIAAC Report op. cit. Annex 11: OECD Trend Statistics (total tax revenues as percentage of GDP).

funds have escaped taxation in one or more jurisdictions".¹⁸ No separate argument has been presented to support the notion that legitimate money is transacted on a massive scale through "tax havens" to evade taxes. This is loose and woolly thinking.

For all these reasons, it will also be of critical importance to the OTs in the future to determine whether this intermingling or interface of tax and money laundering issues is legally justifiable.

The interface of tax and money laundering

If not justifiable, then it should not be allowed as a basis for draconian measures against fiscal sovereignty and against individuals' rights to confidentiality.

At the practical level, the likely consequences of an attempt at legislating to create the interface of tax and money-laundering issues is starkly illustrated by the experience of those countries which have sought to include tax evasion as a money laundering crime.¹⁹

As the concept is as fungible as money itself, the due diligence responsibilities become extremely difficult, if not impossible, to define. A transaction which starts life offshore free of any taint of tax evasion in the

¹⁸ In its 1996 Annual Report.

¹⁹ Britain itself and among British territories, Bermuda and Jersey are examples.

home country, could nonetheless be deemed to impose due diligence obligations to ensure that no tax offence arises as the underlying capital remains offshore or its transaction changes it and increases its value or when it is to be repatriated.

A notable commentator²⁰ on the equivalent UK Legislation (Section 93 C of the Criminal Justice Act) reflects upon the due diligence burdens it imposes upon professionals and their clients in these terms:

"This deeply unattractive invasion of professional standards and relationships was readily accepted in cases which involve drug or terrorist offences, but it has taken a while for the UK professionals to realise the Government really expects them to take such steps for the sake of helping foreign revenue authorities collect their taxes.

It must be borne in mind that none of these foreign governments (with the possible exception of Belgium and Denmark) have themselves introduced similar legislation. Lawyers with whom I have discussed this in the United States tell me it is very unlikely that the US Government would ever contemplate applying similar legislation at least as far as it

²⁰John Rhodes (of the Law Firm of Macfarlanes in the U.K.) "The Impact of the UK Money Laundering Legislation on Fiscal Crime.

might affect lawyers there because of the importance they attach to client confidentiality."

Perhaps the first and most obvious legal question arising is what is meant in the legislation by the "proceeds of criminal conduct" in relation to tax offences.

Another obvious legal question would be: If the money involved was lawfully obtained in the first place, at what stage and by dint of what activity does it become the proceeds of crime?

These are just some of the difficulties to be resolved if the interface between money laundering and tax evasion is to become a normative basis for international legal response to tax issues in the future.

The attempt at creating an interface between money laundering and tax evasion as a basis for an obligation to enforce foreign tax laws, raises myriad other practical problems and difficulties.²¹ An example is the issue over whether a local professional will need to become knowledgeable about the tax laws of the domicile of his client.

Given that Her Majesty's Government has made clear its present policy for the OTs in this regard, I will return to comment further upon this in the next

²¹ For a further discussion see Rhodes *op. cit.* and Gilmore: Professor of International Criminal Law University of Edinburgh: "Money Laundering and International Tax Co-Operation: Exploring the Interface," paper to the European Financial Forum June 2000.

section of this paper where it can more appropriately be addressed in the context of the relationship between the United Kingdom and the OTs. Before leaving the subject in this context, I must acknowledge the truism reflected in the FATF's recognition of the relationship between money laundering and tax offences in its warning against the possible abuse of the "fiscal excuse loophole" by drug money launderers and other organized criminals:²²

²² Recommendation 15 of the FATF 40 recommendations and interpretative notes: FATF Annual Report 1998 - 1999 p.33

The modern interrelationships: The United Kingdom, the Overseas Territories and the European Union

In his White Paper issued in March 1999 the Foreign Minister Mr. Robin Cook referring to the UK's Overseas Territories stated:

"They have a responsibility to ensure that their regulatory regimes are effective, transparent and offer adequate accessibility for the legitimate investigation of criminal activity, including tax fraud and evasion."

