

The Status of Jersey and Guernsey as International Financial Centres

Introduction

The inclusion, following the Group of Twenty ("G20") summit in London in April 2009, of the Channel Island financial centres of both Jersey and Guernsey on the "white list" of jurisdictions that have substantially implemented the internationally agreed standard for the exchange of tax information is an acknowledgement that Jersey and Guernsey are cooperative, responsible and well regulated, low tax international financial centres meeting the highest standards of transparency and regulation.

This Briefing looks at:

- the background to the recent summit;
- the agreed standard for the exchange of tax information;
- the next steps for the offshore financial centres;
- Jersey's and Guernsey's regulatory systems;
- tax havens;
- banking secrecy;
- tax information exchange agreements; and
- other forms of information exchange.

Following the release on 21 April 2009 of the progress report of the "Foot Review of British Offshore Financial Centres" (the "Foot Review"), these topics will be the subject of the final report of the Foot Review expected later this year.

The G20

The G20 exists to promote global economic stability. The membership of G20 includes both industrial and emerging market countries. It was created in response to the financial crises affecting the Asian markets in the late 1990s and has, since its inception, progressed a number of issues including: funding for struggling economies, combating terrorist financing, reducing abuse of the financial system including tax evasion and implementing higher standards of transparency and exchange of information. The London summit was held, specifically, to address the 2008/2009 international financial crisis, restore stability and lead a recovery of the financial markets.

G20 focus on "non-cooperative jurisdictions" including "tax havens"

In the period running up to the summit, there was speculation about the root cause of the global financial crisis and, linked to this, much debate over the future of the world's financial centres. The debate included those centres situated "offshore" and commonly, but not necessarily accurately, considered to be "tax havens". The French President, Nicolas Sarkozy, blamed "*Anglo-Saxon business practices*" and famously threatened to walk out of the summit unless his proposals for a radical reform of global financial regulation, designed to "*put morality back into capitalism*" and including a crackdown on tax havens, were agreed. The UK's Chancellor, Alistair Darling, also pointed his finger at "offshore centres" which he claimed attract business with lower taxes and offer no contribution to the UK exchequer.

It is both incorrect and unfortunate that the "offshore" financial centres have been linked to tax evasion. It is critical that a clear distinction is now drawn between legitimate tax mitigation and tax evasion. It is also important to note, notwithstanding the credibility of the G20's moves to tighten and improve financial regulation across the globe, that the well-regulated "offshore" financial centres were not in fact at the root of the global economic crisis. The fundamental cause of the crisis was inadequate and ineffective regulation in major "onshore" financial centres - London, New York

and others - which allowed "bad practice" including, notably, sub-prime lending. In this regard, the unfortunate focus on "tax havens" has been seen as something of a sideshow intended to deflect attention from the real causes.

The Foot Review: financial regulation and reform

Against the backdrop of the London G20 summit, Michael Foot was commissioned to undertake the Foot Review, to cover the "*long-term opportunities and challenges facing the British Crown Dependencies and Overseas Territories as financial centres, which have been brought into focus by recent financial and economic events*". This includes an examination of:

- financial supervision and transparency, including the track records of the various financial centres in meeting international minimum standards;
- taxation and other factors which impact upon investor choice of the financial centres;
- financial crisis management, including compensation schemes for depositors;
- international cooperation, including tax exchange and the implementation of the international standard;
- the degree of interdependence between the financial centres and the UK, including the quantum and nature of the business flow between them;
- the impact on the financial centres and the UK if some or all of the financial centres are adversely affected; and
- whether the interrelation between the UK and financial centre authorities could be changed for the benefit of all parties.

Even at this early stage (the progress report having been produced in time for the UK budget in April 2009), Michael Foot has noted that the regulatory regimes concerned, taken as a whole, "*have received broadly favourable review from the International Monetary Fund*" and that "*there is a willingness to match developing international standards*".

