Exposing and curtailing secret offshore tax shelters: the tools and the enablers. A call for vigilance in South Africa*

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Abstract

In order to minimise global tax exposure, taxpayers involved in international trade often invest in low tax or offshore tax-haven jurisdictions which promote secrecy in investors' financial affairs. Often this secrecy prevents other countries from finding out and thus taxing the business actives of their residents who invest in those jurisdictions. In this paper the schemes involved in secret offshore tax shelters are exposed. It is argued that although the international community has come up with some measures to curtail offshore secret tax shelters and although some countries have enacted legislation to prevent the resultant tax loss, there is still a lot of revenue lost by many countries due to the secrecy involved. Considering the recommendations of some international bodies and other countries' initiatives, this article analyses the effectiveness of South Africa's policies in addressing this problem.

Introduction

Because taxes vary, not only from individual to business, but also from country to country, taxpayers often exploit tax variations across international borders and international tax systems. These variations include differences between countries' tax rates, legal concepts, standards of administration, reporting and enforcement, and governments' attitudes towards the liberty and privacy of taxpayers and the confidentiality of financial and business transactions.[1] Taxpayers will, for instance, invest in offshore tax-haven jurisdictions which promote banking secrecy provisions and lack transparency and exchange of tax information with other countries. These

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1 United Nations Ad Hoc Group of Experts on International Cooperation in Tax Matters *International cooperation in tax matters: guidelines for international cooperation against the evasion and avoidance of taxes (with specific reference to taxes on income, profits, capital and capital gains)* (1984) at 18.

factors make it almost impossible for national governments to implement their tax laws and the resultant loss of revenue can be tremendous.

This paper attempts to expose the intricacies of secret off-shore tax shelters, its enablers and some of the sophisticated schemes they get involved in. This article goes out from the premise that secret offshore tax shelters are encouraged by low-tax and tax-haven jurisdictions that develop tax policies aimed primarily at diverting finances and other geographically mobile capital from high tax countries.[2] Although countries may have legislation to curb offshore tax abuse by their residents; the secrecy involved makes it difficult to enforce this legislation as tax payers will insure that their transactions are kept from the knowledge of tax officials. International and national initiatives are now geared towards using more pro-active measures to 'crack down' on offshore tax shelters. This has resulted in a remarkable recovery of revenue.[3] The article describes the effectiveness of these initiatives and from their success story, recommendations are offered as to how South Africa can improve its policies in this respect.

Jurisdictions that encourage secret offshore tax shelters

The notion of 'offshore tax shelters' generally denotes the use of tax schemes to avoid domestic taxes by investing in tax-haven jurisdictions. These are jurisdictions that actively make themselves available for the 'avoidance of tax' that would have been levied in high-tax countries.[4] Offshore tax shelters thrive in a climate of secrecy, non-transparency, and lack of bilateral and multilateral cooperation that characterises tax-haven jurisdictions.[5]

Tax havens and banking secrecy

Tax-haven jurisdictions are characterised by high levels of secrecy in their banking and commercial sectors which makes it difficult for other countries

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2 OECD *Harmful tax competition: an emerging global issue* (1998) at 13.

3 RJ Peroni 'Back to the future: a path to progressive reform of US international income tax rules' 51 *U Mich L Rev* (1997) at 975.

4 'Tax avoidance' refers to the use of perfectly legal methods of arranging one's affairs so as to pay less tax. It involves utilising loopholes in tax laws and exploiting them within legal parameters. See *IRC v Duke of Westminster* (1936) 19 TC 490 at 520. 'Tax avoidance' should be distinguished from 'tax evasion' which is illegal and usually involves the non-disclosure of income, rendering of false returns and the claiming of unwarranted deductions. See D Meyerowitz *Meyerowitz on income tax* (2008) at 29.1.

5 OECD Report n 2 above; B Spitz & G Clarke *Offshore service* (March 2002) at OECD/3; OECD 'Issues in international taxation no 1 *International Tax Avoidance and Evasion* (1987) at 20; A Ginsberg *International tax havens* (2ed 1997) 5–6; P Roper & J Ware *Offshore pitfalls* (2000) at 5.

to establish whether their residents are using the tax haven to avoid taxes.[6] Taxpayers often avail themselves of these banking secrecy rules to ensure that their business transactions are kept from the knowledge of the tax authorities.[7] Many jurisdictions follow the common law precedent in terms of which the information a banker receives from his customer is privileged. This has evolved into a standard basis for protecting banking affairs and financial transactions from divulgence to foreign tax authorities.[8] These secrecy provisions are, however, often abused in tax havens not only to facilitate the evasion and avoidance of taxes, but also to hide the actions of tax haven promoters who aid and abet such practices.[9]

Because the term 'tax haven' connotes the circumvention of another country's tax laws, many tax havens are increasingly selling themselves as 'offshore financial centres' in order to create a more positive image.[10] The latter term reflects the wide range of commercial and financial activities carried on in those jurisdictions.[11] Although an offshore financial centre may be a tax haven, not all tax havens are offshore financial centres.[12] The combination of tax havens and offshore financial centres creates a highly secretive and under-regulated globalised infrastructure.[13]

It is important to note that although geographically, many tax havens are located on small islands, politically and economically the majority of tax

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6 OECD Report n 2 above.

7 United Nations Ad Hoc Group n 1 above at 18.

8 WH Diamond & DB Diamond *Tax havens of the world* (2002) Publication 722 Release 108 at INTRO–35.

9 M Hampton *The offshore interface: tax havens in the global economy* (1996) 12; Ginsberg n 5 above at 13; L Olivier & M Honiball *International tax: a South African perspective* (2008) 553. In one Cayman Islands case, a bank from the United States which had a subsidiary in the Cayman Islands was issued with a summons by the United States' Internal Revenue Service for the purpose of identifying (for tax liability) persons who had transferred or received large sums of money during a specific period. The Cayman Islands court held that the safeguarding of confidentiality was a cornerstone of the Cayman Islands' banking business and that the preservation of this principle was the basis on which the economy of the Cayman Islands so substantially relied. The preservation of this principle outweighed the interests of the US's Internal Revenue Service in enforcing its summons. See *In the matter of Bank of America Trust and Banking Corp (Cayman) Ltd*, and *In the matter of Bank of America National Trust and Savings Association* 1992 93 CILR 574, read from Spitz & Clarke n 5 above at 158.

10 Ginsberg n 5 above at 3 and Olivier & Honiball n 9 above at 553

11 G Clarke *Offshore tax planning* (9ed 2002) at 250.

12 Ginsberg n 5 above at 3; Olivier & Honiball n 9 above at 463.

13 Hampton n 9 above at 13.

havens are linked to major developed countries.[14] For instance, many banks, law firms and accounting businesses located in London also operate out of satellite offices located in British Overseas Territories and Crown Dependencies.[15] Many tax havens act largely as booking centres for instructions issuing from cities such as London, New York, Tokyo, Frankfurt, Paris and Zurich.[16] Major international banks make use of these jurisdictions because of their permissive regulatory regimes, zero or minimal tax rates, and their secrecy arrangements that entail the non-disclosure of beneficial ownership of companies and trusts.[17]

Over the past fifty years, most of the world's major international banks have opened branches or subsidiaries in offshore financial centres.[18] Some of these banks have commercial substance and either service the local market or operate as service centres for the international business community. Others are merely 'brass plate' banks – legal fictions used to book deposits and loans so that they fall outside the regulatory rules of the bank's home country.[19] The active collusion between banks and their clients in offshore secrecy is vividly demonstrated by the United States (US) investigations into the operations of the Swiss bank (UBS) and Bank of Liechtenstein (LGT).[20]

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14 R Palan 'Offshore and the structural enablement of sovereignty' in MP Hampton & JP Abbott (eds) *Offshore finance centres and tax havens: the rise of global capital* (1999). Traditionally, the core tax-haven jurisdictions have been islands in Europe and the Caribbean that are located off the shores of the mainland continents. That is why the term 'offshore' is used in respect of these jurisdictions, although the term also applies to land-locked jurisdictions. See Clarke n 11 above at 6.

15 Tax Justice Network 'Tax us if you can – the true story of a global failure, London' (2005) at 1.

16 Palan n 14 above.

17 In many tax-haven jurisdictions non-resident banking activities are not subject to bank reserve requirements and they are taxed more lightly (if at all). See Palan n 14 above; Spitz & Clarke n 5 above at INT/7; A Ogley *Tolley's tax havens: a practical guide to the leading tax havens of the world* (1ed 1990) 7; B Arnold & MJ McIntyre *International tax primer* (2ed 2002) at 139.