If we regard the statement as asserting or reflecting the new standards for international relations on tax, I think as a statement of principle it must now be regarded as unexceptionable.

As to just how the British Overseas Territories are to meet that mandate and what steps remain to be taken to do so, is the subject of the recently completed KPMG Review.²³

In its conclusions on the question of the interface between money laundering and tax crimes, the KPMG Report proffers guidance in general and standard

²³ Review of Financial Regulations in the Caribbean Overseas Territories and Bermuda, Reports published in October 2000.

terms. The advice is that the Overseas Territories should recognise and assume the responsibility of treating tax evasion as a money laundering offence in the way the United Kingdom does, notwithstanding the absence of dual criminality.

The justification is stated in terms that "failure to apply that treatment makes it easier for criminals to get away with tax evasion which is a serious crime in and of itself and undermines efforts to combat other forms of offending". However, in response to the difficulties arising from the scenario of the money involved being originally lawfully obtained or earned, the Report observes:

"There is also an argument the "there is no such thing as the laundering of money from tax fraud" on the grounds that it involves the concealment of legitimately obtained money. However, the proceeds of tax evasion are still the proceeds of crime".

Thus, the justification for the interface in the Report appears to be that the money laundering offence where the predicate is tax evasion, should be regarded as activity intended to enable the successful evasion of taxes which would be due on the amounts which would be liable to tax.

One might reasonably conclude that that takes us full circle back to tax evasion as the real concern.

Nonetheless the KPMG Report concludes in the following terms:

"As part of the efforts to combat money laundering the UK is encouraging others to close loopholes. We would therefore encourage the OTs to ensure, in whatever way is most appropriate for the individual jurisdictions, that assistance can be provided in money laundering cases involving, or appearing to involve, tax offences, at least to the extent that the UK itself is able".

I think the emphasis here must be upon the words "whatever may be the most appropriate way for the individual jurisdictions".

In considering that advice in the context of making tax evasion a money laundering offence, I think the note of caution must be that penal legislation must always carry certainty of application. The rules or regulations must be clear and capable of application so that one can be assured of avoiding penal sanction if one seeks to comply.

We have seen examples of the difficulties which arise in treating tax evasion as a money laundering crime if there is lack of definition of the activity

being criminalized. This is further evident, for example, from the Jersey Code of Practice.²⁴ There, although the Proceeds of Criminal Conduct Law treats tax evasion as a money laundering offence, the Code of Practice issued by the Jersey Financial Services Commission has found it necessary to contain qualifications such as the following:

"A financial service business is not under a duty to investigate the tax affairs of its customers. A financial service business is not required by law to possess a knowledge of the tax laws of a foreign jurisdiction".

"A suspicion that a customer is merely intending to commit a tax related offence is not sufficient for the purposes of the law."

"A financial service business may reasonably assume that its customers will meet their liabilities - the assumption is unlikely to be set aside, and relevant knowledge or suspicion arise, unless there is something tangible pointing to acts which amount to deceit or dishonesty".

²⁴Issued with the Proceeds of Crime (Jersey) Law 1999 and the Money Laundering (Jersey) Order 1999.

Those extracts say what the offence of laundering the proceeds of tax evasion is not, but not what conduct constitutes the offence.

I think they also fairly pose the question whether, as we look to the future, the criminal standard should be that only where there is "tangible" evidence of deceit or dishonesty could it be possible to impose penal liability for breach of a duty to report under the Proceeds of Crime laws in respect of tax evasion by a client or customer.

If so, that would seem to be a departure from the standard of "reasonable suspicion or belief" which typically underpins the due diligence duties in respect of other money laundering crimes.

These are some of the kinds of difficulties which are bound to arise from the artificiality of treating tax evasion as a money laundering crime and which will have to be addressed.

