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Abstract

Central to the question of legitimacy in the difficult issues of international taxation and confidentiality is the comity principle, which is an extension of the principle of territorial sovereignty. The real concern of onshore countries such as Australia in relation to offshore activity is often actual financial loss, rather than high or moral principles. The argument thus follows that, in response to the international pressures exerted through directives and sanctions of supranational bodies such as the OECD, all things being equal, offshore states have a similar right to safeguard their economic and political interest by upholding them.

Keywords

international taxation, territorial sovereignty, OECD, tax

THE HYPOCRITICAL STANCE BY THE OECD, REPRESENTING THE DEVELOPED NATIONS - INAPPROPRIATE PRESSURE ON LESS DEVELOPED NATIONS TO ADOPT COMPLIANT TAX REGIMES

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Central to the question of legitimacy in the difficult issues of international taxation and confidentiality is the comity principle, which is an extension of the principle of territorial sovereignty. The real concern of onshore countries such as Australia in relation to offshore activity is often actual financial loss, rather than high or moral principles. The argument thus follows that, in response to the international pressures exerted through directives and sanctions of supranational bodies such as the OECD, all things being equal, offshore states have a similar right to safeguard their economic and political interest by upholding them.

Introduction

The OECD is the most well-known of a group of international bodies, which includes the Financial Action Task Force (FATF), Financial Stability Forum (FSF) and International Monetary Fund (IMF) which together have set out to directly or indirectly regulate global capital mobility and tax regimes.

Analysis of the OECD's campaign against harmful tax competition

OECD's concept of harmful tax competition flawed

One of the major weaknesses of the 1998 OECD '*Harmful Tax Competition*' Report[1] can be identified as the vagueness of the concept of 'harmful tax practices' itself. While the report concedes that tax competition can, indeed, be beneficial, 'when tax competition ceases to be beneficial and starts to be harmful is not clear, and is essentially,

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1 Organisation for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue* (1998 OECD).

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subjective'.[2] In determining whether a jurisdiction has a low or nominal tax rate, the 1998 OECD Report failed to provide an exact figure or range that would determine the threshold.[3]

The OECD acknowledges that countries should be free to design their own tax systems.[4] However, this must be according to internationally accepted standards. The problem is that the 'international accepted [tax] norms' with which offshore financial jurisdictions[5] are encouraged to align themselves, are non-existent. The implication is that such norms are, in fact, those which will be determined solely by high tax, onshore countries afraid of tax competition.[6]

The OECD Report pays little regard to the well-established rule of international law which states that one state does not enforce the tax laws of another. This rule recognises the territorial application of tax law.[7] The OECD simply asserts the inaccurate presumption that it is unfair or harmful for offshore countries to continue enforcing this rule.[8] This is despite the fact that the rule continues and, presumably, will continue to be applied by onshore nations outside the offshore financial concept.

The Report accuses offshore financial centres (OFCs) of 'ring fencing' and discriminatory practices.[9] This speaks to a legal system where the positive benefits of the fiscal policy are reserved only for non-residents. This is a simplistic and inaccurate assumption made about offshore financial jurisdictions as a whole. Several offshore

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2 Mason Gaffney, 'International Tax Competition – A Discussion of the OECD Report and its Implications' (1986) *Private Client Business* 304-5.

3 See Alexander Townsend Jr, 'The Global Schoolyard Bully: The Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition' (2001) 25 *Fordham International Law Journal* 215, 256 (expressing the need for an example of an appropriate tax rate to guide jurisdictions).

4 Organisation for Economic Co-operation and Development, above n 1, 15.

5 In the context of financial transactions, the term 'offshore' refers to transactions which take place between non-residents. By this definition 'offshore transactions' can take place in any jurisdiction, but as a result of their fiscal and secrecy rules, some jurisdictions attract a very high number of offshore transactions and offshore banks, and have thereby become known as offshore financial centres. Guy Stessens, *Money Laundering: A New International Law Enforcement Model* (2000) 93.

6 Gaffney, above n 2, 308.

7 Gilbert NMO Morris, 'The Loss of Sovereignty, the United Nations, and Offshore Financial Centres' (2001) 10 *Tax Notes International* 1297.

