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Indian Wars

Remember Humpty Dumpty? He featured in this newsletter last June (Who is to be Master? Volume 12, Number 2) when I wrote about the Organisation for Economic Co-operation and Development's Model Tax Convention. If beauty is in the eye of the beholder, is a spoken word's meaning equally subjective, being in the ear of the listener? In Humpty Dumpty's world, as Alice in Wonderland was told, a word means what he chooses it to mean, and in the absence of an office of Grand Interpreter of Tax Co-operation, as I wrote before, who will decide when a tax information request from a foreign country falls within the spirit of the rules that are to be applied? What would the jovial egg, sitting on his wall, make of that part of the MTC which requires information about an individual's tax affairs to be released when it is "foreseeably relevant" (sic)? To quote the defining words in Article 26 of the Convention. Humpty's opinion would depend on which side of the wall his legs were, I suppose: in other words, where his interests lay. The late American actor, John Wayne, is said to have reasoned thus: "I don't feel we did wrong in taking this great country away from them. There were great numbers of people who needed new land and the Indians were selfishly trying to keep it for themselves". Most certainly this logic would turn the abbreviation, US, used to identify the superpower, into a pronoun, being the objective case of "we".

One thing's for sure: the US is looking for scalps, like the Indians did, and vague, if grammatically

incorrect, terms such as "foreseeably relevant" are its tomahawk in the present campaign against Switzerland over hidden tax income. Remember, the US has charged UBS AG of Switzerland with aiding and abetting US taxpayers not to pay their share at a time when public finances dictate a need to recover every possible cent of taxes due. In this the US is simply echoing the words of the 19th-century British prime minister, Lord Palmerston, who believed that his government had "no eternal allies and we have no perpetual enemies. Our interests are eternal and perpetual, and those interests it is our duty to follow". There's that "we" again. But Article 26 of the MTC also mentions that tax information should not be supplied that, inter alia, would be contrary to public policy, let alone the law. Such a situation has arisen because of a Swiss court case heard in January that conflicts with both the existing tax treaty and the UBS agreement made with the US government; public policy and the law have put Bern in a quandary.

The agreement with UBS had been seen as the most palatable solution to rescue the bank from imminent disaster following the original position taken by the US which demanded that UBS disclose information on 50,000 American clients. This number was finally whittled down to only 4,450 names (those believed to have been involved in particularly egregious tax evasion or fraud) and in addition, the bank paid a \$780 million penalty under the terms of a deferred prosecution agreement.

Now, before we go any further, we must not lose sight of the fact that this triumph for the US Internal Revenue Service came about because of the complicity of UBS and not because the ramparts protecting the principle of Swiss bank secrecy were stormed and breached.; if that were so, the January case would be inconsequential. This was not D-Day, it was, in essence, the duplicity of, ironically, an American, Bradley Birkenfeld, who worked for UBS. Not steeped in Swiss banking traditions, he changed the bank's famous three-key logo from a symbol of security to one signifying easy access to locked doors. But that access, because of the Swiss court, has now been blocked and the UBS agreement has been placed in animated suspension.

The UBS agreement allowed any affected clients to still challenge the release of information under Switzerland's existing privacy laws; this fell in line with the US intention of smoothing the political waters between the two countries but which has now put the agreement in jeopardy after a UBS client won an appeal in January which prevented her account information being given to the US authorities; presently there are a further 25 similar cases in the works. Meanwhile, until the situation has been clarified – the Swiss tax authorities had a right of appeal – Switzerland will not provide any further UBS files to the IRS (6, so far, have been sent out of 1174) according to Swiss justice minister, Eveline Widmer-Schlumpf.

The Swiss Federal Administrative Court that heard the American woman's appeal found that her failure to fill out a required tax form, notwithstanding the sums involved (she is a millionaire), was not fraud or fraud-like activity under Swiss law. Fraud must be present before Switzerland's banking secrecy can be relaxed and Swiss law defines tax evasion as failing to declare income, which is treated as a civil offence (as it is in Panama). Tax fraud, on the other hand, and which extends to falsifying documents, is a criminal offence and if the woman had committed such a crime her data could be released.

Naked Bankers

Earlier in January the alarm had sounded when the very same court, but in a separate case, ruled against the release of another UBS client's information to the US although this case hinged on procedures and not principles unlike the second case which goes to the very root of the bank secrecy laws. In the first case the Swiss financial watchdog, the Financial Market Supervisory Authority, had authorised disclosure of 255 UBS account details to the IRS but the court subsequently ruled that this was unlawful as only the court could sanction such action. FINMA has since appealed against the ruling while the court has made clear the distinct differences between the two UBS cases. Administrative assistance under the law can only be given to the US in terms of the present double taxation treaty entered into between the two countries which permits co-operation only in cases of "fraud and the like". The like? Applying that term surely must be enough to make Humpty Dumpty fall off his wall, with the Swiss Federal Administrative Court's reference to fraud-like activity ringing in his ears as he hits the ground.