18 Hampton n 9 above at 15; Spitz & Clarke n 5 above at INT/5; Roper & Ware n 5 above at 5; R Rohatgi *Basic international taxation* (2002) at 337.

19 United Nations 'Financial havens, banking secrecy and money laundering' (1998) 12. available at: http://www.un.org/News/Press/docs/1998/19980608.socna784 html (accessed on 18 May 2009).

20 Both of these banks are major players in the private banking market, and are well known for assisting wealthy US clients in concealing their ownership of the assets held offshore by creating nominee and sham entities. See J Christensen 'Africa's bane: tax havens, capital flight and the corruption interface' at 5 available at: http://www realinstitutoelcano.org/wps/portal/rielcano_eng/Content?WCM_GLOBALCONTEXT=/Elcano_in/Zonas_in/Sub-Saharan+Africa/DT1-2009 (accessed on 21 May 2009).

In 2008 the US released a report[21] that shows that UBS had opened Swiss accounts for an estimated 19 000 United States clients with nearly $18 billion in assets, and had not reported any of these accounts to the US Internal Revenue Service.[22] Numerous cases were also unveiled of US citizens who had secretly stashed millions of dollars in LGT accounts. These cases unfolded like spy novels, with secret meetings, hidden funds, shell corporations, and complex offshore transactions spanning the globe from the United States to Liechtenstein, Switzerland, the British Virgin Islands, Australia and Hong Kong.[23] What these cases had in common was that officials from LGT and its affiliates acted as willing partners to move a lot of money into LGT accounts, while obscuring the origin of the funds from tax authorities, creditors, and courts.[24]

Indeed, the active collusion of major international banks in offshore secrecy has been identified as one of the major factors that caused the global financial crisis that started in 2007. The International Monetary Fund (IMF) released a report in 2009 in which it affirmed that secret offshore investments in securitisations have been long employed by many banks to create complex financial instruments (such as swaps and deep-discount securities) as part of their tax arbitrage policy.[25] Between 2003 and 2007, the business of a number of large international banks such as Lehman Brothers and Goldman Sachs in the United States, as well as the Royal Bank of Scotland, boomed as a result of such investments.[26] The IMF, however, notes that these huge investments resulted in tax distortions that encouraged excessive leveraging

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21 United States Senate Permanent Subcommittee on Investigations 'Tax Haven Banks and US Tax Compliance – Staff Report' (2008).

22 The New Zealand Herald 'Secret Swiss Bank tactics revealed in UBS Tax Case'. Available at: http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10560164 (accessed on 21 July 2011). See also Statement of Senator Carl Levin (D-Mich) 'Tax haven banks and US Tax compliance: obtaining the names of US Clients with Swiss accounts' (4 March 2009) Available at: http://hsgac.senate.gov/public/_files/OPENINGCARLLEVINMarch409Hrg0.pdf (accessed on 21 May 2011).

23 US 2008 Investigation Report on Tax Haven Banks n 21.

24 *Ibid*.

25 IMF 'Global Financial Crisis: Tax Policies Made Countries More Vulnerable to Crisis' (16 June 2009) available at: http://www.imf.org/external/pubs/ft/survey/so/2009/res061709a htm (accessed on 21 April 2011); See also IMF Fiscal Affairs Department 'Debt bias and other distortions: crisis-related issues in tax policy' (12 June 2009) available at: http://www.imf.org/external/np/pp/eng/2009/061209.pdf (accessed on 4 June 2010).

26 Tax Justice Network 'IMF realises offshore contributes to financial crisis' available at: http://taxjustice.blogspot.com/2010/03/imf-realises-offshore-contributes-to.html (accessed on 1 June 2010).

(the ratio of total assets to shareholders equity) and other financial market problems that were the main cause of the global financial crisis.[27] This is confirmed by the report of the Tax Justice Network[28] and a report by the Bank for International Settlements[29] which confirm that bank investments in securitisation transactions played a major role in the financial crisis that emerged in mid-2007. In the much-publicised US fraud case involving a lawsuit filed by the US Securities and Exchange Commission against Goldman Sachs Bank, evidence pointed to the fact that securitisation transactions worth $2 billion were assembled in the Cayman Islands resulting in huge losses in USA taxes.[30] Another case involving the Lehman Brothers US bank revolved around the development of complex financial instruments which securitised $146 billion in mortgages during 2006 and 2007.[31] Indeed, according to the June 2007 and 2008 IMF surveys of US portfolio liabilities, the Cayman Islands were the largest foreign holders of the private-label US mortgage-backed securities which contributed to the financial crisis.[32]

Lack of Transparency and Information Exchange

Another characteristic of tax havens that enhances secrecy is the lack of transparency and information exchange with other governments concerning the benefits taxpayers receive from the tax havens.[33] Information exchange provisions help countries monitor the foreign portfolio investments of their residents in offshore jurisdictions so that they can effectively enforce their tax laws.[34]

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27 IMF n 25 above.

28 Tax Justice Network 'Mapping the fault lines – key financial indicator 12: protected cell companies' available at: http://www.secrecyjurisdictions.com/PDF/CellCompanies.pdf (accessed on 12 May 2010).

29 Bank For International Settlements 'Basel Committee on Banking Supervision: Joint Forum Report on Special Purpose Entities' (September 2009) at 1 available at: http://www.bis.org/publ/joint23.pdf (accessed on 13 May 2010).

30 Tax Justice Network 'Goldman deal went through Cayman Islands' available at: http://taxjustice.blogspot.com/2010/04/goldman-deal-went-through-cayman.html (accessed on 1 June 2010).

31 IMF n 25 above.

32 IMF Working Paper prepared by Philip R Lane & Gian Maria Milesi-Ferretti 'Cross-border investment in small international financial centers' (February 2010). Available at: http://www.imf.org/external/pubs/ft/wp/2010/wp1038.pdf (accessed 1 June 2010).

33 Lack of transparency and effective exchange of information in tax haven jurisdictions are the key attractions for tax abuse because taxpayers can place their assets in these jurisdictions with confidence that their business activities will not be disclosed to the tax authorities back home. See OECD 1998 Report n 2 above at par 79.

34 JG Salinas 'The OECD Tax Competition Initiative: a critique of its merits on the global market place' (2003) 25 *Houston Journal of International Law* at 534–535.

It should be noted that it is not only tax-haven jurisdictions that lack transparency and information exchange with other countries.[35] The 1998 OECD report[36] states that this characteristic is also common in 'preferential tax regimes', which can occur in high-tax jurisdictions.[37] However, it is mainly the tax-haven jurisdictions that are notorious in this respect.[38]

The enablers of offshore tax shelters

Offshore tax shelters are actively marketed on Internet websites, mainstream newspapers and magazines, by a combination of multinational accounting firms, law firms, broker-dealers, company formation agents, service providers, and trust administrators.[39] Indeed, it has been noted that the growth in corporate tax shelters is a reflection of the more accepting attitudes of tax advisers and corporate executives towards aggressive tax planning.[40]

Major accounting firms, investment banks as well as some law firms, maintain large departments staffed with professionals who devote a lot of effort to generating complex tax shelter products[41] which involve legal entities established in several offshore jurisdictions that are used as 'black boxes' to hide assets from the law enforcement.[42] One commentator has noted that this is a world of 'smoke and mirrors', where a typical strategy might well involve an offshore trust created in jurisdiction 'A' with trustees in jurisdiction 'B'. The offshore trust would then be the sole shareholder in

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35 Salinas n 34 at 541; Olivier & Honiball n 9 at 552; J Owens, Director, Centre for Tax Policy and Administration OECD 'Offshore Tax Evasion: The Role of Exchange of Information' (2007) available at: http://www.ceff.univ-cezanne fr/documents/owen.doc (accessed on 18 May 2009).

36 OECD n 2 above at par 75.

37 'Preferential tax regimes' are also are characterised by no or low effective tax rates on income and they are ring-fenced. See Salinas n 34 above at 540.

38 Diamond & Diamond n 8 above at INTRO 1; Clarke n 11 above at 250; Hampton n 9 above at 15; Spitz & Clarke n 5 above at INT/5; Ginsberg n 5 above at 3; Olivier & Honiball n 9 above at 553.