8 Terry Dwyer, 'The New Fiscal Imperialism' (2002) 18(4) Policy 12.

9 Organisation for Economic Co-operation and Development, above n 1, 26.

financial centres, such as Hong Kong and Singapore, in fact, do not make distinctions between residents and locals in their tax policies. This is also the case in The Bahamas and the Cayman Islands, for example, where there are no direct taxes but rather, consumption taxes, which apply to all.[10]

Competing philosophies

The first five years of the initiatives against offshore financial centres can be viewed as driven by a different philosophical approach on how to deal with the major flaw in the system of direct taxation - that capital is mobile. But there is another problem relating to this form of taxation, which is that of a new political correctness which states that tax competition be viewed as essentially unjust competition.[11]

Whichever way it is interpreted, a direct system of income tax in large part must rely on voluntary compliance by its citizens for it to work.[12] This, in part, explains the effort expended by onshore revenue authorities on negative publicity about the offshore world. However, it remains a fact that, historically speaking, some jurisdictions such as the US, the UK and Canada have had relatively high taxpayer compliance,[13] while tax evasion has been endemic in many European and Latin American countries.[14] It is because tax evasion has been so pervasive in Europe[15] that automatic reporting appeals so much to the EU governments, but not, unsurprisingly, to Switzerland, Austria, Belgium, Luxembourg and now Guernsey, which are favoured jurisdictions for discrete banking.[16]

10 Rose-Marie Antoine, *Confidentiality in Offshore Financial Law* (2002) 319.

11 Anthony Travers, Global Concern (2003) The Lawyer Group <http://www.thelawyer.com/cgi-bin/item.cgi?id=99607&d=11&h=24&f=23> at 14 October 2003.

12 John Hasseldine, 'Increasing Voluntary Compliance: The Case of Tax Amnesties' (1989) 6(4) *Australian Tax Forum* 509.

13 Cedric Sandford, 'International Comparison of Administrative and Compliance Costs of Taxation' (1994) 11 *Australian Tax Forum* 291.

14 Vito Tanzi, *Taxation in an Integrating World* (1995).

15 Bruce Bartlett, *Europe's Underground Economies* (1998) National Centre for Policy Analysis <http://www.ncpa.org/ba/ba278.html> at 10 July 2004.

16 *Council Directive (EC) No 2003/48/EC of 3 June 2003 Taxation of Savings Income in the Form of Interest Payments* [2003] OJ L 157, 38.

Uneven hand

Having produced its first report in 1998,[17] the OECD then initiated, in a unilateral and arbitrary manner, the identification of jurisdictions that it considered to be competing in tax matters in a way that was harmful to its member-states. In 1998, the OECD indicated that there were 47 jurisdictions it deemed to be tax havens. Later that year, six of these jurisdictions were dropped, but the OECD never disclosed their identity. It can only be surmised that the OECD decided to exclude these six undisclosed jurisdictions for political reasons, such as the reluctance of its member-states to engage in a confrontation with the governments concerned. It is noteworthy, for instance, that Hong Kong was never named as a tax haven, yet, by every criterion that the OECD established, Hong Kong should have been a prime target. Was Hong Kong's omission an indication that the OECD did not want to offend the Peoples Republic of China?[18]

When the OECD produced another report in 2000 entitled, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*,[19] it was revealed that the OECD was treating its member states quite differently from the unilateralist and arbitrary stance taken with the targeted jurisdictions. First, while the targeted jurisdictions were quite categorically named as 'tax havens', some OECD members, such as Switzerland, Belgium, Portugal, Luxembourg, Canada and the United States, were described only as having regimes that were 'potentially harmful'. Second, the OECD carried out a unilateral evaluation of the so-called 'tax haven' jurisdictions, but its own members each performed 'a self-review' to determine whether or not they had preferential tax regimes.

One observation offered by one such labelled 'tax haven', Antigua and Barbuda,[20] was that the OECD countries were the principal advocates of the virtues and merits of competition in the provision of goods and services globally. For them 'competition' is the new panacea for the world's economic ills, because their industrial and agricultural capacity has reached the point where it needs unrestricted access to global

17 Organisation for Economic Co-operation and Development, above n 1.

18 This was an observation made by Sir Ronald Sanders, High Commissioner to the United Kingdom for Antigua and Barbuda. Amanda Banks, *Sanders Renews Attack on OECD* (2003) Tax-News.com. <http://www.tax-news.com/asp/story/story.asp?storyname=10447> at 10 July 2004.

