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ANTI-CORRUPTION, ANTI-MONEY LAUNDERING AND REGULATORY COMPLIANCE

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Spilling secrets: The end of confidentiality in offshore financial centres

By Nadia Chiesa

The Cayman Islands, Nevis and the British Virgin Islands ("**BVI**") bring to mind images of turquoise waters, white sand beaches and…offshore bank accounts and corporations where the super wealthy stash their millions to avoid (and evade) taxes in their home countries. Formerly known as "tax havens", these jurisdictions, which are not limited to the Caribbean but include Switzerland and Hong Kong, among others, are now referred to as international financial centres or offshore financial centres ("**OFCs**"). OFCs have established significant financial industries which attract corporations and individuals from around the world by offering incentives such as low or no taxes, little to no financial regulation and perhaps most importantly, a high degree of privacy.

OFCs are a big business. The BVI, a chain of islands to the east of Puerto Rico and a British overseas territory, is home to 45 percent of the world's offshore companies, and its corporations outnumber its residents fourteen to one. It is estimated that there is approximately US$290 billion in American assets held in the Cayman Islands alone, where there are almost twice as many offshore companies as residents, and that figure rises to more than $1 trillion worldwide.

Secrecy laws: A defining feature of OFCs

OFCs are most frequently associated with tax evasion or other unlawful uses, although there are numerous legitimate purposes for setting up an offshore account or corporation. This reputation is due, in large part, to the very feature that makes OFCs so attractive: confidentiality of financial information. Nevis' *Confidential Relationships Act* protects a broad scope of confidential information related to financial or business interests located in the jurisdiction, which would include the identity of beneficial owners or the assets or property held by a company or in an account. The Act imposes serious penalties, including imprisonment, for divulging or obtaining or even attempting to divulge or obtain confidential information. A similar statute in the Cayman Islands, the *1976 Confidential*

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Relationships (Preservation) Law, prohibits the disclosure of "all confidential information with respect to business of a professional nature which arises in or is brought into the Islands", although the act was amended in 2009 to permit the disclosure of information pursuant to a Tax Information Exchange Agreement ("**TIEA**"), a bilateral agreement permitting the exchange of information related to taxes and intended to combat illegal tax practices. Several OFCs have entered into these agreements but the Organization for Economic Co-operation and Development ("**OECD**") recently reported that several jurisdictions, including Switzerland, have failed to put into place the necessary legislation for the exchange of tax information. The BVI, which has tax exchange legislation in place, was rated as non-compliant with international tax transparency standards by the OECD for failing to apply that legislation properly.

John Doe, disclosure and data leaks: The end of the OFC?

The glory days of secret bank accounts and offshore corporations may, however, be numbered as recent developments including major data leaks, new tax reporting legislation, the US' *Foreign Account Tax Compliance Act*, and recent case law in the United States and Australia, for example, are eroding the confidentiality which has long been the hallmark of OFCs.

A "John Doe" summons is a powerful information-gathering tool employed by the Internal Revenue Service ("**IRS**") where it suspects a federal tax violation by unknown persons. The court will authorize the summons where: (i) the IRS can establish that it relates to a particular person or ascertainable class; (ii) there is a reasonable basis for issuing the summons; and (iii) there are no alternatives for obtaining the information.

Two recent orders made by the United States District Court for the Southern District of New York in November 2013 signalled the American government's current focus on tracking down American assets abroad – and the citizens who own those assets. In early November 2013, Judge Kimba M. Wood authorized the IRS to issue John Doe summonses against New York Mellon (Mellon) and Citibank NA (Citibank), which will compel the banks to divulge information related to suspected American tax evaders who hold accounts – and assets which have not been disclosed to the IRS – with Switzerland's Zurcher Kantonalbank and its affiliates. Just a week later, Judge Richard M. Berman authorized the IRS to issue similar summonses against five American banks, including JPMorgan Chase Bank NA, HSBC Bank USA NA and Bank of America NA, in order to collect information on American taxpayers with interests at The Bank of N.T. Butterfield & Son Limited and affiliated entities across the Caribbean, Europe and Hong Kong.

The recent New York orders followed a decision of an Australian court to allow the use of confidential documents related to a major tax case, despite a ruling by Justice Charles Quin of the Cayman Island's Grand Court in *M.H. Investments and J.A. Investments v. The Cayman Islands Tax Information Authority* which held that the release of the information was unlawful and in breach of the TIEA entered into between those two countries. The documents were protected by Cayman's confidentiality legislation because they pre-dated the TIEA, which permitted the disclosure of information for the taxable period beginning on 1 July 2012. The Australian court ignored Quin J.'s order that the documents be returned or destroyed, even acknowledging that use of the documents was in breach of Cayman laws.