Channel Islands' track record in independent endorsement

Jersey and Guernsey are not new to reviews of their financial and regulatory requirements and have, over the years, been consistently and independently recognised as having high levels of compliance with global regulatory standards. Notable examples include:

- confirmation by the OECD in (March 2009) that both Jersey and Guernsey play an active and constructive role, leading the way in the signing of tax information exchange agreements, and taking a key part in the development of greater transparency;
- endorsement by the International Monetary Fund in 2003 as offshore centres offering transparency standards superior to those found among many other OECD and EU member countries;
- recognition as cooperative jurisdictions "*close to complete adherence*" by the Financial Action Task Force in 1999; and
- the Edwards Report (1998) which described both Guernsey and Jersey as being in the "top division of offshore centres": "*The Island authorities all have a clear objective that their finance centres should be the best of offshore centres, not only in terms of quantity and quality of business but also in terms of international standards of regulation, policing and cooperation*".

The confirmation that Jersey and Guernsey conform with the highest standards is testimony to their commitment to OECD principles and places the Islands in a favourable position both with a view to assisting with the development of the "global level playing field" and with boosting the recovery of the global economy where they have provided, and will continue to provide, critically needed liquidity to the banking system.

International standard on exchange of tax information

Following the G20 summit, a communiqué was published summarising the main decisions taken, for example, in relation to financial regulation and economic growth. Specifically regarding non-cooperative jurisdictions, the communiqué stated the agreement of the G20 to:

"...take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information."

As a result of continued political pressure, the OECD subsequently published a detailed report on progress made around the globe towards the implementation of an internationally agreed standard on the exchange of information for tax purposes. This report was originally divided into three parts. The first list included the "white list" of those jurisdictions

which have substantially implemented the agreed standard. This includes some forty jurisdictions such as the UK, the USA, most EU countries, Jersey, Guernsey and the Isle of Man. The second list is the "grey" list naming those countries which are described as tax havens or other financial centres and which have expressed an intention to comply with the international standard going forward. The "grey list" includes Switzerland, Belgium, Luxembourg, Bermuda, Cayman and others. The third list was the so called "black list" and named those countries that were considered to be uncooperative. There were four such countries (the Philippines, Uruguay, Malaysia and Costa Rica) but, within days of being "black listed", all four committed to assist the OECD and were moved to the grey list as "*jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented.*" As such, all jurisdictions surveyed by the OECD Global Forum are now committed to cooperate against tax abuse and remove impediments to the implementation of the agreed tax standard.

Tax havens and offshore financial centres

The Oxford English Dictionary tells us, very generally, that a tax haven is "*a country or autonomous area where taxes are levied at a low rate*". This non-technical definition may provide an indication, but it would now appear ripe for refinement. A "tax haven" might now, properly, be defined as a "secrecy jurisdiction" i.e. a jurisdiction that has laws and practices which make it difficult for other countries to evaluate whether those laws and practices are being used to evade taxes.

The word "offshore" is a confusing one and can in no way be said to be synonymous with the concept of an island or haven for illicit fiscal activity. Other financial centres which one might regard as "onshore", including London and New York, also do work of an "offshore" nature. Manhattan is, in any event, an island and other "offshore" jurisdictions such as Switzerland, Liechtenstein and Luxembourg have no coastlines.

Nor is the definition really about tax. London offers a low tax environment to international investors and Germany, Spain, France and others offer low or no tax holding company tax regimes. Ireland and Holland also offer certain tax advantages. The real issue here is regulation.

Secrecy and privacy

The Channel Islands offer investors a low tax environment not dissimilar to those offered by other large financial centres including London and New York. They do not have secrecy laws: rather, high levels of regulation and sound supervisory controls, within which clients can still benefit from appropriate levels of privacy. Jersey's and Guernsey's protection of the privacy and confidentiality of financial information for the legitimate activity of law-abiding persons is similar to English principles, which have derived over many years from the common law.