Otherwise, although there may be no predicate offence of tax evasion when one first becomes involved with a client, a practitioner in the OTs could be placed at risk of committing an offence in the OTs if it turns out that the client for whom he acts subsequently embarks upon a tax evasion scheme. A further problem with including tax evasion in the Proceeds of Criminal Conduct laws is that it introduces a uniform regime which fails to

distinguish between overseas tax regimes. By introducing the notion of tax criminality into domestic laws it makes it difficult to refuse assistance to any country, even those whose citizens placed assets their offshore out of fear of repression, terrorism or kidnapping.

Yet another difficulty with introducing tax evasion into the PCCL is its practical retroactive effect, because once money has been placed offshore and becomes money on which tax has never been paid, disclosure to tax authorities will enable them to prosecute for tax evasion in prior years. This is although the tax payer would have committed no offence under the laws of OT where he had kept his assets.

These are issues which the OTs will need to address as a matter of public policy concerns of fairness. At the very least they seem to give rise to the question whether some form of amnesty would not be appropriate.

More fundamentally, from the point of view of professionals and practitioners in the OTs these problems also suggest the need for a fairer and more certain basis for the creation of potential criminal liability against them. It is here that the earlier reference to a criminal code of conduct fits in. It could be one that criminalizes the wilful involvement in assisting a client to breach the tax laws of his home country and criminalizes the solicitation (by advertisement or otherwise) of business which would involve that type of activity.

In this manner, the OTs would be creating their own Foreign Tax Offences Laws by which certainty and fairness can be ensured.

Having digressed somewhat, I return to the KPMG Review. I think that in its generality, the KPMG Review is to be welcomed. Although one might reasonably question its timeliness, its relevance is not in my view diminished because of the position already taken by the FATF.²⁵

As a reference for determining the status of regulatory and law enforcement functions in the Overseas Territories, the KPMG Review is objectively intended to be relied upon to inform the processes of change, where change is needed.

As those of us who live and practice in the OTs knew all along, it has also served to confirm that we are not quite the laggards that the FATF and the Financial Stability Forum Reports would make us out to be.

Because of its provenance, the KPMG Review also carries the potential to be the touchstone for agreed changes as between Her Majesty's Government and the OTs in a constructive way.

In particular, given the sensitivities of the OECD and E.U. Tax harmonisation initiatives and indeed the FATF initiative, there may well

²⁵ In its blacklisting of 15 non-co-operating jurisdictions including some U.K. OT's in the Report of 22.6.2000.

now be a standard for agreement on change as between the OTs and the UK Government consistent with the Constitutional relationships which recognise that the OTs have the right to determine the nature of their own fiscal Regimes.²⁶

Again, when we turn to consider what changes would be appropriate, the pressing issues would not be those involving the core principles already recognized, but those at the periphery.

Certainly in the case of the Cayman Islands and Bermuda which have already given "Advanced Commitment" to the OECD, the provision of assistance in respect of tax evasion crimes is already agreed in principle and subject to the appropriate bi-lateral or multi-lateral arrangements to be put in place, will commence after December 2003.

Under the OECD agenda, an important issue which is now at the periphery but which will be brought center stage come the end of December 2005²⁷ will be the requirement that countries give assistance for the enforcement of civil and administrative tax measures without regard to whether the issue is tax evasion or tax avoidance.

²⁶ As confirmed in the UK Report (dated 16 November 1998) submitted to the Code of Conduct Group of the European Council in which it was pointed out that HMG's reserved powers eg; for order and good government in the OTs, have never been used to legislate for taxation and that in some territories these arrangements have been in place for centuries. The view taken in the Cayman Islands is that this amounts to an inviolable Constitutional Convention.

²⁷ See proposed Letters of Advanced Commitment, draft MOU (op. cit.) and draft Convention Proposed by the OECD Secretariat, 11 October 2000.

As the Advanced Commitments given in this regard are predicated upon there being a level playing field by 2005, it follows that there should also be the requirement that the international standards then prevailing generally require that level of assistance.

However, already we see among the European Union and OECD members an unwillingness to go that far at this stage.²⁸

In the case of the E.U. - led by the UK's position on exchange of information rather than withholding taxes - the expressed intention is to provide routine automatic disclosure of information for all tax purposes not now but at some unspecified time in the future.