These are just the latest examples in a growing line of cases dealing with the conflict between secrecy

legislation in OFCs and court-ordered disclosure of otherwise protected information, which raise serious concerns about the future of the confidentiality in OFCs and more generally, judicial respect for the principles of comity. American courts have leaned towards ordering disclosure of confidential information in violation of foreign law and sanctioning parties for non-compliance with those disclosure orders.

The 2009 case of *United States v. UBS AG*, before the US Federal Court in the Southern District of Florida, was arguably the beginning of the end, at least for the secret Swiss bank account. A former UBS banker alleged that his employer had routinely set up offshore accounts to enable clients to evade American taxes, leading to an investigation of the bank by the US Department of Justice, which issued John Doe summonses for the production of confidential information related to thousands of American clients. The bank initially refused, citing Switzerland's bank secrecy laws which criminalize the release of financial account information. The Swiss government also opposed the John Doe summonses, which were so broad that compliance would constitute a breach of Swiss law, and asked the court to refuse to authorize the summonses on the basis of international comity. In early 2009, UBS entered into a deferred prosecution agreement, and admitted that its employees had been involved in using offshore accounts to defraud the US. Despite the Swiss confidentiality laws, UBS agreed to pay $780 million in fines and penalties, and reveal the identity of almost 5,000 American clients. The IRS later established its offshore voluntary disclosure program to encourage Americans to self-report previously undisclosed income from offshore accounts in order to avoid criminal prosecution.

It is not only foreign court orders which have threatened the confidentiality previously offered by OFCs. In early 2013, the International Consortium of Investigative Journalists ("**ICIJ**") obtained a computer hard-drive with 260 gigabytes of information about approximately 122,000 offshore companies or trusts, apparently from a whistleblower, and set out to publish this information. Partnering with media organizations around the world, including the CBC and The Guardian, the ICIJ, a Washington-based organization of investigative journalists working in more than 60 countries, publicly identified more than 130,000 people in 170 countries with offshore interests. In the wake of this major data leak, Canada, the US and the UK, among others, announced crackdowns on citizens with undisclosed assets abroad.

The issue of OFCs and tax evasion was at the top of the agenda at this summer's G8 Summit, where leaders signed the Lough Erne declaration which included a commitment to "fight the scourge of tax evasion", in part by facilitating the exchange of tax information between nations.

All eyes on OFCs: What these recent developments mean for OFCs and clients with offshore accounts or corporations

While it is unlikely that these developments foretell the end of the offshore financial industry, often the principal and most profitable industry in many of these jurisdictions, they do raise new concerns for individuals and corporations with offshore assets, and the professionals who advise them. The Canadian government, and others, are rolling out strategies to target tax evaders. Increased scrutiny of citizens with assets abroad can be expected, so it will be essential to ensure that offshore assets remain onside with domestic tax requirements. Clients must also understand that privacy is no longer guaranteed, as the trademark confidentiality once promised by OFCs is being eroded by bilateral information exchange

agreements, foreign court orders and data leaks.

These developments may also lead to litigation in OFCs seeking to enforce the penalties and sanctions in their respective confidentiality legislation, especially if foreign courts continue to ignore the domestic legislation and court orders in offshore jurisdictions.

It is clear that the legal landscape in which OFCs operate is in transition, and individuals and companies with interests in these jurisdictions as well as their legal advisors will be keeping a close watch on the evolution of OFCs.

WeirFoulds' Anti-Corruption, Anti-Money Laundering and Regulatory Compliance team helps business entities, organizations and individuals confront and pursue regulatory, criminal, and commercial investigations, and assists them in developing compliance policies and procedures.

Do you have questions? *The lawyers of WeirFoulds are able to assist you with a wide variety of litigation matters in various jurisdictions, including the Caribbean and Central America. For more information, please contact* ***Frank Walwyn*** *at fwalwyn@weirfoulds.com or* ***Nadia Chiesa*** *at nchiesa@weirfoulds.com.*

Nadia Chiesa

Nadia acts on a wide variety of civil and commercial matters, with a particular emphasis on multi-jurisdictional litigation involving complex business disputes in various jurisdictions including the Eastern Caribbean, Central America and the U.S. She has an interest in Offshore Financial Centres (OFCs), and the interaction between confidentiality legislation in OFCs and statutory disclosure obligations in foreign jurisdictions.

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