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Public Hearing

The Role of Lawyers, Accountants and Bankers in Panama Papers - (Part I)

Tuesday, 24 January 2017 (9h00 - 12h30)
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Brussels

Written questions to Professor Ronen Palan, Senior advisor, Tax Justice Network

1. Have you analysed the Panama Papers leak in any way? What would you say are the breaches to EU law that can be identified? Is there a problem in the design of the control instruments? Or in the implementation of anti-tax evasion and anti-money laundering directives? In what ways would you improve the current framework or plug loopholes to tackle money laundry, tax avoidance and tax evasion?

   Answer:

   To put the Panama papers in context, the demand side for offshore 'services' arise from three main sources: First, laundered proceeds of criminal behaviour including corruption, embezzlement, organised crime and the like; Second, wealth preservation by HNWI seeking tax avoidance and evasion in order reduce their taxable bills and/protect their or their family's wealth. Third, tax optimisation strategies of international firms. The first source of demand is the most spectacular and clearly falls foul of many national and EU laws on tax evasion, money laundering and corruption. But in sheer volume term and/or

overall significance to the world economy, it is arguably the smallest item on the offshore menu.

In addition, the strategies of evasion and avoidance can be divided broadly into three categories: secrecy and opacity facilities to obscure links between assets and owners of capital; arbitrage techniques, namely, use of breaks, loopholes and incompatible international legislations in order to fall 'between the cracks' of taxation rules; the use of sophisticated financial techniques such as derivatives and swaps for tax planning purposes. While much of the international effort to combat tax evasion and avoidance has been focused for the past two decades on secrecy and opacity, it is becoming increasingly clear that arbitrage plays equally, if not greater role, in securing avoidance and possibly sometimes evasion. The OECD BEPS project is concerned primarily, therefore, with arbitrage. There is little research so far on the subject of financial engineering, the use of derivatives and swaps arrangement. But in my opinion financial engineering may be the largest source of tax avoidance in the world. To its merit, the OECD BEPS' scheme is concerned with financial swaps arrangements.

The Panama papers confirm (what was suspected by the academic community) that Panama caters largely to the first and second demand groups, namely, criminals, corrupt officials, as well as wealthy individuals – although for reasons that I discuss below, Panama is less suited for wealth management strategies of HNWI (because of its poor reputation). Large multinational firms appeared to have stayed clear of Panama, in particular in the past few years. It appears that also due to the introduction of the US FATCA and other measures, very few US citizens have made use of Panama in the past few years (as opposed to the past). Citizens of EU countries as well are less represented in the Panama papers. The majority of users tend to arise from emerging markets.

Issues of concern with Panama are centred almost exclusively on the first strategy, secrecy. That makes Panama an 'outlier' in the offshore world, one of the last holdouts of 'old' style evasion strategies through offshore jurisdictions. It is an incredibly spectacular case for the reasons described above, but in terms of sheer volume of tax avoided, I suspect that Panama is far less important, then, say, what we have learned from HSBC scandal in one branch Geneva (which covered deposits at one point in excess of $120,000,000,000, please bear in mind that HSBC has branches in Zurich, Bern and the like as well), or the information gleaned from the so-called Luxleaks.

The Panama papers reveal, therefore, that Panama is no longer used much by large multinational firms, as well as HNWIs from advanced countries. I believe, although I do not have firm evidence to corroborate my hunch, is that this positive trend is most probably the result of the tightening rules and policies adopted by OECD countries, combined with Panama's poor reputation. Anecdotally, I have heard for the past few years from those working for 'enablers' firms in advanced countries, accounting, legal and wealth management firms, advice their clients to shy away from Panama.

With regards breaches of EU law, I would like to stress that breach of national or EU laws is a matter for the Courts. Each case must be looked at individually by the Courts. Having said that, nearly all the stories that I have heard so far relating to Panama papers arise suspicion in the sense that an economic logic of transacting through Panama is not obvious.

TJN has been a vociferous critique of the Global Forum on Transparency and Exchange of Information (TEIA) for tax purposes. The peer review process, we believed, relies far too much on unverified response of participating countries, both on the demand and supply side. We also heard anecdotally comments from various reviewers how criticisms were toned down or either ignored altogether. Following the release of the Panama papers, The OECD put a brave face claiming that it pointed out to Panama's failure to cooperate on critical matters. That is correct up to a point. The OECD's supplementary peer review report on Phase 1 of its review published in 2015 (before the leaks) sounded probably more upbeat then the OECD would have liked to acknowledged at this point.