19 Organisation for Economic Co-operation and Development, *Towards Global Tax Co-operation, Progress in Identifying and Eliminating Harmful Tax Practices* (2000 OECD).

20 Ronald Michael Sanders, 'The OECD's 'Harmful Tax Competition' Scheme: The Implications For Antigua And Barbuda' (Speech delivered at the luncheon meeting of the Antigua and Barbuda Chamber of Commerce and Industry, Antigua and Barbuda, 27 March 2001).

markets to continue to provide employment and profits to their people. Yet, while they (G8) promote competition in everything else, they seemed to decry it in taxation.[21]

Their objection appears to have been derived from the fact that, in a globalised world, the mobility of financial and other services, such as shipping and internet gambling, provide an opportunity for small states, but pose a threat to them. The low tax or no tax regimes of these small states, coupled with literacy in English and good telecommunications, gives them an advantage with which many OECD countries cannot compete. Instead of trying to vie with small states by lowering their own taxes, the OECD responded by demanding that these small jurisdictions change their tax systems and structures or face damaging sanctions.

Sanders suggests that the OECD's concern is that its member states[22] will lose investors who would otherwise be subject to their high taxation. Their purpose is to tax the profits and interest income of those investors wherever they may be. The consequence would be to deprive small developing countries from advancing their economic development through their tax structures and systems.[23]

Of course, the OECD argument represents the views of its member states which have reached a high level of industrial development precisely because of tax competition in which they lured foreign investment into their countries by tax breaks. In fact, many of them continue with this practice.[24]

In the United States, for instance, institutions, both banks and non-banks, held more than $1.8 trillion in deposits from foreign persons at the end of 2000.[25] That money is

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21 Ibid.

22 The 30 OECD member countries are: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States.

23 Presented to a Ministerial Conference hosted by the Government of Barbados in association with the Commonwealth Secretariat and the Global Forum on International Taxation of the OECD, 8-9 January 2001.

24 Ibid.

25 Bureau of Economic Analysis (BEA) US Department of Commerce, 'The Net International Investment Position of the United States at Yearend 2000' Harlan W King (ed) in *Survey of Current Business*, July 2001.

there because the US exempted the holders of those accounts from taxes on their interest income!

OECD's authority

A fundamental difficulty still remained. It was one that had far reaching implications and was by no means limited to this particular initiative of the OECD. Should the offshore jurisdictions around the world accept that the OECD had the right or authority to set itself up to make tax directives which they expected non-members to follow? By doing this, would these jurisdictions, targeted by the OECD as 'tax havens', not be opening the floodgates to a raft of other demands by an organisation with no international authority except the coercive power of its member states? The OECD is only a multinational grouping of 30 countries. It is not an international organisation and it has no legal authority to speak for the world or to establish rules, norms or standards for any state except its own members. Nonetheless, it was now dictating terms on what, in short, could be described as cross-border tax matters.

In the first 1998 Report, the OECD acknowledges that there is no compelling reason why any two countries should have the same tax policies and structure. It views this as a political decision.[26] Mitchell, an opponent of the OECD, has accused the 'unelected paper-pushers' and bureaucrats at the OECD of seeking to set up a 'tax cartel' that would set tax policy for the world. His view is that this campaign is a backdoor manoeuvre aimed at 'undermining national sovereignty' of countries by placing the setting of a global tax policy in a few hands.[27]

September 11, 2001

Prior to September 11, 2001, US Treasury Secretary Paul O'Neill and his staff opposed certain aspects of the OECD harmful tax competition initiative and were lukewarm on the rest of it. However, this attitude changed with an executive order by President George W Bush on 24 September 2001[28] requiring jurisdictions to establish a new counter-terrorism economic sanction and export control regime under the threat of

26 Organisation for Economic Co-operation and Development, above n 1, 15 [26].

27 Dan Mitchell, 'Harmful Tax Competition: An Emerging Global Issue' (Research paper, Centre for Freedom and Prosperity, 1998) and Dan Mitchell, 'An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy' (Research paper, Economic Policy Studies, Washington DC: The Heritage Foundation, 2000).