Moreover the UK's position paper²⁹ states in this regard in reflecting upon the need for a level playing field:

"Countries identified by the OECD as tax havens will quite properly expect E.U. and other OECD member countries to meet at least the same standard of effective exchange of information including access to and exchange of bank information for tax purposes, as they themselves are expected to meet under the Harmful Tax Competition initiative."

²⁸See Report of Committee on Fiscal Affairs 12 April 2000.

²⁹H.M. Treasury Inland Revenue February 2000.

Given the programme of economic unification which is at the heart of its mission, the E.U. tax harmonisation initiative may objectively be regarded as being important to European Union success. Seen in that light, the exchange of information on taxation as between the E.U members is a natural development.

But this does not hold true for the rest of the free-market world and already we have heard vociferous voices in repudiation of the OECD initiative to so extend it, from very influential quarters within the United States Congress. The dissenting views have been bluntly expressed:³⁰

"[The OECD] effort is designed in effect to create a tax cartel and, if the OECD succeeds, our nation will face the risk of higher taxes and a weakened economy while developing nations will be hamstrung in their attempts to promote economic growth. ...Mr. Secretary, I hope that you are not committing the United States to actions that are unlikely to receive the approval of Congress. In upcoming years, we intend to implement tax cuts that will make America more attractive to the world's investors, regardless of whether the bureaucrats at the OECD think this is "harmful competition".

³⁰ U.S. Republic Majority Leader of Con H.M. Treasury Inland Revenue February 2000.
OECD initiatives sent to the Treasury Secretary Lawrence Summers

Such developments suggest that in five years time the international community will not be speaking with one voice on these issues, which are now at the periphery of developments.

In anticipating what their response should be in the future to these issues, it must now be paramount that the OTs arrive at an understanding with the UK Government "within the framework of the existing Constitutional arrangements" as to what will be the basis for defining the international standards to be met and the import of the Constitutional arrangements to their responses.

In the debate to distinguish "harmful" from "beneficial" tax competition the OTs will have to be vigilantly opposed to the fiction created by the OECD which suggests that because they have no "substantial activities" their tax regimes are intended only to undermine those of other countries.

It is a fiction that ignores the important value that professional services add to the process of international finance and investment.³¹

The domestic context

In looking at the interface between tax evasion and money laundering, we have touched upon an example of the difficulties which can arise in the

³¹ This argument in support of the value added by "tax havens" is forcefully made by the BIAC in its Report (op. cit.).

domestic as well as international application of the Proceeds of Crime Laws. Given the constraints of time now for focusing on the problems which may arise at the domestic level, I think I will confine myself to only one further subject.

Yet another subject - very involved indeed - as to whether the OTs should accept that it is in their public interest to have in effect to create new regimes of record keeping and reporting so as to give effect to requests from foreign tax authorities, is a matter to be very carefully considered. By way of general comment in passing, it seems only practicable that the OTs' financial industry should be required to maintain records primarily for meeting the requirements of local regulation and standards; with only such limited additional burdens for the purpose of meeting foreign tax demands, as the market can reasonably be expected to bear.

The subject upon which I will finally touch now is the issue of confidentiality - a very large subject in and on itself.

Confidentiality

Now that the debate on harmful tax competition has matured somewhat, it is now being openly admitted by G7 personnel that private client confidentiality or "bank secrecy" as it is sometimes generically (and inaccurately) called, is not necessarily anathema to good regulatory practices

or international exchange of information. As Mr. Gabriel Makhlouf³² stated in his announcement of the OECD Report on Access to Bank Information for Tax Purposes:

"...let me be clear about one thing: this Report does not mean the end of bank secrecy. The Report is quite explicit in recognizing the legitimate role that bank secrecy plays in protecting the confidentiality of financial affairs and in maintaining the soundness of financial systems".

It is clear now as it will be in the future that a balance needs to be struck and maintained as between the rights of the client to confidentiality and the needs of law enforcement and regulators for access to information.

The KPMG Reports recognise the modern trend which requires that the regulatory authorities be able to provide assistance directly to their overseas counterparts for regulatory purposes.