I quote: 'The 2014 Supplementary Report concluded that six of the ten essential elements were in place. Two of the essential elements were determined to be 'not in place'. These were the availability of ownership and identity information (element A,1); and the availability of accounting records (Element A,2). One essential element related to Panama's network of information exchange mechanisms with the relevant partners (element C 2) was determined to be 'in place but certain aspects of the legal implementation of the element needed improvement'. Another essential element concerning Panama's ability to provide information in a timely manner (element C 5) involves practical issues that will be assessed at a larger stage.

The Supplementary report commend Panama on progress made and hence Panama was able to move to a Phase 2. I quote 'significant amendments have been made to the legal framework governing the availability of ownership information in Panama (Element A 1).. the report goes on to list the positive steps taken by Panama.

I appreciate the political environment in which the OECD must operate, but I submit that none of the information that we have learned from the Panama papers could have been discovered even if Panama performed better on phase 2. TIEAs are far too cumbersome and would not have helped much. Under the TIEA system, a foreign authority would have had to request information on a specific case, and would have had to provide some incriminating information to Panama for a case to be opened. Most of the cases on Panama papers were not known to foreign authorities. In addition, many emerging governments are heavily implicated in Panama, including Thailand and Russia, and both governments showed no interest in pursuing any cases. In Thailand, for instance, the Prime Minister (whose name cropped up in the Panama papers) declared such matters to be 'private affairs'. In short, TIEAs were never designed to solve serious problems. Even the system of automatic exchange of information that TJN advocated for years and is supposed to come to effect next year is not a

panacea. If automatic exchange agreements are implemented, a big 'if' at this point (We are studying the implementation phase under an EU funded project entitled COFFER, including the underlying technology of Legal Entity Identifiers (LEI) that will supposedly support those automatic exchanges – and at the moment I would not be overly optimistic), they will be available to national authorities, many of which, including I believe, the British, are reluctant to pursue cases for political reasons. The various leaks and scandals show us that there is still a very long way to go.

Most worryingly, Panama found a creative way of intimidating its critics by using WTO dispute resolution facility again Argentine. In December 2010, Panama requested a ruling by the WTO against a number of preventative anti-avoidance measures adopted by Argentine that Panama claimed, were inconsistent with certain aspects of the GATT and GATS agreement. Panama has tried something similar with Colombia as well.

2. Would you say that it is necessary to regulate intermediaries further? Please specify.

   Yes, but the question is what sort of regulations. Red tape as such will not help resolve any of the problems revealed by the Panama papers. I am not aware of a systemic academic study of the enablers firms to date save the recent published book of professor Herrington's on the wealth management industry. But for reasons well explained in her book, professor Herrington could not provide a good statistical overview of the size of the problem.

   The lack of academic study can be explained by a. the great reluctance of the enablers firms to participate in such studies, combined with lack of access to either corporate archives or inland revenue and treasury archives. b. even if any of the above would have been forthcoming, many funders, including the EU's own ERC and the Commission's ethics rule would have either prevented such studies or would compromise them to the point of rendering them ineffectual.

   My assessment of the enablers profession is based, therefore, largely on following newspapers reports from around the world for many years, discussions with the enablers themselves, networking with the academic community of specialists and bits of information and anecdotes revealed to me from a variety of sources. I would divide the 'enablers' into different categories:

   1. Accounting firms, primarily the big four, who are organised as franchises around the world and are presented heavily in all of the major tax havens.
   2. Accountants working for investment banks and even private banking organisations (or desks), or smaller specialised accounting firms
   3. Law firms, large and small, many of which are international, specialising in various aspects of tax and regulations
   4. Specialist tax lawyers working for large banks and/or multinational firms
   5. Specialist law and and/or accounting firms operating largely from tax havens such as Mossack Fonseca, or Maples and Calder or Ogier and the like.

6. Wealth management firms or consultants.
7. Offshore specialist providers typically expert in offshore company formations.

