CARIBBEAN: Tax havens face rising pressures

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Abstract

Economic and regulatory pressures on Caribbean tax havens.

The offshore financial services sector is extremely important to the economies of many Caribbean Overseas Territories both in terms of GDP and employment, and the Territories play a key role in the international financial system. However, the global financial crisis and growing opposition to 'tax havens' have increased pressure on the sector and the Territories' economies more generally.

Full Text

SUBJECT:Economic and regulatory pressures on Caribbean tax havens.

SIGNIFICANCE:The offshore financial services sector is extremely important to the economies of many Caribbean Overseas Territories both in terms of GDP and employment, and the Territories play a key role in the international financial system. However, the global financial crisis and growing opposition to 'tax havens' have increased pressure on the sector and the Territories' economies more generally.

ANALYSIS: Impacts.

Bermuda is one of the largest centres for reinsurance in the world and a major captive insurance domicile.

The Cayman Islands is a key centre for hedge funds; the BVI is the leading domicile for international business companies.

The offshore sector has become more vulnerable with global downturn and associated focus on tax avoidance, notably in the United States.

Many Caribbean Territories have large offshore sectors (see CARIBBEAN: Offshore jurisdictions clean up their act - September 11, 2009):

Bermuda hosts more than 15,000 international companies, including subsidiaries of three-quarters of the Fortune 100 companies and their European equivalents. Its industry capital base exceeds 35 billion dollars.

The Cayman Islands has over 40 of the top 50 banks from 45 countries holding licences locally.

The British Virgin Islands (BVI), meanwhile, has a 45% share of the international business company market.

However, the global economic downturn that began in 2008 has adversely affected the sector. In the Cayman Islands, for example, overall activity declined by 14.4% in 2009 and 4.8% in 2010. In particular, the total number of bank and trust licences, the number of captive insurance companies, the number of mutual funds, the number of company registrations, and the number of listings on the Cayman Islands Stock Exchange all declined. Growth returned to the sector in 2011 (0.6%) and has continued into 2012, but it is patchy and activity remains someway below its 2008 level. A similar pattern of decline and slow recovery can be seen in Bermuda and the BVI.

Economic impact.

Because the Territories are highly dependent on financial services, the sector's decline has impacted on their economies as a whole. The effect has been exacerbated by their narrow revenue base. There are no taxes levied on income, profits and capital gains, nor are there sales or value-added taxes (VAT). Rather revenue is derived from a combination of import duties, financial sector licence fees and other specific charges. As a result, the economies have stagnated and fiscal deficits have increased. The Cayman Islands' economy shrank by 0.7% in 2008, 6.9% 2009, and 3.4% in 2010. In 2011, there was a weak recovery with growth estimated at 1.1%. The fiscal deficit reached 8.1% in 2009, 3.7% in 2010 and 3.4% in 2011. Total government debt was a relatively high 24.9 % of GDP in 2011.

Growing budgetary pressures have been particularly acute in Anguilla, the Cayman Islands and the Turks and Caicos Islands (TCI). This had led London to take a stronger hand in economic matters. For example, in both Anguilla and the Cayman Islands the United Kingdom has forced revisions to local budgets to cut spending and raise revenue. Further, the United Kingdom and the Cayman Islands have recently agreed a Framework for Fiscal Responsibility which sets out clear guidelines for economic management, while in the TCI London has introduced VAT to broaden the revenue base.

International regulatory pressures .

As well as direct economic impacts, the global financial crisis has led to changes in the international regulation of offshore financial centres (OFCs). At the height of the global financial crisis in April 2009 leaders of the G20 nations made a clear commitment to tackle tax havens, stating that "the era of banking secrecy is over" (see INTERNATIONAL: G20 puts end to tax havens - November 13, 2009). Although progress has been slow, several initiatives have been taken to tighten the regulatory framework and there are indications that these will impact on the OFCs.

OECD.

In June the OECD made clear its support for "automatic exchange of information", which "can help detect cases of non-compliance even where tax administrations have had no previous indications of non-compliance". This is a step change from the present Tax Information Exchange Agreements (TIEAs) and the 'on request' information exchange system which requires countries to know what they are looking for before they ask for it. Automatic information exchange is already being used by a number of countries and with the OECD's support could have a potentially significant impact on opening-up OFCs.

United States.

Meanwhile, in the United States, further pressure is building. In particular, Congress passed the Foreign Account Tax Compliance Act in 2010 which will come into force in January 2013. The Act requires both US citizens and foreign residents to disclose information about their overseas holdings in their tax returns or risk large penalties. Further, foreign financial institutions are required to report on income earned by their US account holders, or face US-imposed fines. As a consequence, holdings in OFCs such as the Cayman Islands will come under greater scrutiny.

Indeed, the whole narrative around OFCs has become more disapproving:

There has a been significant negative press surrounding allegations that US Republican presidential standardbearer Mitt Romney, and his former company Bain Capital , had offshore accounts in Bermuda, the Cayman Islands and elsewhere to reduce their tax obligations.

In addition, the US Senate has heavily criticised HSBC Bank for money laundering, which reportedly included allowing Mexican drug lords to purchase planes with cash laundered through the Cayman Islands.

UK support still strong.

Despite growing international pressure, London remains a strong defender of the Territories' right to maintain their role in the offshore sector. As the recent UK government White Paper on the Overseas Territories -- Security, Success and Sustainability -- suggests, the United Kingdom "will continue to represent the interests of those Territories which meet [international standards]" and "will strongly support their right to compete freely in international markets".

One reason for this support as highlighted in the White Paper is that "the international financial centres in the Territories can play a positive and complementary role to the UK-based financial services industry". A second is that London wants the Territories to be as economically independent as possible and the offshore sector helps them to be so.

London has also highlighted its support for OFCs in several other ways:

The United Kingdom is opposing a move by the European Parliament and the Danish EU Presidency to define tax havens as providing tax measures which entail no, or nominal, taxes, and granting tax advantages even without any real economic activity and substantial economic presence.

Critics of the October 2011 tax agreement between the United Kingdom and Switzerland argue that, rather than dealing with tax evasion, it largely guarantees Swiss banking secrecy and supports tax havens.

CONCLUSION: The Caribbean Territories will retain their significant interest in offshore financial services for the foreseeable future. The contribution of the sector to their economies is vital, and London's support provides a crucial bulwark against attack. However the regulatory framework is tightening, with some related loss of business. This in turn means that the Territories will try to build more diverse and resilient economies.

Details

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