39 Ogley n 17 above at 10; Christensen n 20 above ; OECD n 2 above.

40 United States Treasury Department Report on the 'The Problem of Corporate Tax Shelters – Discussion Analysis and Legislative Proposals' (1999) at 19 available at: http://www.quatloos.com/whiteppr.pdf (accessed on 4 April 2009). The attitudes prevailing amongst offshore tax professionals are captured in this quote in response to a 2004 financial statement by the United Kingdom Chancellor of the Exchequer: 'No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken.' See G Smith & M Stephens as quoted in *The Guardian* 18 March 2004.

41 P Canellos 'A tax practitioner's perspective on substance, form and business purpose in structuring business transactions and in tax shelters' (2001) 54 *SMU Law Review* at 48.

42 US Senate Permanent Sub-Committee on Investigations '*Tax haven abuses: the enablers, the tools, the secrecy'* (2006) at 5.

an offshore company registered in jurisdiction 'C' with nominee directors and shareholders. The offshore company would then operate a secret bank account in jurisdiction 'E'.[43] The ultimate beneficiaries of this structure may have no apparent connection with any of these jurisdictions and the entire structure, which is expensive to both create and operate, will have been designed to prevent investigation. Even when investigators are able to penetrate these hidden structures, flee clauses normally included in their trust agreements, and the re-domiciliation clauses incorporated in their memorandum and articles of association, would allow the structures to shift instantly to other jurisdictions at the first sign of investigation.[44]

International tax consultants typically justify their tax avoidance services on grounds of promoting economic efficiency.[45] Another justification for such practices is that tax policies are overly complex and therefore impose unnecessary burdens on business. The reality is that tax rules have become complex partly in response to the increasingly elaborate tax planning strategies used to avoid paying taxes.[46] It has also been noted that measures to curb offshore tax shelters are often hindered by the lobbying activities of multinational corporations, banking associations, legal associations, trust and estate practitioners, and other influential financial lobbies.[47]

It should however be clarified that not all tax practitioners are involved in these tax shelters; many tax advisers participate in mainstream, high profile tax practice. However, they too have come under some pressure as of late, due to competitive concerns and the demands of corporate clients intent on minimising taxes by virtually any means. [48]

The extent of the offshore tax shelter problem and its disadvantages

Although offshore tax shelters are a big international problem, because of the secrecy involved, there are no precise estimates of the amount of tax at risk.[49] It is estimated that approximately one-third of international foreign direct investment is routed via tax havens and that fifty per cent of global trade is routed on paper via tax-haven jurisdictions, even though they only account for some three per cent of world GDP. Personal wealth totalling 11,5 trillion

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43 Christensen n 20 above.
44 *Ibid*.
45 *Ibid*.
46 *Ibid*.
47 Tax Justice Network n 15 above.
48 Canellos n 41 at 55 above.
49 Owens n 36 above.

US dollars has been shifted offshore by the super-rich, evading taxes of over 255 billion US dollars annually.[50]

Clearly, offshore tax shelters encourage capital flight and this impacts significantly on the capital accumulation and the investment processes of many developing countries.[51] The resultant loss of tax revenue limits the ability of governments to pursue their economic and social objectives, forcing them to divert scarce resources from their intended targets[52] and to shift the burden of taxation to less mobile factors such as labour and consumption.[53] Widespread tax abuse may also result in an increase in the tax payable by the individual taxpayer.[54] This state of affairs encourages a disrespect for the tax system.[55] It also discourages compliance by ordinary taxpayers and enhances a perception that the tax system is unfair.[56]

Offshore tax shelters have led to a proliferation of anti-tax abuse laws that are enacted in response to particular schemes. Invariably, taxpayers devise more complex schemes and the cycle goes on. This has only made the system more complex without significantly eliminating the problems caused by offshore tax shelters.[57] The effect of all this has been the increase in costs for governments and compliance burdens upon all taxpayers.[58]

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50 OECD 'Overview of the OECD's work on countering international tax evasion' in Annexure II (21 April 2009) available at: http://www.oecd.org/dataoecd/32/45/42356522.pdf (accessed on 5 May 2009).

51 DR Lessard & J Williamson *Capital flight and Third World debt* (1987) at 14.

52 South African Revenue Service (SARS) 'Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act' 1962 (Act No. 58 of 1962)' (2005) at 14.

53 RS Avi-Yonah 'Globalisation, tax competition, and the fiscal crisis of the welfare state' (2000) 113 *Harvard Law Review* at 1578; see also SARS Discussion Paper n 52 at 14.

54 L Olivier 'Tax avoidance and common law principles' (1996) *2 Tydskrif vir Die Suid-Afrikaanse Reg* at 378.

55 D Kruger & W Broomberg *Broomberg on tax strategy* (2003) 4 ed at 1; United States 1999 Treasury Report on Corporate Tax Shelters n 40 above at 19.

56 OECD 1998 Report n 2 at 4; The New York State Bar Association – hardly a 'pro-tax' organisation – has stated that: 'The constant promotion of these frequently artificial transactions breeds significant disrespect for the tax system, encouraging responsible corporate taxpayers to expect this type of activity to be the norm, and to follow the lead of other taxpayers who have engaged in tax advantaged transactions.' See Statement of HR Handler on behalf of the Tax Section, New York State Bar Association, before the Committee on Finance (27 April 1999) at 2. Quoted in the United States 1999 Treasury on Corporate Tax Shelters n 40 above at 3.

57 RJ Peroni, JC Fleming & SE Shay 'Getting serious about curtailing deferral of United States tax on foreign source income' (1999) 52 *SMU Law Review* at 508.

58 OECD 1998 Report n 2 in par 30; US Treasury 1999 Report on Corporate Tax Shelters n 40 above at 20.

International initiatives against secret offshore tax shelters

Offshore tax shelters have been under scrutiny by several international bodies.

OECD initiatives against banking secrecy

In a report on banking secrecy issued in 1987,[59] the OECD observed that the decision by one country to prevent or restrict access to bank information for tax purposes adversely affects the tax administration of other countries. It thus recommended that greater international cooperation was needed to combat tax evasion resulting from banking secrecy. The OECD called on countries to relax bank secrecy rules towards the tax authorities and encourage the exchange of tax information from their banks.[60] These sentiments were reiterated in the 1998 report on Harmful Tax Competition, in which the OECD recommended that countries should review their laws and regulations governing access to banking information with a view to removing impediments to accessing such information by tax authorities.[61]

In a further report issued in 2000,[62] the OECD recommended that in order to ensure that tax havens do not impede cooperation with international tax information requests, banks should identify the beneficial owners of all bank accounts and that secret bank accounts should be abolished. Countries were called upon to simplify their laws and regulations affecting information required by tax authorities. The 2000 report did not, however, suggest that banking secrecy should be abolished as the confidentiality of financial information is necessary to preserve confidence in the financial system.[63] Neither did the report permit an unfettered access to bank information or 'fishing' expeditions for information by tax authorities. Rather, it recommended that information requests should relate to specific cases and be for tax purposes only.

In 2003 the OECD published standards of access to bank information for tax authorities that OECD member countries were encouraged to implement.[64]

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59 OECD 'Taxation and the Abuse of Bank Secrecy' (1987); see also Owens n 35 above.

60 OECD 1987 Report on Bank Secrecy n 59 above.

61 Spitz & Clarke n 5 above at OECD/12.

62 OECD 'Improving access to bank information for tax purposes' (2000) available at: http:// www.oecd.org/dataoecd/3/7/2497487.pdf.

63 Rohatgi n 18 above at 337.

64 OECD 'Improving access to bank information for tax purposes – the 2003 Progress Report' available at: http://www.oecd.org/document/35/0,3343,en_2649_201185_15091043_1_1_1_1,00.html (accessed on 31 July 2009).

Successive progress reports since 2007 show that some countries such as Austria, Belgium, Luxembourg and Switzerland appear to have implemented some of these standards, but others, like Liechtenstein, have to date refused to introduce such standards.[65] One of the reasons for this lack of cooperation is that if some tax havens implement banking rules, like the 'know your customer' rule, investors will be inclined to open bank accounts in other tax havens where formalities and checks on customers are minimal. [66]

IMF and World Bank initiatives on banking transparency

One cannot fully discuss the importance of transparency in the banking sector without acknowledging the roles played by the International Monetary Fund (IMF) and the World Bank. In 1999, the IMF and the World Bank initiated certain international standards and codes that banks were expected to observe.[67] Since then, the IMF and the World Bank have published Reports that summarise the extent to which countries observe these standards and codes.[68] Among the key areas that should be observed by banks is fiscal transparency[69] as described in the 2007 IMF report on the 'Code of good practices on fiscal transparency'.[70] This report points out that banking fiscal transparency should ensure proper monitoring, reporting and tracking of taxpayer's revenues and assets.[71] Adherence to the principles in this IMF

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65 OECD 'Tax Co-operation Towards a Level Playing Field: 2007 Assessment by the Global Forum on Taxation' available at: www.oecd.org/document/29/0,3343,fr_2649_201185_39473821_1_1_1_1,00 html – 27k (accessed on 5 May 2009); Olivier & Honiball n 16 above at 558.