In the case of the Cayman Islands - as I understand the policy - the enabling legislation which was recently passed will be underpinned by "regulator-to-

³² Chairman of the Committee on Fiscal Affairs of the OECD; 12 April 2000

regulator" agreements which will embody the working rules as between them and set the minimum standards to be met before assistance can be given.

Where private client confidentiality is involved, as distinct from corporate or wholesale banking information, "regulator-to-regulator" assistance may still reasonably be regarded as a novel practice where the OTs are concerned.

The traditional basis for disclosing private client information is the suspicion or proof of the commission of crime. Where that sort of information is to be provided from regulator to regulator absent any allegation or proof of crime, standards will be new and must be carefully elaborated.

The KPMG Report on the Cayman Islands at page 120 (paragraph 14.10.2.1) recognises that the CIMA³³ now has the power to obtain and pass on private client information to foreign regulators but adds the following caveat:

"It is acceptable for the disclosure of client information to be restricted to access for established regulatory needs and to be subject to strict conditions on non-disclosure".

Indeed the Basle Committee³⁴ has advised that the provision of private client

³³ Cayman Islands Monetary Authority - since the amendments to the Monetary Authority Law in September 2000.

³⁴ Basle Committee of Banking Supervisors: "List of Core Principles for Effective Banking Supervision" and "The Principles for the Supervision of Cross-border Banking" developed in collaboration with the Offshore Group of Banking Supervisors and endorsed by 130 countries at the International Conference of

information on a "regulator-to-regulator" basis in the absence of crime, can only be an exceptional matter.³⁵ An example of this arises where the liquidity of a bank may be affected by over-exposure to a single client or group of clients.

This however is in stark contrast to the OECD position on tax which will seek to require routine disclosure.

The message here for the OTs as we look to the future of the rule of law in financial regulation must be the need for caution and care. This, of course, must be towards ensuring that the balance between protecting the legitimate interests of the client public and providing assistance to the regulators and law enforcers (domestic and foreign) is maintained.

Even in the midst of the international initiatives and imperatives under discussion, the OECD Member Governments have themselves expressed intentions to refine and strengthen laws which protect the rights to privacy of their citizens.³⁶ It seems there will soon be emerging new international

Banking Supervisors, June 1996.

³⁵ Core Principles 9, 15 and 19

³⁶ See for example Canada's "Personal Information Protection and Electronic Documents Act" which has been described by the Canadian Law Firm of Torys as "responding to E.U. directives which require EU countries to pass legislation prohibiting the transfer of personal information to countries that do not have an adequate level of privacy protection and to public opinion in Canada which favours increased privacy protection"; Practice Note 7th April 2000.

standards also as to what those rights should be and how they are to be balanced against the needs of law enforcement and regulators.

It is worthy of note that the KPMG Report appears in principle to accept the validity and workability of the existing confidentiality laws such as that of the Cayman Islands. The Cayman Islands KPMG Report suggests no justification for the deprecatory or pejorative "secrecy" labels with which the OECD/FATF have sought to tarnish those laws.

The interests of the OTs themselves and of their legitimate client public recognise many good reasons why client confidentiality should be preserved.³⁷ In our anxiety to respond to external pressures and such new international standards as are to be properly maintained, we must be careful and measured even while we are helpful in our response.

The OTs should also be astute to ensure that their voices are heard in the emerging international debate on private client confidentiality so that the standards which emerge will have been influenced by their own socio-economic and political needs as well as those of the countries in the driver's seat of the international initiatives.

³⁷ For example fear of kidnapping for ransom by terrorists or criminals; fear of confiscation by or reprisals from repressive regimes; protection of trade secrets from competitors; market sensitivities; protection from insider dealing; protection against "unfair" forced heirship laws etc...

As George Bernard Shaw is said to have advised:

"Take care to get what you like or you will be forced to like what you get."

Hon. Anthony Smellie
CHIEF JUSTICE
CAYMAN ISLANDS

Date the 10th November 2000.