I believe that the big four accounting firms are the heart and soul of the world's corporate 'tax planning' business. Legal firms are often asked for a 'second opinion' on a particular structure as a way of insurance against future legal challenges by inland revenues, but the structures are set up by normally the big four. The big banking houses, such as Goldman Sachs, tend to have their own in-house units who dream up new and sophisticated mechanisms of avoidance and would then go 'road shows' to sell those to so-called preferred clients. Big and middle size multinational firms would have in-house teams of laywers and accountant, who would work with external consultants. They all have their preferred contact specialists firms and consultants located in various tax havens. Typically, a deal for say, aircraft buying or leasing will take place in London. The specialist London legal firm would then subcontract the registration of the vehicle (and the special purpose vehicle) to an agent in Cayman Island, Bermuda and the like. The 'deal' would show then on the Cayman's financial statistics aggregate, but in reality it took place in London.

Legal firms, private bankers, wealth management firms and consultants, specialist offshore company formations firms and the like cater for the large 'community' of HNWI. They would advise them on the best strategy, caution against latest moves by the US, EU and the like. They would have knowledge of legal loopholes, and would try and navigate through those loopholes to ensure their clients achieve maximum 'efficiency' in planning.

There is, of course, a 'dirty' side to all of the above that consists of lawyers, accountants, specialist consultants and financiers who would either knowingly and intentionally take a 'lazy' attitude to know your clients rules and other compliance rules. There are those that aggressively pursue clients by offering essentially tax evasion and money laundering services.

I do not know whether there is a clear distinction, empirically or otherwise, between 'clean' and 'dirty' companies, or whether the distinction is down to desks or even individuals operating within companies. From what I have learned of Mossack Fonseca, I would classify them as belonging to the 'dirty' side of the business. In term of social harm, I estimate that the 'clean' side could be as harmful, if not more, in the aggregate than the 'dirty' side.

In general, enablers would try and make sure they do not breach the law, by which I mean, they will try and ensure that a. they comply to the letter of the law of national rules and regulations, and b. they ensure that breaches of the law would be attributed to their clients. The enablers take advantage by arbitrating one national law against the other. That is why the business tend to be international, and all schemes involved two or more jurisdictions. Viewed separately, each component of an international structure would be entirely legal, in term of the laws of the country in which that portion is registered, and

often, appear very innocent, but only in combination with other components located in different countries, the true purpose of the structure is revealed.

For instance, in my research I reviewed recently a particular structure run by a large household name multinational energy company. We discovered that investment in Thailand was run through a series of SPVs, each controlling another. One SPV in the chain was registered as a packaging company whose address was in a tattoo parlour in Bangkok. It controlled another SPV presented as a piping company in an address very near the tattoo parlour, the next link in the chain was investment company bearing a name derived from the mother company. It is impossible to tell whether the structure has any tax implication, but it does look a bit strange.

International taxation and financial regulation is a highly complex and specialist filed that consists of many sub-specialities. No government, even the US, can be expected to have all the necessary expertise in-house. Governments have tended, therefore, to rely heavily on the very 'enablers' they need to regulate for advice. There is, in addition, considerable degree of 'revolving door'. In smaller countries, particularly OFCs (or as some call them, tax havens), the enablers may often draft laws barely understood by local governments.

The 'enablers' tend to argue that they follow the letter to the law, and it is not their fault the law has created so many loopholes. While individually they may be correct, as an industry they are not. They are highly complicit, indeed, they are the enablers of offshore – no one can set up an offshore structure without the services of an enabler.

The enablers are likely to warn against 'throwing the baby with the bathwater', claiming that offshore serves many legitimate purposes. Some claim that they help defend clients against corrupt governments – but then, who judges which government is corrupt and whether the so-called defence is indeed defence.

While I heard those arguments, they are always couched in very general and broad terms and so the validity of the specific cases cannot be verified. In addition, the arguments are never substantiated with any verified quantitative information. The committee should treat such arguments cautiously and recognise that they may be self-serving.

For regulations to work, they must overcome somehow this 'dispersal' of organisation and duties along different SPVs located in different countries. - Structures have to be viewed 'whole,' and responsibility should shift from the clients to enablers. Those providing 'road shows' of tax maximisation should be required to register those road-shows. The providers of offshore SPVs should attract particular scrucity

The fundamental issue is one of liability and responsibility. A

Money laundering regulation and know your client regulations are helping.