66 United Nations 'The geography of offshore financial centers and bank jurisdictions' (1998) available at: http://www.globapolicy.org/nations/finhavv99 htm (accessed on 18 May 2009).

67 IMF and World Bank 'The standards and codes initiative – is it effective? And how can it be improved?' (2005) 5 available at: http://www.worldbank.org/ifa/ROSC%20review%202005.pdf (accessed on 10 September 2010).

68 World Bank 'Reports on Observance of Standards and Codes' http://www.worldbank.org/ifa/rosc_more html (accessed on 15 September 2010).

69 The IMF has recognised twelve areas and associated standards as useful for the operational work of the IMF and the World Bank. These comprise accounting; auditing; anti-money laundering and countering the financing of terrorism (AML/CFT); banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation. See IMF 'Reports on the Observance of Standards and Codes (ROSCs)' available at: http://www.imf.org/external/np/rosc/rosc.asp?sort=date (accessed on 10 September 2010).

70 IMF 'Code of Good Practices on Fiscal Transparency' (2007).available at: http://www.imf.org/external/np/pp/2007/eng/051507c.pdf (accessed on 16 September 2010).

71 *Id* at par 2.2 and 2.2.1.

report can be instrumental in ensuring the exposure of offshore banking secrecy.

An international institution worth mentioning that has worked alongside the IMF and the World Bank in ensuring banking transparency is the Basel Committee on Banking Supervision.[72] This committee issued a document in 1997 entitled the 'Core Principles for Effective Bank Supervision'[73] which emphasises the importance of transparency in banks' supervisory processes and the strengthening of market discipline. In its 2004 report commonly referred to as Basel II,[74] the Basel Committee sets out certain international standards to enhance financial stability by ensuring minimum capital requirements for internationally active banks. The third pillar of the Basel II principles covers transparency and the obligation of banks to disclose meaningful information to all stakeholders. In light of the banking weaknesses revealed by the financial markets crisis, in 2009, the Basel Committee issued further documents aimed at strengthening the regulation and supervision of internationally active banks.[75] The proposed enhancements will help ensure that the risks inherent in banks' portfolios related to trading activities, securitisations and exposure to off-balance sheet vehicles are better reflected in minimum capital requirements, risk management practices, and accompanying disclosures to the public.[76]

OECD initiatives on transparency and information exchange

In order to counter harmful tax practices in both tax havens and preferential tax regimes, the 1998 OECD report on harmful tax practices recommended that countries should have rules on the reporting of international transactions and foreign operations of resident taxpayers, and that countries should exchange any information obtained under such rules.[77] In 2002, the OECD issued a list of countries that lacked transparency and effective exchange of

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72 The Committee's Secretariat is located at the Bank for International Settlements in Basel, Switzerland. For details on the Committee's members, see Bank for International Settlements 'About the Basel Committee' available at: http://www.bis.org/bcbs/ (accessed on 15 September 2010).

73 Bank for International Settlements 'Core Principles for Effective Bank Supervision' (1997) available at: http://www.bis.org/publ/bcbs30a.pdf (accessed on 15 April 2011).

74 Basel Committee on Banking Supervision 'International Convergence of Capital Measurements and Capital Standards: A Revised Framework' (2004).

75 Bank for International Settlements 'Basel Committee on Banking Supervision Announces Enhancements to the Basel II capital framework' available at: http://www.bis.org/press/p090116.htm (accessed on 10 September 2010).

76 *Ibid*.

77 OECD 1998 Report n 2.

information,[78] calling on them to reform or they would be regarded as uncooperative tax havens that present a threat not only to the tax systems of developed and developing countries, but also to the integrity of international financial systems.[79] Jurisdictions that made a commitment to reform were not included on that list,[80] and they participated in developing international standards of transparency and information exchange under the OECD's 'Global Forum on Taxation'.[81] These standards require:

> –Exchange of information on request where it is foreseeably relevant to the administration and enforcement of the domestic laws of a treaty partner.
> –No restrictions on exchange caused by bank secrecy or domestic tax interest requirements.
> –Respect for taxpayer's rights.
> –Strict confidential information exchange.

The above standards are embodied in the OECD 'Model Agreement on Exchange of Information in Tax Matters' issued in 2002, which serves as a model for the negotiation of bilateral or multilateral agreements.[82] The standards are also embedded in article 26 of the OECD Model Tax Convention and are considered the international norm for tax cooperation.[83]

In 2006, the OECD issued a report[84] which assessed the legal and administrative frameworks required to achieve a 'global level playing field'

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78 For this list, OECD 'Towards Global Tax Co-operation: Report of the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices' (2000) in par 11 http//www.oecd.org/dataoecd/9/61/2090192.pdf (accessed on 17 April 2011); LB Samuels & D C Kold 'OECD initiative: harmful tax practices and tax havens in *Taxes'* (2000) at 240.

79 Arnold & McIntyre n 17 above at 122–123.

80 A total of thirty-three jurisdictions (including Bermuda, Cyprus, Cayman Islands, Malta, Mauritius and San Marino) made such commitments leaving only five jurisdictions currently on the OECD's list of un-cooperative tax havens, *viz* Andorra, Liberia, Liechtenstein, Monaco and Marshall Islands. The text of every commitment is available on the OECD website available at: http://www.oecd.org/taxation (accessed on 12 June 2009).

81 OECD n 50 above.

82 Details on the 'Model Agreement on Exchange of Information on Tax Matters' are available at: http://www.oecd.org/dataoecd/15/43/2082215.pdf (accessed on 23 May 2009).

83 It is also worth noting that the United Nations has also incorporated the OECD's standards on transparency and Exchange of information in tax matters in its own Model Tax Convention. See OECD n 50 above.

84 OECD 'Tax co-operation: towards a level playing field' (2006) available at: www.oecd.org/document/29/0,3343,fr_2649_201185_39473821_1_1_1_1,00 html - 27k (accessed on 5 May 2009).

in the areas of transparency and effect exchange of information for tax purposes. The 2007 follow up assessment[85] and successive reports show that a number of tax havens have continued to make commitments to implement the OECD's standards of transparency and information exchange.[86] Some of these jurisdictions have signed exchange of information agreements with various OECD member countries.[87] However, in April 2009, the OECD noted that a great deal of work remains to ensure that all jurisdictions accept these standards, and that those that made commitments to accept the standards follow through and implement them.[88] Countries such as Andorra, Liberia, Liechtenstein, Marshall Islands, Monaco and Singapore still refuse to endorse the standards.[89] One of the reasons that some tax havens refuse to cooperate with information exchange, is that tax evaders are likely to shift their funds from the cooperative jurisdictions, thereby rewarding those who remain recalcitrant.[90] The OECD has urged that all negotiations to sign exchange of information agreements should come to a successful conclusion within a reasonable time.[91]

European Union (EU) initiatives

The EU has also been instrumental in dealing with offshore tax shelters among its member states. The measures included a 'Code of Conduct' on business taxation,[92] in terms of which EU member states are called upon to

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85 OECD 'Tax Co-operation Towards a Level Playing Field: 2007 Assessment' n 65; Olivier & Honiball n 16 at 558.

86 Such countries include: Monaco, San Marino and Uruguay. Details available at: http://www.oecd.org/ (accessed on 21 April 2011); For Monaco see: http://www.oecd.org/document/33/0.3343,en_2649_34487_42437729_1_1_1_1,00.html (accessed on 30 April 2009).

87 Such agreements include the agreements between Netherlands and Guernsey; Isle of Man and Ireland; Guernsey and Netherlands; Germany and Jersey; Cayman Islands and the Nordic Economies; Bermuda and the Nordic Economies. For details see http://www.oecd.org/ (accessed on 30 April 2009).