The Swiss justice department last November had said that most of the names of the UBS account holders intended to be handed over to the IRS belonged to people suspected of serious fraud rather than tax evasion; but based on the court's January decision in this second case, only 250 of the 4,450 names requested should be made available. The Swiss justice minister has said that "formal or material changes" to the tax treaty with the US are now a possibility; alternatively, the Swiss parliament could approve changes to the law which would allow co-operation with the US in less serious cases of tax evasion, enabling release of all 4,450 names. In the past opposition political parties have threatened to oppose any attempt to dilute bank secrecy and the justice minister expects that any eventual settlement reached with the US will require parliamentary approval to changes in Swiss law. But in acknowledging her intent to reach an amicable outcome, she has said that there will be no emergency decree to fast-track any changes to the law.

I appreciate that writing a newsletter like the Offshore Pilot Quarterly does not have the instant update of the internet and commentary can become redundant through events, but I can't see a quick-fix solution. Already the Swiss justice minister has said that UBS could collapse if talks with the US break down and her position has been made clear: "We have nothing to blame ourselves for. I don't think anyone could prove that we acted badly". UBS has said that it fully supports its government's decision to engage the US in talks but that it will "fulfil all our commitments under the agreement" if necessary.

The facts show that UBS, not the Swiss government, is to blame for the position the bank finds itself in and the IRS probably can't believe its luck: the largest bank in Switzerland caught red-handed conspiring and aiding American taxpayers to evade taxes. There is no defence and there shouldn't be. Is there another way out for UBS and Switzerland? According to some experts, the current UBS agreement includes a provision that if 10,000 of the bank's customers voluntarily come clean under a US tax amnesty programme, then this will be an acceptable alternative for the IRS. The 31st December, 2009, amnesty deadline has been extended by the US to a new, but so far undisclosed, deadline.

This month in the Southern hemisphere, naturists are celebrating their nudity with a naked bike ride. UBS management must feel just as exposed, and at the same time they must be hoping that as events unfold, they won't include a slip from the saddle to the crossbar for the bank's chairman and his board.

Reserved Comment

I have said before that Panama is looking to developments in Switzerland for guidance in its own approach to international tax co-operation; the silver lining in the UBS affair could be that the eventual outcome will lead to a set of tax treaty guidelines which Panama (and other jurisdictions) can equally apply. Now that the UBS case is no longer an international front page story, maybe cooler heads will prevail and the Swiss will be able to save (some) face. As developments occur, Panama (as it negotiates tax treaties) should study

them very carefully. In Hong Kong, for example, tax information rules proposed will restrict investigations just to income tax and every enquiry must be justified, specific and relevant. The taxpayer would have to be notified of the enquiry and, importantly, the information released must not relate to a period before the effective date of the tax treaty.

As I finish writing, Panama has just held its 100th annual Carnival and it is surprising to reflect that a year has past since my 2009 February column in Offshore Investment.com (Latin Letter) when I wrote about the situation in Delaware in the context of the transparency standards demanded by the US of all international offshore finance centres ("Man, Angels and Brazil"). One year on that state continues to allow the identities of owners of companies to remain anonymous; nothing has changed except the carnival floats in this year's parade along Panama's Via España in the city. Those who read the Letter from Panama in January or Latin Letter ("The Spirit of Palmerston") last month will know, however, that Delaware is not the only US state with opaque practices which have been otherwise condemned by the US government; Nevada, for example, is no better.

If the US was not in the vanguard of the OECD's collective outcry against jurisdictions whose laws keep shareholders' names secret, hobbling tax collectors pursuing them, this application of double standards – whilst distasteful – would not be so astounding. Jeffrey Owens, head of the OECD's tax division, acknowledges the difficulty with Delaware and has said "there is a discussion going on within the US" and that "There are a number of bills that have been put forward to address this issue, so I am sure it is an issue that will eventually be addressed". Why the delay? Tax Justice Network, a non-profit organisation, has said that despite the US commitment to strict tax transparency, Delaware is the world's most secretive jurisdiction. A stretch perhaps, but the message is clear and despite Delaware and Nevada, the OECD has said that the focus of the Global Forum on Transparency and Exchange of Information, which is under its auspices, although now an independent

body, is changing from getting commitments to achieving an effective implementation of the standards.

The OECD itself has publicly declared that it accepts the right of all governments to obtain the names of tax cheats by fair means or foul. If this means receiving data stolen from banks (a criminal act) then so be it; I recall a former US Attorney General endorsing torture, another criminal act. Little wonder that private banks in Switzerland are lobbying their government to introduce a ban on the use of stolen bank data in tax enquiries. So criminality becomes the taxman's ally and one wonders what form of fiscal, as opposed to physical, waterboarding might be in store for taxpayers. It would seem that anything is possible, although Alice in Wonderland struggled with this

contention. If Humpty Dumpty confused her, then the Queen most certainly did.

"There's no use trying," she said, "one can't believe impossible things."

"I daresay you haven't had much practice," said the Queen. "When I was your age, I always did it for half-an-hour a day. Why sometimes I believed as many as six impossible things before breakfast!"

In the meantime, is it possible that the US president will bring pressure to bear on Nevada and other non-transparent states? The OECD's Global Forum should certainly raise the matter when it meets in Singapore in October, unless, of course, there are changes before then. Like today's Native American Indians, however, I have my reservations. John Wayne would have understood.

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