The Channel Islands' legal systems and financial regulation focus upon transparency and openness, both of which are principles fundamentally different from that of secrecy. Jersey and Guernsey have both committed to the OECD principles of transparency and information exchange and concentrate, among other things, upon accountability, access to information, clarity and predictability, which are all essential elements of a well regulated environment. Transparency does not necessarily need to go hand in hand with a loss of privacy for legitimate activity. Where disclosures are made in order to prevent abuse, these will be strictly limited to dealing with the purpose for which disclosure is required, with restrictions on any wider disclosure and on the use to which such information can be put. Legitimately confidential information will therefore remain protected.

In an historic development for global private banking, the pressures surrounding the G20 summit have led some of the world's strongest defenders of banking secrecy (including Switzerland, Liechtenstein, Andorra, Monaco, Hong Kong and Singapore) to consider actions to improve levels of transparency and information exchange. In most cases, these actions are likely to include the renegotiation of existing tax treaties and the negotiation of new tax treaties by the countries concerned.

Secrecy and tax offences, fraud, evasion and avoidance

Switzerland has been at pains to point out that banking secrecy, a central pillar of its private banking industry, does not protect from tax offences. That said, Swiss law does not recognise tax evasion as a criminal offence, unless it is connected with fraudulent activity. It may therefore seem predictable, given the global pressures for greater transparency, that the secrecy jurisdictions will see continued moves to push their domestic secrecy laws back further still.

What does amount to a tax offence, as we have known it, looks set to come under detailed scrutiny with growing international focus on the practice of "tax avoidance". Historically, there has been a long-standing and simple distinction between acceptable, tax avoidance, and unacceptable, tax evasion. For many, simple and accepted means of paying less tax include: tax free savings, investment in pensions, and maximum use of tax allowances, all of which are quite

normal tax planning measures that are in no way illegal or unacceptable. Similarly, banks, companies, and individuals (whether or not of high net worth) are entitled to manage their affairs, domestic and international, in sensible, legal and tax efficient ways.

Tax is an issue that crosses the boundaries of politics and morality, touching on social structures, wealth distribution, welfare, economic development and more, and an issue from the dawn of civilisation. It is "tax" that threatens to muddy the waters of the current global debate even further, bringing focus not just to regulation and transparency, but also to taxation of business and the wealthy, wealth planning and structuring, and the related use of the international finance centres. Moves by the UK government to tax the wealthy more heavily and focus more closely on tax avoidance suggest that measures which are currently legitimate will somehow become immoral. This is a potentially dangerous route to follow with the prospect of far-reaching and damaging consequences for global prosperity and the rule of law. It will tend to discourage wealth creation and, consequently, employment prospects and general financial wellbeing in both the public and private sector.

Tax information exchange agreements ("TIEAs")

The OECD Model Tax Convention contains standard exchange of information provisions designed to facilitate the exchange of information that is "foreseeably relevant" and required to ensure the application of the tax treaties and laws of the treaty countries. Information exchange involving Jersey and Guernsey is upon specific request. The fine detail is for the individual jurisdictions concerned to negotiate on a case by case basis. The OECD has a target criteria of twelve TIEAs. As at the date of this Briefing, Jersey has negotiated TIEAs with the following fourteen countries, and is in negotiations with Italy, New Zealand, Canada and Spain:

- USA;
- Netherlands;
- Germany;
- Sweden;
- Norway;
- Iceland;
- Finland;
- Denmark;
- Greenland;
- Faroes;
- UK;
- France;
- Ireland; and
- Australia

Guernsey has negotiated TIEAs with the first thirteen of the above countries and TIEAs with Australia and other countries are planned to follow shortly.