88 OECD n 50 above.

89 Owens n 27 above.

90 R Avi-Yonah 'The OECD harmful tax competition report: A 10th Anniversary Retrospective' in University of Michigan Law School's Public Law and Legal Theory Working paper Series (August 2008) available at: http://www.law.umich.edu/centersandprograms/olin/abstracts/2008/Documents/08-013aviyonah.pdf (accessed on 12 May 2009).

91 Owens n 27 above.

92 The 'Code of Conduct' is a political commitment, not a legally enforceable rule. See W Bratton & J McCahery 'Tax coordination and tax competition in the European Union: evaluating the Code of Conduct on Business Taxation' (2001) 28 *Common Market Law Review* 677.

stop any measures that constitutes harmful tax competition.[93] The EU has also come up with measures to address banking secrecy among countries like Luxembourg and Switzerland which attract the savings income of non-resident individuals that drains other states' tax revenues.[94] These measures include the issuing of a Directive on a common system of taxation on interest and royalty payments made between associated companies of different member states.[95] There is also a Directive on the effective taxation of savings income.[96] The EU has further signed agreements with Switzerland, Liechtenstein, Monaco and San Marino,[97] to ensure that a system of exchange of information on harmful tax competition is implemented.[98]

The EU directives and the European Court of Justice, which is steadily enforcing tax harmony in the name of the single European market, give the EU a better chance of curbing tax shelters among its own members. However, any success the EU achieves internally may simply make it more vulnerable to tax abuse from non-EU countries.[99]

The G7/G8/G20 initiatives

In 1998, the G7 countries[100] came up with a comprehensive 'Code of Conduct on Business Taxation' that entails a commitment to take international action on tax issues, including the exchange of information

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93 B Spitz *Offshore strategies* (2001) at 251; BJM Terra & PJ Wattel *European tax law* (4 ed 2005) at 242; MF Ambrosanio & MS Caroppo 'The reponses of tax havens against harmful tax competition: formal statements and concrete policies' (October 2004) *Quaderni Dell'Istituto Di Economia E Finanza* at 6 available at: http://www.unicatt.it/Istituti/EconomiaFinanza/ Quaderni/571004.pdf (accessed on 25 May 2009).

94 Terra & Wattel n 93 at 243.

95 Interest and Royalty Directive 2003/49/EC as read from Terra & Wattel n 93 above at 627.

96 The Savings Income Directive 2003/48/EC as read from Terra & Wattel n 93 above at 643. There is also the Directive on a common withholding tax to prevent the flow of funds to low-tax jurisdictions. See Diamond & Diamond n 8 at INTRO 24.

97 Terra & Wattel n 93 at 643.

98 *Id* at 243.

99 T Bennet *International initiatives affecting financial havens* (2001) at 35.

100 The term 'G7' refers to the Group of Seven industrialised countries. Before 1997, this group comprised: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States of America. In 1997 Russia formally joined the group to make it the G8. The G20 is a group of finance ministers and central bank governors from 20 economies. It consists of: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, México, Russia, Saudi Arabia, South Africa, Korea, Turkey, the United Kingdom, United States and European Union. See Wikipedia 'The G-20 Major Economies' available at: http://en.wikipedia.org/wiki/G-20_major_economies (accessed on 28 July 2009).

among member states.[101] The G7 made it clear that they would not tolerate tax haven bank secrecy and tax abuse by residents of high-tax countries.[102] In various successive summits, the G7 has agreed to reinforce the initiatives of the EU and the OECD in tackling harmful tax competition and obtaining information about transactions in tax havens and preferential tax regimes.[103]

National leaders at the the May 2009 G20 Summit in London pledged to crack down on the tax abuse and shadow banking through offshore jurisdictions which they claimed were central to the global financial crisis.[104] The British dependent territories were put under renewed pressure by the British Prime Minister to end their culture of banking secrecy and sign agreements to share tax information by September 2009 or face sanctions.[105] The G20's initiatives also forced countries like, Costa Rica, Malaysia, the Philippines and Uruguay (that were blacklisted by the OECD for not agreeing to share tax information), to reform and they have now been moved to the grey list.[106]

National initiatives to 'crack down' on offshore tax shelters

Although international bodies have made many efforts to discourage offshore tax shelters, this fight can only be won if the political will of the governments involved is harnessed.[107]

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101 G8 Information Centre: The Birmingham Summit 'G7 Initiative on harmful tax competition' (15–17 May 1988) available at: http://www.g7.utoronto.ca/summit/1998 birmingham/harmfultax html (accessed on 3 June 2009). See also Diamond & Diamond n 8 above at INTRO 23;

102 Diamond & Diamond n 8 above at INTRO 23.

103 See G8 Information Centre 'Cologne Summit' (1999) http://www.g8 fr/evian/English/navigation/g8_documents/acrchives_from_previous_su (accessed on 3 June 2009); G8 Information Centre: Kyushu-Okinawa Summit 'Actions against Abuse of the Global Financial System' (21 July 2000) in par C available at: http://www.g7.utoronto.ca/summit/2000okinawa/abuse htm (accessed on 3 June 2009); G8 Information Centre: G8 Finance Minister's Meeting Rome, Italy 'Fighting the Abuse of the Global Financial System' (7 July 2001) in par D available at: http://tspace.library.utoronto.ca/bitstream/1807/262/2/fm010707-b htm (accessed on 3 June 2009).

104 L Komisar 'Finance: tax havens in spotlight at G20 Meet': http://ipsnews net/news.asp?idnews=46308 (accessed on 21 May 2009).

105 F Lawrence Guardian.co.uk. 'Tax havens must end culture of secrecy or face sanctions' available at: http://www.guardian.co.uk/business/2009/apr/09/pm-warns-tax-havens-to-end-secrecy (accessed on 10 June 2009).

106 *Ibid*.

107 Rohatgi n 18 at 338.

The United States

From about 1993 to 2003, there was a wave of corporate tax shelters in the US. This resulted in a real decline in corporate tax revenues from three per cent to two per cent of the GDP.[108] In 2003, the Internal Revenue Service (IRS) began a serious crackdown on tax shelters, involving action against accounting and law firms that were essential to devising and marketing the shelters. The result was a remarkable recovery in revenue to four per cent of the GDP, which significantly broadened the corporate tax base.[109] In 2006, a report was issued exposing complex tax shelters peddled as investment strategies that involved deceptive networks of offshore trusts and corporations.[110]

One example is a thirteen-year offshore empire built by Sam and Charles Wyly.[111] The Wylys transferred over seventeen million stock options and warrants worth $190 million to nineteen offshore trusts that owned thirty-nine shell corporations on the Isle of Man and the Cayman Islands. In return, the offshore corporations gave the Wylys private annuities which were to be paid out years later. The proceeds of the stock options were invested in securities, hedge funds, businesses, and real estate for the Wyly family. The Wylys continually instructed the offshore trustees when to exercise the stock options and when to sell the shares, but they claimed that the trusts were independent. In this way, the Wylys participated in a thirteen-year sham that circumvented US tax laws.[112]

The US also unearthed the infamous Ugland House, a five-story building in the Cayman Islands that is the official address of over 18 800 registered companies. About half of the alleged Ugland House tenants had a billing address in the US and were not actual occupants of the building. The only

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108 JR Hines & EM Rice 'Fiscal paradise: foreign tax havens and American business' (1994) *Q J Econ* 149 (1994) 149; R Altshuler & TS Newlon 'The effect of US tax policy on the income repatriation patterns of US multinational corporations' in *Studies in International Taxation Giovannini et al* eds (1993).

109 Peroni n 3 above at 975.

110 US Senate Permanent Subcommittee on Investigations n 42 above; R Avi-Yohan 'Testimony Before the US Senate Permanent Subcommittee on Investigations, Hearing on Offshore Transactions' (1 August 2006) available at: http://hsgac.senate.gov/_files/STMAviYonahUafMI.pdf#search=%22Prepared%20testimony%20of20Avi-Yonah%20before%20permanent%20subcommitte%20 (accessed on 20 April 2009).

111 *Ibid*.