28 George W Bush, 'Executive Order on Terrorist Financing' (2001) The White House <http://www.whitehouse.gov/news/releases/2001/09/20010924-1.html> at 14 May 2004.

more economic penalties. Further, the US introduced *The USA Patriot Act*[29] imposing a series of extra-territorial measures targeting offshore financial institutions in the belief that they could be used to fund terrorist organisations. The belief that the terrorists and particularly the al-Qaeda organisation of Osama Bin Laden had used offshore financial centres to move money to finance their activities caused the US Treasury to temper its criticism of the OECD initiative. In the first place, the US needed the other OECD member-states to help forge its coalition against terrorism, and in the second it was easy to believe that financial institutions in small jurisdictions might have unwittingly provided facilities for terrorist organisations through legitimate companies. As it turns out, most of the terrorist bank accounts were actually in OECD countries including the US and the UK.[30]

Offshore financial services by OECD members

Sanders offered some interesting findings worth noting:[31] 80% of the total offshore financial services industry is located in the OECD countries. The remaining 20% is in the non-OECD countries, with even this segment dominated by a few large centres such as Hong Kong and Singapore which, the OECD had not named as 'tax havens'. This means that approximately less than 10% of offshore business in the world is done in the targeted jurisdictions.

Account should also be taken of the fact that searches of banks throughout the world for money used to finance terrorism in the wake of the atrocities of 11 September 2001 in New York and Washington, revealed that most of the funding of the al-Qaeda organisation and other terrorist groups was found in the banks of OECD countries.[32] Only US$20 million was discovered in The Bahamas after a search by that country's authorities, and even then it was in a branch of a bank headquartered in an OECD country. Despite these findings, the pressure for OFCs to adhere to the 'transparency' and 'effective exchange of information' requirements will only increase.

Coercion by soft laws

In addition to the OECD, the FATF and the FSF, there are many other organisations, both public and private, which are pursuing various money laundering control initiatives. Their activities have led to a number of agreements, memoranda of

29 'Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001'.

30 Sanders, above n 20.

31 Ibid.

32 Ibid.

understanding, statements, codes and standards of conduct, all of which have legal significance. As such, their work may be characterised as what Norton calls 'soft law', which he defines as follows:[33]

legally significant international rules emanating from international bodies that are intended to be binding (notwithstanding their non-legal characterisation), and which subsequently come to be enforced or adhered to in some form.[34]

What should be kept in mind throughout, is that each of these initiatives forms a kind of 'soft law'. None has resulted in the creation of legal international rules in the traditional sense in that these initiatives have not culminated in the signature of any formal treaties or the creation of legal customs. In fact, debate persists as to whether international rules outside traditionally recognised sources of international law, like treaties and legal customs, exist. The reason this debate is ongoing is that the principles of state sovereignty and equality of states means that neither a state nor the citizens of a state can be made subject to the laws of another state, in the absence of some form of enabling legal mechanism.

Responding argument for a level playing field

Stikeman Elliot suggested strongly that progress must be premised on the basis that uniform rules, developed in an inclusive process, are implemented by all states, on the same time frame, with the same consequences for those states which do not co-operate. This is a fundamental objective, and essential to effectively achieving an equitable result.[35]

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33 Joseph Norton, *Devising International Bank Supervisory Standards* (1995) xxv. Professor Norton's discussion is focused around the work of the Basle Committee and the definition of soft law that Professor Norton actually uses is as follows:
'liberty is taken in using the term "international soft law" to depict "legally significant international rules" of the Basle Committee emanating from national supervisory authorities that were intended by these authorities to be binding (notwithstanding their non-legal characterization) among the involved authorities and that subsequently became enacted into national laws or administrative rules subsequently in accord with the substance and intent of the Basle Committee pronouncement.'

34 Kris Hinterseer, *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context* (2002) 224.

35 Stikeman Elliot, *Towards a Level Playing Field – Regulating Corporate Vehicles in Cross-Border Transactions* (2002).

The imposition of more onerous 'compliance requirements' exclusively on non-OECD member countries could be seen as hypocritical. For example, efforts to minimise the misuse of corporate vehicles should not be used as a guise for undermining the competitive position of those jurisdictions which have limited input into the standards' design process. To allow this misuse would be to compound the non-tariff barriers to the trade in services arising in other initiatives.

The International Trade & Investment Organisation (ITIO)[36] believes that individual sovereign jurisdictions should have the opportunity to develop their own methods to ensure the timely access to corporate ownership information and the exchange of such information which was consistent with their own legal and social environment.[37]

Balancing competing considerations – confidentiality

It is essential that confidentiality considerations are also taken into account in any development of new laws and regulations. It is dangerously inappropriate to seek law enforcement objectives to the exclusion of other considerations in civil society. Confidentiality is a basic human right and accordingly, any implications which may concern confidentiality, need to be seriously considered by all the countries concerned.