TIEAs are considered an important means, in addition to sound regulatory practice, of countering financial crime, terrorist funding and money laundering. TIEAs must be individually and carefully negotiated in order to protect the confidentiality of legitimate activities while allowing the exchange of information in fiscal cases of a suspect nature, whether criminal or civil. For example, requests for information will need to provide precise information and detail specific requests about the circumstances and individuals concerned. General "fishing expeditions" will not result in an exchange of information and there will be no automatic exchange of information. Furthermore, those who are the subject of requests for information will need to be under suspicion, investigation or examination in the requesting jurisdiction.

Other forms of information exchange

The Channel Islands' pro-active role in information exchange and international cooperation is not limited in application to taxation. The Jersey Financial Services Commission (the "JFSC") has recently published a handbook to assist overseas supervisory authorities which details the types of assistance the JFSC can provide within the limits and protections permitted by law. The key areas where the JFSC may assist overseas supervisory authorities include:

- Financial services: obtaining and providing information on licensing applications and on beneficial ownership and senior management, obtaining information on the fitness and propriety of senior management, investigation of unlicensed activities and onsite examinations of Jersey branches and subsidiaries. The JFSC has powers to refuse or revoke registrations and/or conditions of registration, obtain documents and information, appoint inspectors, obtain warrants for entry and search, and share information obtained.

- Anti-money laundering and financial crime: obtaining and providing information on applications for licensing and registration, and on the fitness and propriety of relevant persons, investigating suspected unlicensed and unregistered activities and undertaking onsite examinations of branches and subsidiaries. As noted above, the JFSC has powers to refuse and revoke registrations, refuse, revoke or vary conditions of registrations, obtain documents, obtain warrants for entry and search, and share information obtained.
- Non-profit organisations: limited to assisting in the countering of terrorism, the JFSC may share non-public information regarding non-profit organisations with an overseas regulatory body.
- Insider dealing and market manipulation: obtaining documents and information, appointing inspectors, obtaining warrants for entry and search, and communication of information.
- Company affairs: obtaining information and documents, examination of persons concerned, obtaining and examining directors' bank accounts, and obtaining warrants for entry and search.

The Royal Courts of Jersey and Guernsey also provide important gateways for the exchange of information and assistance for overseas applications. This is particularly important in the field of international insolvency and asset tracking, where case law evidences numerous examples of the Royal Courts assisting, for example, overseas liquidators or trustees in bankruptcy to obtain information and ultimately assets for distribution to creditors. Another area of notable cross border cooperation relates to foreign claims affecting companies and trusts. Further, the Attorney Generals of each Bailiwick have powers to make orders and assist foreign authorities (subject to judicial review) in relation to international criminal activity, fraud, money laundering, terrorism and drug trafficking.

Conclusion

Both Jersey and Guernsey offer appropriate regulatory standards to ensure their position as international financial centres of repute. The continued commitment of the Channel Islands to maintain high regulatory standards is vital to preserve the integrity of their financial services industries and in continuing to attract new business of the right type. Jersey and Guernsey will continue as centres of vitality for legitimate international finance, leading the way in funds, structured finance and other capital markets activities.

Jersey and Guernsey channel billions of pounds worth of capital into financial centres such as London every year and provide substantial liquidity support to the UK banking system. It is clear, therefore, that these jurisdictions make a significant contribution to the UK exchequer. Earlier this year, Michael Foot confirmed for the purposes of the Foot Review, that *"business flows both ways between the [larger centres covered by this Review] and the UK....defining these business flows will provide evidence to analyse the impact on the City of London should the viability of any of this business in future be called into question. The close relationship the centres have with the UK also gives the UK Government a direct interest in understanding each centre's ability to remain viable, both economically and in terms of complying with international regulatory standards, during the current global economic downturn"*.

Jersey and Guernsey welcome the Foot Review as a further opportunity to demonstrate their strong track record and look forward to the return of investor confidence, clarification of the meaning of "tax avoidance" and detailed guidance on those tax practices considered to be harmful. As on previous occasions, Jersey and Guernsey will continue to adapt to an ever changing environment and will respond positively and in accordance with the emerging consensus.

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