112 Under US law, tax on the income of a truly independent trust is paid by the trustees. But if a US person controls the trust's assets and investments, then the trust's income is generally taxable to that person. See Avi-Yohan n 110 above.

true occupant was a Cayman Law firm. The companies that were incorporated in the Cayman Islands were mere shell operations with no little or physical presence in that jurisdiction, as the key personnel and decision makers who used this shelter to avoid paying US tax, were in fact in the US.[113]

It is estimated that the secrecy behind schemes such as these, robs the US Treasury of some 100 billion dollars each year.[114] Since 2007, political consensus has formed among US politicians to close the so called 'tax gap' of undeclared income hidden in offshore tax havens. In May 2009, the US President, Barrack Obama, called for the curbing of offshore tax havens and corporate tax breaks to collect billions of dollars from multinational companies and wealthy individuals.[115] Also in 2009, the 'Stop Tax Haven Abuse Act' was tabled in the US Senate.[116] This Act aims at making it more difficult for US taxpayers to use offshore secrecy laws and practices to hide their offshore investments from the IRS. It would also allow the US to bar its own banks from doing business with foreign banks that refused to cooperate with US tax authorities.[117] The Act offers a set of practical measures that would help shut down offshore tax cheats and begin to reduce the 100-billion dollar offshore tax gap.[118]

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113 C Levin Statement on 'Introducing The Stop Tax Haven Abuse Act' (2 March 2009) at 11–12. Another case that was unearthed involved a Seattle-based securities firm (Quellos) which developed a tax shelter that was sold to five wealthy clients in separate transactions. The strategy entailed the creation of fake stock portfolios with fake securities that were used to generate fake stock losses which were in turn sold to partnerships with a false business purpose. The end result was $2 billion in real and taxable capital gains that were supposedly erased. For details, see US on Tax Haven Abuses n 58 above; Avi-Yohan n 110 above.

114 Levin n 113 above.

115 Je Calms & EL Andrews 'Obama calls for curbs on offshore tax havens' (4 May 2009) *New York Times*.

116 Barack Obama co-sponsored this Act as a senator and has endorsed it as president. See Levin 'Introducing the Stop Tax Haven Abuse Act' n 113.

117 *Ibid*.

118 The measures include: a rebuttable presumption that US persons with offshore investments are involved in offshore tax abuse unless evidence to the contrary is tendered; in order to curb Ugland type tax shelters, tax benefits would be denied foreign corporations managed and controlled in the United Sates; increased disclosure of offshore accounts and entities; measures to close foreign trust loopholes; to prevent Wyly type tax shelters, stronger penalties would be levied for failing to disclose securities; strengthening tax shelter penalties; and deterring financial institution participation in abusive tax shelter activities. See Carl Levin 'Statement before Senate Finance Committee hearing on tax issues related to ponzi schemes and an update on offshore tax haven legislation' (March 17 2009) at: http://levin.senate.gov/senate/statement.cfm?id=309907 (accessed on 21 May 2009).

Ireland

Ireland recently recovered almost one billion pounds in an investigation into offshore bank accounts,[119] where Irish residents were hiding undeclared income. More than 15 000 taxpayers came forward to make voluntary disclosures.[120] Before commencing the investigation, the Irish tax administration approached certain large domestic banks with offshore operations. The banks were advised that their offshore operations would be investigated and were given a date on which investigations would commence. The banks agreed to cooperate and informed their customers accordingly. At the same time, the tax administration engaged in an extensive media strategy to ensure that all non-compliant taxpayers would be aware of the benefits of the voluntary disclosure regime.[121] Ireland is also currently negotiating tax information exchange agreements with some tax-haven jurisdictions.[122]

Australia

The Australian government unearthed various tax schemes with an estimated loss of tax revenue involving one promoter exceeding 208 million US dollars.[123] Australia is now vigorously investigating offshore banking secrecy and has come up with a multi-agency operation to address this problem. Australia's investigation of tax evasion by individuals and businesses has, for example, forced the Pacific tax haven of Vanuatu to reverse its longstanding policy of banking secrecy. The Australian Tax Office's operation, called 'Project Wickenby', which carries out inquiries into the abuse of offshore financial centres, alleges that Vanuatu has established offshore bank accounts for more than 400 wealthy Australian individuals and businesses. These accounts were used to evade more than ninety-four million US dollars in Australian taxes. Eighty companies now face tax audits as a result of the inquiry's revelations.[124]

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119 OECD 'Overview of the OECD's Work on Countering International Tax Evasion' n 50.

120 Owens n 35 above.

121 *Ibid*.

122 *Ibid*.

123 *Ibid*.

124 International Tax Review 'Australian tax investigation forces Vanuatu to abandon banking secrecy' availble at: http://www.internationaltaxreview.com/?Page=9&PUBID=210&ISS=24746&SID=706362 (accessed on 21 May 2009).

The South African perspective

South Africa has estimated that it is losing sixty-four billion Rand (9,1 billion US dollars) to tax havens.[125] Since South Africa rejoined the global economy after the democratic elections in 1994, there has been increased international interest in the country and this has encouraged South Africans actively to participate in and become reintegrated into the global economy. The heightened global trade competition and the mobility of capital in the modern world have also encouraged South African residents, both individuals and corporations, to make considerable investments offshore, and also to look for ways of minimising their global tax exposure.

Like the other countries, South Africa does have legislation to curb offshore tax abuse. This includes: Controlled Foreign Company legislation,[126] transfer pricing,[127] thin capitalisation provisions,[128] and anti-avoidance legislation that deals with offshore trusts.[129] Alongside the above legislation, South Africa has exchange control regulations that are very instrumental in ensuring the timeous repatriation into the South African banking system of foreign currency acquired by residents of South Africa. Exchange controls also prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa.[130]

Despite the existence of this legislation, there is a dearth of reported cases on offshore tax shelters. This is partly due to the fact that, like most international tax laws, South Africa's legislation – for instance the CFC legislation – is very complex and largely prophylactic. Thus, taxpayers generally plan their affairs to avoid the application of the legislation, rather than risk a case questioning whether their activities fall within the scope of

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125 Owens n 35 above.

126 Under s 9D of the Income Tax Act 58 of 1962. For the details of the workings of s 9D and see Olivier & Honiball n 9 above at 430–471.

127 Under s 31(2) of the Income Tax Act. For details see Olivier & Honiball n 9 above at 484–510.

128 Under s 31(3) of the Income Tax Act. For details see The Second Interim Report of the Commission of Inquiry into certain aspects of the tax structures of South Africa *Thin capitalisation rules* (1995) at par 1.1; OECD Issues in International Taxation 2 *Thin capitalisation: taxation of entertainers, artists and sportsmen* (1987) at 10.

129 Sections 7(5), 7(6), 7(8) and 25B(2) of the Income Tax Act. See also paras 70, 71, 72 and 80(3) of the Eighth Schedule to the Income Tax Act 58. For the details see Oliver & Honiball n 9 above at 277–286.

130 South African Reserve Bank (SARB) 'Exchange control manual' par E: http://www.reservebank.co.za (accessed on 11 May 2009). In terms of Exchange Control Regulation 2, the general policy approach to exchange controls is that of prohibition except with permission granted by the Treasury.

the legislation, let alone a case questioning the validity of the provisions themselves.[131] Although the existence of this legislation has prevented a decline in corporate tax revenues that would otherwise have taken place, the estimated sixty-four billion rand that South Africa loses to tax havens,[132] suggests that taxpayers get involved in secret offshore schemes that circumvent the legislation.

A study of the available literature shows that South African residents have long been actively involved in offshore tax schemes that contribute to the depletion of the country's tax base. It has been noted that the Isle of Man is a particularly favourite haven for outward investment for South Africans, with at least thirty-five of the largest South African companies operating on the island. The Isle of Man is also used by many South African individuals for personal investment and wealth management, despite considerable competition from other offshore business centres.[133] Although Mauritius is not among the jurisdictions listed in the OECD 2002 list of tax havens,[134] Rohatgi[135] argues that Mauritius is an established treaty haven for offshore activities involving South Africans. Mauritius's close proximity to South Africa, and its stated policy of preferring to conclude double tax agreements with African countries, along with its membership of regional bodies, such as the South African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA), makes it an ideal location for setting up offshore entities.[136] Its extensive tax treaty network, particularly with African and Asian countries, offers South African residents the opportunity to route their investments to those regions via Mauritius.[137]

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131 D Sandler *Tax treaties and controlled foreign company legislation*, *pushing the boundaries* (2ed 1998) at xix.

132 Owens n 35 above.

133 J Gorringe 'Outward investment from South Africa – the offshore perspective' http://www.lowtax net/lowtax/html/offon/southafrica/sa_outward html (accessed on 21 May 2009).

134 G Makhlouf, Chair of the OECD's Committee on Fiscal Affairs 'The OECD list of Un-cooperative Tax Havens' (2002) available at: http://www.oecd.org (accessed on 4 May 2009).