Proportionate and risk-based regulation

Appropriate regulation must strike a balance between law enforcement objectives and the reasonable needs of legitimate commerce. Accordingly the regulations must be proportionate to the risks and benefits associated with the activity being regulated.

A regulatory regime should focus attention and resources on those customers, accounts and transactions that are most vulnerable to money laundering and terrorist financing. An approach which does not permit a meaningful differentiation among customers, accounts and transactions will result in a misallocation of resources and reduce effective deterrence and prevention.

The level of co-operation by the prominent OFCs is now at an unprecedented level and the depth and quality of their regulation far outstrips many of those nations which constantly criticise the island nations through global agencies. Switzerland, an

36 The ITIO was the body which commissioned Canadian law firm, Stikeman Elliot, to produce the Report, ibid.

37 Stikeman Elliot, above n 35.

OECD member, still has not given up on banking secrecy and bankers in Switzerland still seem reluctant to move.[38]

It appears that the larger developed economies which benefited through the coercion of these offshore states with the name-and-shame tactics, may cease their political manoeuvrings. The OFCs have complied in full measure but the big states are perceived to have manifestly failed to achieve a level playing field. In a forthright demonstration of their intellectual creativity, the offshore centres – notably Gibraltar and the Isle of Man – have managed to create a tax environment which meets the full demands of international transparency and a competitive marketplace. It is this degree of agility of thought and action which the OFCs will need on a continuing basis, if they are to stand a chance of survival in the international corridors of power.[39]

OFCs under no obligation to assist in fiscal matters

The legality or otherwise of tax planning, though important, is of itself insufficient to demand that confidentiality be preserved in relation to tax information. While some may be uncomfortable with the argument that offshore states are under no obligation to assist onshore states in increasing onshore coffers though tax collection offshore, there is firm legal precedent for this. Even without the particular context of offshore business, the international law has always recognised that the fiscal and penal matters of one state with respect to enforcement of foreign judgments and other types of international assistance should be outside the realm of another.[40] This rule has been followed rigorously by the OFCs.[41] It is also consistent with the rule on the legality of tax avoidance measures which refrain from imposing a duty on the individual, to voluntarily assist tax authorities in gaining revenue.

The influence of soft law

The term 'soft law', as cited previously, refers to the lack of justiciability of the instruments in which the rules are enshrined, rather than to the content of the rules

38 Bob Reynolds, 'Editor's Note' (2003) 8 *Offshore Red: An OFC News Update* 153.

39 Ibid.

40 This is illustrated in the cases of *Government India v Taylor* [1955] AC 491, [1955] 1 All ER 292 and A-G *(New Zealand) v Ortiz* [1984] AC 1, [1983] 2 All ER 93. 'We do not sit to collect taxes for another country or to inflict punishments for it'; *Ortiz* [1984] AC 1, 20 (Lord Denning).

41 According to the Articles of the Draft Declaration on Rights and Duties of States (1949) by The International Law Commission of the UN. Article 3: 'Every State has the duty to refrain from intervention in the internal or external affairs of any other State'.

themselves. An important factor which explains the role of soft law in the fight against money laundering is the aversion to government interference that financial institutions have often displayed. In some countries, money laundering was initially fought, not through legislative measures, but via codes of conduct or by regulatory measures issued by banking supervisors. The content of a number of initiatives to curb money laundering was thus highly influenced by the financial sector itself.[42]

Given the absence of a formal international legislator, it is not surprising that the influence of soft law has been especially notable on the international level.[43] The contribution of international soft law instruments to the fight against money laundering is impressive. One of the earliest international initiatives undertaken in this field was the Recommendation No R(80)10 adopted by the Committee of Ministers of the Council of Europe on 27 June 1980, entitled *Measures against the transfer and safeguarding of the funds of criminal origin*.[44]

The crown jewel of soft law, however, is the set of the 40 recommendations issued by the FATF on money laundering in 1990. The recommendations are no more and no less than recommendations: non-binding soft law. It was a deliberate choice not to cast the recommendations into the mould of a treaty. This was to avoid elaborate ratification procedures and to allow the flexible adaptation of the recommendations, as was done in 1996. Flexibility was also the motive behind the loose structure of the FATF.[45]