3. Were you surprised by any of the methods for tax evasion as revealed in the Panama Papers? Did the Panama Papers reveal something new for you or was it merely a confirmation of already known practices?

   Panama papers did reveal anything new. The techniques used are familiar. Panama has had a reputation among the expert community as one of the jurisdictions that were not interested in 'cleaning' up their act.

4. Is the most efficient way of combatting tax evasion to act for further EU-legislation or should the focus rather be on implementing the legislation that is already in place?

   In addition to automatic exchange agreements, I believe that a variant of US's FATCA applied now to the EU would be very helpful. FATCA addressed two thorny regulatory problems. First, the sovereign problem. How can one state legislate for another its taxation and regulation rules. Second, liability. Traditionally liability was with the client, whereas the intermediaries were mere facilitators. FATCA solved the two problems by doing the following:

   First, Unlike the OECD FATCA does not seek change in offshore jurisdictions. FATCA merely insists that clients who wish to trade in the U.S. or with a U.S. entity must provide transparency of information. Clients may, of course, chose not to, but then they would not be able to trade in the US. The EU is a large enough economy to follow similar

   There are criticisms of FATCA. But under an EU version of FATCA, every Panamanian account holder, whether company or individual, would have to reveal all essential information to banks. . This would not have solved the emerging market problems, but those countries would probably follow if the US and EU.

   would have more or less ensured that no reputable bank

   FATCA in principle shifted the lines of liability from the individu

5. How can the supervision of the implementation of the EU-legislation be strengthened? Would you say that the member states have relevant supervising authorities and could more be done on EU-level?

6. The EU does, obviously, not have the power to impose legislation on countries outside of the union. Do you have any suggestions on how the EU could ensure that tax havens apply global standards? Will money laundering and tax evasion

always move to new countries or are there possibilities to force a change, for example by stricter regulation on which countries European banks and other intermediaries can conduct business with?

EU version of FATCA

7. Can you provide some insight on the role of tax havens in globalization? You say in your book ("Tax Havens, How Globalization Really Works", co-authored with Richard Murphy and Christian Chavagneux) that tax havens are not working on the margins of the world economy, but are an integral part of modern business. Can you please expand on this? Can you provide a definition of tax havens?

   We estimate that about half of the global stock of money is traversed through tax havens, that is half of international saving and deposits. We also estimate that about one third of FDI are routed through offshore. We estimate that there are in excess of 3 million international companies in tax havens. Of the top 500 banks in the world, 486 have branch in the Cayman Island. Most banks and middle to large size firms would have many subsidiaries, holding companies and special purpose vehicles offshore. The evidence suggest that the offshore world is deeply embedded in the world market. Panama however is an outlier

8. What are tax havens used for? You've developed in your book (co-authored with Richard Murphy and Christian Chavaneux) on the different uses of tax havens by individuals and companies. Can you expand on this? What are the instruments used by tax havens?

9. The number of banks that are operational in tax havens is remarkable. What is the role of banks in relation to tax evasion, tax avoidance and money laundering through tax havens? What would you say is the role of tax havens on financial instability?

   My sense is that things have changed dramatically in the past ten years or so. Many banks would have maintained accounts offshore with no question asked. I do not think this is the case anymore, and a study conducted by Prof. Jason Sharman now of Cambridge University, suggests that compliance issues are by no means an offshore world issue. Modern banking has shifted dramatically, in my view, from secrecy provisions to the much more sophisticated techniques of avoidance through arbitrage and financial engineering. We need to bear in mind, in addition, that banking is only a portion of the financial system. Indeed, the so-called 'shadow banking' sector is estimated at around $US125 trillion. Cayman Islands for instance, is host more than half of the world's hedge funds. The front of such fund is the fund manager, normally located London, NY and will be regulated by those jurisdictions. The onshore managers merely managed offshore funds typically domiciled in jurisdiction such as Cayman. Since Cayman has no taxation whatsoever, and has easily licensing provisions, and low fees,

and are regualated by the Cayman financial authority. Accoring to the rule of these insitutiton no one else can regulate a Cayman fund. So all the profits accrued to the offshore funds, tax free. Repatriation would require additional arbitrate mechanism and/or financial swaps arrangements that easy to come by. But this is only one element in a very complex system.