135 Rohatgi n 18 above at 284.

136 Olivier & Honiball n 9 above at 559.

137 Mauritius Offshore Business Activities Authority (MOBAA) 'Mauritius: a sound base for the new millennium' (5 July 1999) available at: http://www mondaq.com/article.asp?articleid=7371&searchresults=1 (accessed on 2 June 2009). For more on MOOBA see also Schulze HCAW Schulze *International tax-free trade zones and free ports: a comparative study of their principles and practices* (1997) at 185–186.

The ability of South Africans to invest offshore has been enhanced by the continuous relaxation of the exchange control regulations that begun in July 1997.[138] Currently, the exchange control regulations permit South African residents to make direct offshore investments of up to four million rand.[139] This offshore allowance has been utilised to transfer investments into offshore trusts.[140] Ware and Roper[141] note that South African residents frequently make use of interest-free loans to transfer the amount permitted by the Exchange Control authorities to non-resident trusts.[142]

Over the past few years, however, trusts have been singled out for harsh tax treatment by the South African legislator, to ensure that they are no longer used as a tool for offshore tax avoidance.[143] This does not mean, however, that the offshore trust has altogether outlived its usefulness as a tax planning vehicle. Sophisticated taxpayers still make use of combinations of trust and company structures to avoid taxes. For instance, with the help of certain banks, some South African taxpayers formed 'loop structures' that contravened Exchange Control Regulation 10(1)(c). Under these structures, investments were made to offshore trusts, using the foreign investment allowance.[144] The offshore trust would then purchase or subscribe for shares in a South African company that would use the proceeds from the trust and local borrowings from the founder or a bank to purchase capital assets in South Africa. Should those capital assets have included shares, dividends would be remitted overseas.[145] On realisation of the capital assets, the company would be liquidated and the capital gain would be remitted to the offshore trust.[146] Investments in such loop structures have been popular in the

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138 DM Davis, C Beneke & RD Jooste *Estate Planning* (September 2004) Service Issue 17 par 17.1; Ginsberg n 5 above at 29 and at 581; J Ware & P Roper 'The impact of residence-based tax on offshore trusts' (2001) 16 *Insurance and Tax Journal* at 21.

139 SARB 'Exchange Control Manual' n 120 in par 6.1.1.

140 *Ibid.*

141 Ware & Roper n 138 above at 21.

142 Davis *et al* n 238 above at par 17.9.

143 Olivier & Honiball n 9 above at 277.

144 J Gordon 'The R750 000 offshore allowance: loans and 'loop backs' between trusts and beneficiaries' (2000) *Insurance and Tax Journal* par 1; L du Preez 'No sign of extension to amnesty yet' (8 November 2003) http://www.persfin.co.za/index.php?fSectionId=&fArticleId=280017 (accessed on 20 May 2009); W Khuzwayo 'Business Report 'FirstRand' loop legal – Dippenaar' (September 9, 2007) http://www.busrep.co.za/index.php?fArticleId=4023192 (accessed on 20 May 2009); Olivier & Honiball n 9 above at 449.

145 Olivier & Honiball n 9 above at 277.

146 *Ibid*.

Jersey Islands,[147] being offered by numerous financial institutions in South Africa.[148] Loop structures, however, have been considerably curtailed with the issuing of the South African Reserve Bank's Exchange Control Circulars D 417 and D405, instructing certain commercial banks to ensure that their clients unwound these structures in order to take advantage of the concessions under the Exchange Control Amnesty of 2003.[149]

The Exchange Control Amnesty and Amendment of Taxation Laws Act[150] is perhaps the most effective weapon that South Africa has came up with to crackdown on offshore tax shelters. This Act enabled violators of Exchange Control Regulations and certain tax Acts to regularise their affairs in respect of their foreign assets for only the 2003 year of assessment. Tax amnesty was granted to certain applicants who disclosed their foreign assets and repatriated them to the Republic.[151] As a result, the secrecy of offshore tax shelters appeared to have been thwarted and South Africa's tax base extended.[152] The government collected some 2,3 billion Rand in taxes from these amnesty applications.[153] These results show that measures of this nature can be effective in recovering revenue. Indeed, the OECD affirms that 'a crackdown on tax havens and cross border tax evasion will help developing countries to raise more revenues to pay for much needed schools, roads, and hospitals'.[154]

It is interesting to note that SARS has now decided to run a Voluntary Disclosure Program from 1 November 2010 to 31 October 2011 which

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147 C van Gass & C Benjamin 'South Africa: Noseweek to publish as Judge denies bank gag' *Business Day* (21 September 2007).

148 Khuzwayo n 134 above.

149 Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.

150 Section 3(1)(a) and (b) of the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.

151 *Ibid*.

152 B Cameron 'Why offshore trusts have lost their appeal' (26 July 2003) *Personal Finance* at: http://www.persfin.co.za/index.php?fSectionId=706&ArticleId=196524 (accessed on 4 May 2009); Investec Bank (UK) Ltd (Investec Trust) 'Post-amnesty planning: remain offshore or repatriate funds' at: http://www.investec.co/NR/rdonlyres/114C2988-0095-45EF-B5C0-40CFE13F1FD9/1433/PostAmenstyplanning.pdf (accessed on 9 May 2009).

153 Treasury 'Taxation' http://www.treasury.gov.za/documments/mtbps/2004/mtpps/Chapter%204.pdf (accessed on 20 April 2009).

154 OECD 'Tax havens crackdown will help developing countries says OECD's Gurria' available at: http://www.oecd.org/document/14/0,3343,en_2649_37427_42630286_1_1_1_1,00.html (accessed on 30 April 2009).

encourages taxpayers to come forward and avoid the future non-discretionary imposition of interest. Taxpayers may come forward during this period to disclose any unpaid taxes and rectify their tax affairs. If disclosure is made before they are aware of a SARS audit or investigation, the full amount of tax will remain payable. However, additional tax, penalties (other than administrative penalties) and interest relating to the default will be waived for qualifying taxpayers. SARS will also not pursue criminal prosecutions in respect of defaulters. In circumstances where taxpayers have become aware of an audit or investigation, disclosure may still be made. However, only 50 per cent of the interest relating to the default will be waived. SARS envisages that the voluntary disclosure program will be supported by a simultaneous exchange control program that will be brought into effect separately.[155]

As described above, secret offshore tax shelters are encouraged and enabled by the accommodating attitude of many tax practitioners. Thus, the regulation of the activities of such practitioners is an indispensible aspect in any country's endeavours to clamp down on offshore tax shelters. In South Africa, tax professionals have been largely unregulated for years. However, efforts in this regard began in 2002 when the then Minister of Finance announced in his Budget Speech the proposed regulation of tax practitioners.[156] He indicated that the regulations would commence with SARS initiating discussions on the appropriate regulation of tax consultants and advisors in order to promote compliance and ensure that taxpayers receive advice consistent with tax legislation. Consequently, in November 2002, SARS released a discussion paper on regulating tax practitioners, pointing out concerns such as the fact that the public is not always aware of the code of conduct binding tax practitioners.[157] Subsequent to the release of the SARS' discussion paper, the Income Tax Act[158] was amended with the introduction of section 67A into the Act in 2005.[159] This section requires the registration with SARS of every natural person who provides tax advice, completes tax forms, or assists therewith. Section 75 of the Income Tax Act was also subsequently amended to provide that it is an offence for a person

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155 National Treasury 'Draft Taxation Laws Second Amendment Bill 2010' available at: http://www.sars.gov.za/home.asp?pid=294.

156 South African Government Information 'Budget Speech by the Minister of Finance, T A Manuel (20 February 2002) available at: http://www.info.gov.za/speeches/2002/020220246p1001 htm (accessed on 6 July 2010).

157 SARS Discussion Paper 'Regulating Tax Practitioners' available at: www.sars.gov.za/home.asp?pid=1328 (accessed on 6 July 2010).

158 Act 58 of 1962.

159 Section 67A of the Income Tax Act was introduced by s 9 of the Second Revenue Laws Amendment Act 34 of 2005.

who is required to register, to fail to register as a tax practitioner with SARS. On conviction that person may be subject to a fine or imprisonment. SARS has indicated that the requirement of registering with SARS was the first step in the process of regulating tax practitioners in South Africa.