Political and economic motives for attacking offshore laws

If criminal activity is not the true focus of offshore activity, and if it is demonstrable that offshore laws do not exist either to promote or conceal such activity, then why has such an offensive been launched against the offshore sector? The argument is that the real issue, concerns the loss of revenue, particularly, but not solely, fiscal revenue flowing from onshore economies and filtering offshore. The revenue, albeit in savings which filters from onshore countries, results in the economic developing of many offshore countries, several of which can be labelled as developing countries.[46] The fear on the part of onshore countries of the loss of revenue as a direct result of offshore

42 Stessens, above n 5, 15.

43 UN Economic and Social Council, Commission on Crime Prevention and Criminal Justice, 'Review of Priority Themes, Control of Proceeds of Crime – Report of the Secretary-General, E/CN.15/1993, Vienna, 13-23 April 1993, 14'.

44 Stessens, above n 45, 16-7.

45 Ibid 17-8.

46 This can be viewed as a kind of 'balancing effect'.

activity is not one to be dismissed. Already, non-offshore jurisdictions within the European Union are beginning to experience an increase in loss of revenue as a result of offshore business, as noted in the 2003 Boston Consulting Report.[47]

European unification has improved European citizens' ability to relocate their assets to other European countries and many investors are choosing to invest in European offshore jurisdictions such as Cyprus and Ireland,[48] and in Asian jurisdictions such as Singapore[49] and Hong Kong.[50] The enrichment of offshore coffers at the expense of those onshore provides a powerful economic and political motive for the legal offensive aimed at the offshore sector. This factor cannot be ignored when the question of the acceptable limits of offshore activity and law are to be addressed.

The real concern of onshore countries in relation to offshore activity is often actual financial loss rather than high or moral principles. Whilst it is clearly within the right of any country to safeguard economic and political interests, this element must be recognised for what it is and should not be allowed to cloud the relevant legal issues, such as the validity of the offshore interests. The argument would thus follow, that all things being equal, offshore states have a similar right to safeguard their economic and political interests by upholding their laws and policies. This is an important argument in the difficult issues relating to comity, taxation and the confidentiality principle. It is central to the question of legitimacy.

Comity principle and confidentiality

According to Antoine,[51] efforts toward disclosure at the expense of offshore confidentiality laws may involve conflict of laws. The question of sovereignty with respect to confidentiality is paramount, and has been highlighted by offshore courts in responding to the OECD challenges to the OFCs.

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47 *'Winning in a Challenging Market: Global Wealth 2003'*, The Boston Consulting Group, July 2003.

48 'Greengrocers Flight', *The Financial Mail* (South Africa) 16 April 1996, 6.

49 Singapore is managing about US$2.2 trillion offshore assets. Figure provided by Pulses, a monthly publication of Singapore Exchange Limited, dated November 2003.

50 The total trade value of Hong Kong's offshore trade was HK$1,425 billion in 2000. Figure provided by Hong Kong Trade Development Council (2000) <http://www.tdctrade.com/econforum/boc/boc021101.htm> at 28 April 2004.

51 Antoine, above n 10, 273-4.

It is argued by Antoine that the OECD and its member states are violating international law, according to the Articles of the Draft Declaration on Rights and Duties of States (1949) by the International Law Commission of the UN.[52]

The comity principle is an extension of the principle of territorial sovereignty. It sets the standard for resolving conflicting jurisdictional issues which may arise. In its legal sense, comity is:[53]

the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or other persons who are under the protection of its laws.

It is 'the degree of deference that a domestic forum must pay to the act of a foreign government not otherwise binding on the forum'.[54]

The key principle in the comity rule is the recognition that states have sovereign interests which need to be reconciled. The principle recognises each of these conflicting interests as legitimate, but acknowledges the necessity for one state to succumb to the other's interest if the other's interest is recognised as greater. Where a potential jurisdictional conflict exists, a court should look beyond the *lex fori* and consider a foreign state's interest.[55] Comity is seen as essential in preserving international harmony and good relations between states.[56]

As the confidentiality principle is grounded in the national interest of the offshore state, conflicts arise in areas where both onshore and offshore states assert jurisdiction to proscribe and enforce rules of law. Offshore states have an interest both in the

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52 *Draft Declaration on Rights and Duties of States* (1949) Art 1-3, 14.

