

## COMMENT

# Protection Ratchets Up: Long Finance and Offshore Centres



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Michael Mainelli's latest book, co-authored with Ian Harris, *The Price of Fish: A New Approach to Wicked Economics and Better Decisions*, won the 2012 Independent Publisher Book Awards Finance, Investment & Economics Gold Prize. Z/Yen – [www.zyen.com](http://www.zyen.com) - created and compiles the Global Financial Centres Index – [www.globalfinancialcentres.net](http://www.globalfinancialcentres.net).

**From January to June 2013, the UK media had headlines such as “Google, Amazon, Starbucks: The rise of ‘tax shaming’” (BBC), and “David Cameron: Tax avoiding foreign firms like Starbucks and Amazon lack ‘moral scruples’” (The Telegraph).**

In late June 2013, Starbucks agreed to pay £10 million to the UK Treasury. Given that Starbucks reportedly paid no tax in the previous four years, £8.6m in corporation tax in the UK over the previous 14 years, yet had sales in the UK of £400m per annum, this might sound like a victory over tax evasion.

At no point has any authority accused Starbucks of not complying with tax law. Having followed the tax code correctly, Starbucks reached annual agreements with HM Revenue & Customs that little or no corporation tax was payable. The majority of people seem to have no problem with Starbucks' payment or feel an urgent need to reform tax laws. However, as an accountant I wonder how the payment should be booked, certainly not to marketing. Tax liabilities have always been a complicated area, but in this case is the payment:

- A mistake, an adjustment to historic tax liabilities, or a retroactive tax?
- A bonus payment or donation to HM

Revenue & Customs?

- A donation or bribe paid to the UK coalition government, or perhaps David Cameron's Conservative Party?
- A shakedown or protection racket payment to a corrupt government?

Perhaps I might mischievously suggest that Starbucks be reported to the US authorities under The Foreign Corrupt Practices Act of 1977 which “was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business.” [US Department of Justice website] The rules on international corporate taxation are close to unworkable, though I wonder why more people do not question the theoretical basis for taxing corporations, which is at best dubious.

Things are no better with international personal tax, whether it is the inheritance tax nightmares we see in probate courts as lawyers drain away estates, or the future delightful Catch-22s of the US Foreign Account Tax Compliance Act (FATCA) ranging from the illegality of overseas compliance to denial of service for US citizens or residents.

Though the intentions of some of the bodies shouting for reform can be questioned, it is clear that tax reform is essential. The road to tax reform is

unlikely to be smooth or straight, so expect a large number of awkward, contradictory, and dangerous steps along the way.

It is no surprise that aggressive tax enforcement follows a series of financial crises in developed countries. Monetary systems are under strain following a period of excessive credit growth and banking leverage that now requires much tighter budgets and recapitalisation. During financial crises weightless capital flies to safe havens, yet there are many dangers beyond grasping governments.

Global unrest has been enormous. Just mentioning the Arab Spring, Thailand, Turkey, Ukraine, and Russia encompasses huge numbers of people and territory enduring civil unrest. These conditions form a perfect storm for wealth destruction.

London, home to a few financial crises, has paradoxically benefitted from capital flight. Though London itself needs to shape up, in comparison with many other places it is a safe haven. Nevertheless, London may have moved from being a centre of wealth creation to a centre for wealth protection, potentially harming its domestic economy's future.

Since 2008, offshore centres have held their own in the Global Financial Centres Index. But that's not sufficient. In all the turmoil they should have thrived.

A racket is a service that is fraudulently offered to solve a problem that would not otherwise exist. At the moment, larger economies exhibit many of the characteristics of a protection racket, particularly when tax is taken into account. Looking at the EU over Cyprus or Ireland, the USA on FATCA, the OECD on tax equalisation, the UK on retroactive and windfall taxes, and it is easy to see that the value of wealth protection is growing. Offshore centres compete by providing stability and simplifying financial services. What we have here is a failure to take positive action and communicate offshore centres' roles to clients and onshore authorities. Offshore centres should focus on how they 'signal', in economics jargon, to the outside world, credibly conveying their long-term stability. Offshore centres must increase their reputations for long-term stability and openness. Offshore centres must prove that they are far less likely to make capricious changes to rules or regulations.

The essential offshore services are to support long-term finance and provide regulatory simplicity. What sorts of action could be taken? A 2013 Long Finance, CISI and BSI report, *Backing Market Forces: How To Make Voluntary Standards Markets Work For Financial Services Regulation*, contains several signalling ideas such as working more closely with the International Standards Organisation (ISO) on Anti-Money Laundering (AML), Know Your Customer (KYC), alternative currency management, barter, or even developing a standard for a Secure International

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Financial Centre that could be audited. A few centres are exploring transferable AML and KYC passports. Others are looking at improving intellectual life. Alderney is working on alternative currency regulation.

I would suggest going further faster, perhaps even 'selling' good regulation. Imagine a value-added silver or gold service where an offshore centre provides external inspection reports to family office owners alongside benchmarks with other family offices on the same island.

Large states have a comparative disadvantage in global finance, unable to combine wholesale and retail financial regulation without incurring booms and busts.

Our work has identified several possible 'long finance' strategies for offshore jurisdictions which I would pull together as:

- **Get Real** - more aggressive promotion directly stating that larger nations do have shortcomings with long-term planning and capricious regulatory change, combined with a clear legislative cycle in finance where finance bills change regularly but not too rapidly;
- **Get Integrated** - consider 'mid-shore' strategies where there is a symbiotic offshore relationship with larger nations allowing businesses

to function under less-than-ideal or complex onshore regulation;

- **Get Better** - tackle long-term skills shortages with better training for indigenous populations rather than relying on imported skills; improve power, transportation and communications infrastructure;
- **Get Connected** - host high-profile regular events, create strong academic links, simplify visa and work permit processes;
- **Get Serving** - increase levels of service both for those entering the centre and long-term residents; use benchmarks, data comparisons, and awards to keep service high.

I might also add 'Get it together' with other offshore jurisdictions. Cooperation, particularly towards more regulatory uniformity and consolidation, could strengthen the hands of offshore negotiators. As Bob McDowall, Finance Minister for the States of Alderney, says, "No island is an island in the 21st century."

Innovative, integrated and cooperative offshore centres should be thriving in these times of crises. It is hardly too late. As the value of long-term protection ratchets up, offshore centres could underpin global financial reforms to build a safer, more efficient, and longer-lasting financial services sector. **IFC**



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