SARS has also indicated its intention to establish an independent tax practitioners' board (ITPB) that will regulate tax practitioners.[160] As a further measure in the drive for regulation, a draft Tax Practitioners Bill was released in 2007 for public comment. Section 2 provides for the establishment of the ITPB to regulate tax practitioners, so as to ensure that they are appropriately qualified, have the necessary experience, adhere to ethical practices, and are held accountable for their professional conduct.[161] This will encourage compliance and improved quality of advice to taxpayers, as the practitioner responsible for such advice and the filing of documents on the taxpayer's behalf, will be easily identified to ensure appropriate sanctions are imposed on such practitioner in the event of non-compliance with the regulatory standards.[162]

As a further drive towards regulation, in 2007, the South African Institute of Tax Practitioners (SAIT) was established as the professional body in South Africa focusing solely on taxation, although other professional bodies that deal with tax matters, such as the South African Institute of Professional Accountants (SAIPA) and the South African Institute of Chartered Accountants (SAICA), already existed. In response to SARS's call for comment on the Tax Practitioners Bill, the above tax professional bodies sent a joint submission to SARS stating that the stakeholders did not favour the creation of a statutory regulator for tax practitioners as this would create a double layer of regulation and additional costs to practitioners. The joint submission called for an exploration of alternative models for regulation, such as an accreditation model similar to other professional bodies. In their view, this model would ensure that both SARS and the profession are provided with a qualitative model that will benefit the profession, the

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160 The South African Institute of Tax Practitioners (SAIT) 'Joint submission – comment on the revised Draft Regulating Tax Practitioner Bill' available at: http://www.thesait.org.za/downloads/SAIT-IAC-ICSA-ICB-SAIBA-Joint-Comment-2nd-Draft-TP-Bill.pdf (accessed on 6 July 2010).

161 *Ibid*.

162 Institute of Certified Public Accountants of South Africa 'Guidance: tax practitioners regulation' available at: http://www.saipa.co.za/documents/Tax%20Practitioner%20Registration%20Compiled%20SARS%20guide%20TT8T%201.5A1.pdf (accessed on on 6 July 2010).

government and the country as a whole.[163] At the time of writing of this article, the Tax Practitioner's Bill had not yet been enacted into law. It will be interesting to see if SARS will take the above comments into consideration. Nevertheless, SARS' endeavours are an indication to tax practitioners that the government will not stand by while tax practitioners devise and advise taxpayers on sophisticated offshore tax schemes to the detriment of the fiscus. It is common knowledge that, in the present economic downturn, SARS is keenly looking for ways of increasing its collections. Endeavours to tighten the regulatory control of tax practitioners are one way this can be achieved.[164]

Regarding measures to expose and curtail banking secrecy, South Africa has taken measures to regulate the framework for the financial sector. In 2008, South Africa implemented the Basel II principles (discussed above) through the Banks Amendment Act 2008, which seeks to ensure that South Africa's banking system remains stable in the turbulent aftermath of the global financial crisis, through the introduction of mechanisms for better risk management and monitoring, capital adequacy, transparency, and accountability.[165] The transparency measures implemented under the Basel II principles can be relied on by SARS in addressing the problem of offshore banking secrecy.

In line with the OECD exchange of tax information campaign, South Africa has signed the 'Custom Agreements on Mutual Administrative Assistance' with some countries, to encourage the exchange of information, surveillance, investigations, and visits by revenue officials.[166] These agreements will be instrumental in exposing offshore investments. However, no such agreements have been signed with tax haven jurisdictions. For many years, South Africa

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163 SAIT 'Joint submission' n 150 above.

164 RC Williams, South African Institute of Tax Practitioners Tax 'The economic downturn and the regulation of tax practitioners' *Time News Letter* 30, 15 Feb 2010.

165 G Matarirano 'Global credit crisis: a paradigm shift in the implementation of Basel II?' Available at: http://www.portfolio-property.com/article/view/id/167 (accessed on 15 September 2010).

166 By April 2010 such agreements were in force with Algeria, China, France, India, Mozambique, Netherlands, the United Kingdom and the United States. Similar agreements were ratified with Brazil, Czech Republic, Democratic Republic of Congo, Iran, Norway, Sudan, Turkey and Zambia. An agreement was signed with Canada but it is not yet ratified. See http://www.sars.gov.za/home.asp?pid=53076 (accessed on 22 April 2010).

called on a number of tax havens to sign similar agreements but the calls were ignored. However, with pressure from world leaders for tax havens to change their financial and fiscal regulations due to the global financial crisis that begun in 2007, a number of tax havens have became willing to engage in tax information exchange agreements.[167] In 2010, South Africa signed Tax Information Exchange Agreements in line with the OECD standards, with the Bahamas, Bermuda, the Cayman Islands, Guernsey, Jersey and San Marino.[168] These agreements will enable SARS to have access to information with regard to what South African taxpayers have invested in those jurisdictions.[169] The agreements cover exchanges of information on all kinds of taxes. Tax information will be exchanged whether or not the requested party has a domestic tax interest in it, or even whether a taxpayer's conduct under investigation would or would not constitute a crime under the laws of the countries concerned. This will allow tax havens to exchange information held by banks, other financial institutions, and any person, including nominees and trustees acting in an agency or fiduciary capacity. The exchanged information would include information regarding the legal and beneficial ownership of companies, partnerships, foundations and other persons – including in the case of collective investment schemes, information of shares, units and other interests, and in the case of trusts, information on settlers, trustees and beneficiaries.[170] National Treasury is also involved in negotiations with other tax havens to enter into similar agreements and a number of tax haven jurisdictions have signalled an interest to engage in such negotiations.[171] It is hoped that South Africans will no longer be able to hide their investments in tax haven jurisdictions as long as information about those investments is exchanged between South Africa and those tax havens.

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167 National Treasury 'Budget Vote Speech' (11 May 2010) at 10 available at: http://www.treasury.gov.za/comm media/speeches/2010/2010051101.pdf (accessed on 10 August 2010).

168 SARS 'International tax treaties – tax information exchange agreements' available at: http://www.sars.gov.za/home.asp?pid=5307 (accessed on 10 August 2010).

169 National Treasury 'Budget Vote Speech' n 167 above at 10.

170 *Ibid*. T Lund 'SARS blocks tax havens' 4 August 2010 available at: http://www fin24.com/Economy/Sars-unlocks-tax-havens-20100804 (accessed on 10 August 2010); D Pressly 'Tax havens to share information with SA authorities' *Business Report* 5 August 2010.

171 National Treasury 'Budget Vote Speech' n 166 above at 10.

Conclusion and recommendations

The above analysis has shown that international initiatives are likely to have a significant impact on the future development of secret offshore tax shelters and they are expected to lead to a better global regulatory framework and a greater level of international tax transparency and exchange of information between the onshore and offshore jurisdictions.[172] These international initiatives, coupled with vigorous actions by governments to crack down on offshore tax shelters will ensure that the integrity of national tax systems is not undermined.[173] For instance, the OECD recommends that secret offshore tax shelters can be curtailed by encouraging transparency and information exchange between countries. Indeed, a number of tax haven jurisdictions have signed such Exchange of Information Agreements with various OECD member countries. With the global financial crisis that began in 2007, world leaders have put tax havens under renewed pressure to change their financial and fiscal regulations. As a result, South Africa has also signed agreements with a number of tax havens that are now willing to engage in tax information exchange agreements. It is presumed that South Africans will no longer be able to hide their offshore investments in tax haven jurisdictions as long as information about those investments is exchanged between South Africa and those tax havens.

To further curtail offshore secrecy, it is recommended that South Africa makes a concerted effort involving not only legislative measures, but also pro-active measures to crack down on offshore tax shelters. The revenue recovered as a result of the 2003 Exchange Control Amnesty and Amendment of Taxation Laws Act[174] testifies to the need for continual effort. The SARS' voluntary disclosure program, envisaged to take place from 1 November 2010 to 31 October 2011, is thus a most welcome initiative.[175] Nevertheless, it is common knowledge that the secrecy of offshore tax shelters implies that a number of taxpayers may not come clean. It is thus recommended that in addition to this voluntary disclosure program, an investigation should be conducted on offshore investments by South African residents who refuse to disclose those investments voluntarily. The investigations could follow the Irish example, which involved investigations

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172 Rogatgi n 18 above at 338.
173 Owens n 27 above.
174 Act 12 of 2003
175 National Treasury 'Budget Vote Speech' n 166 above at 10.

of the activities of international banks together with accounting and law firms, requiring them to disclose clients' secret offshore dealings to SARS. Such investigations, under the umbrella of the SARS' endeavours to regulate tax practitioners,would also go a long way in cracking down on the tools and the enablers of offshore tax shelters by imposing harsh penalties for the disregard of ethical codes of conduct.