53 *Hilton v Guyot* 159 USA 113 163-164 (1894). Its English expression is found in F Mann, 'The Doctrine of International Jurisdiction Revisited After Twenty Years' *Studies in International Law* (Oxford: Clarendon Press, 1973). (Reprinted in CA Mann, *Further Studies in International Law* (1990) 31).

54 *Laker Airways v Sabena* 791 F 2d 909, 937 (DC Cir, 1984). In the USA the comity principle is strengthened by the act of state doctrine originating from *Underhill v Hernandez* 168 USA 250, 252 (1897) Sup Ct that states: 'Every sovereign state is bound to respect the independence of every other sovereign state, and the courts of the country will not sit in judgment on the acts of [foreign] government done within its own country.'

55 *Hilton v Guyot* 159 USA 113 (1895).

56 *Oetzen v Central Leather Co* 246 USA 297, 304 (1918).

sovereignty of their legal systems and the stability of their economies which are threatened by attempts to undermine confidentiality laws. The contrasting attitudes toward confidentiality between offshore jurisdictions and the major onshore countries may lead not only to political conflict, but to conflict of laws. It is argued that there is a delicate balance to be struck between the utility of confidentiality laws in an offshore state which uniformly denies access to information in favour of preserving that country's economy, and the requests for information from onshore jurisdictions in an attempt to detect and prevent undesirable activity facilitated by such confidentiality practices.[57]

In 1967, the Social and Economic Council of the United Nations founded what is today its Ad Hoc Group of Experts. The group is composed of 25 members, experts, and tax administrators from 15 developing and 10 developed countries. As the UN group evolved, it was given various tasks such as guidelines for tax treaties, proposals for international cooperation to combat tax evasion and avoidance, and international cooperation to reduce incompatibilities between tax systems.[58]

The Ad Hoc Group recognised the need for legal legitimacy in all state-to-state and agency-to-state relations in the international arena. Morris asserts that, however, such rhetoric may provide little solace to the OFCs since it appears to be a public relations 'spin'.[59] The intent of the Ad Hoc Group is apparent: it states:

the inability to obtain information from tax haven countries and tax information not available within its jurisdiction impedes the efforts of many tax administrations to deal effectively with the cases of tax avoidance and tax evasion.

It has opted for a series of bilateral treaties which link the developing world with the developed world; with the former giving up its tax information, whilst the latter developed countries offer assistance to developing countries to enable them to carry out exchanges of information procedures to control harmful tax competition. This is apparently taken to be a fair exchange.[60]

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57 Antoine, above n 10, 273-8.

58 United Nations: Department of Economic and Social Affairs, *Ad Hoc Group of Experts on International Cooperation in Tax Matters*. <http://www.un.org/esa/ffd/ffdtaxationmandate.htm> at 10 July 2004.

59 Morris, above n 7.

60 Ibid.

According to Antoine, the conflict of laws typically arises where banks, companies or individuals are called upon by onshore states to produce documents or other information concerning offshore business.[61] This is in situations where compliance may invite criminal or civil sanctions under strict offshore confidentiality laws. Where, simultaneously, offshore states seek to protect their confidentiality laws and onshore states, their legal interests in disclosure, the result is a 'jurisdictional deadlock'. The subject of disclosure proceedings must then make a choice whether to obey the offshore or onshore law forum. The dilemma is made even more acute, as such entities or individuals also face potential legal sanctions such as contempt actions from onshore courts for failure to produce compelled information.

The question to be resolved, therefore, is which law is to be followed, that of the offshore jurisdiction protecting confidentiality, or the onshore country compelling disclosure? This is the fundamental issue posed in the on-going debate; a challenge which has raised complex issues of international law and political sovereignty. The subject involves both a jurisdictional issue based on geographical territorial limits and one of conflict of laws in relation to the substantive content of such laws. These two questions are inextricably linked. An artificial separation of the two issues is made here merely for purposes of clarity.

The dilemma posed by the comity question has been caused mainly by the deliberate extraterritoriality initiatives of onshore states. Equally problematic is the conflict which arises from the polarisation of offshore and onshore attitudes toward disclosure and the limits of confidentiality laws. This goes beyond matters of mere jurisdiction, tending toward a dichotomy in philosophical attitudes on the nature and importance of financial confidentiality and, by implication, the sovereignty and legitimacy of laws which uphold it. This polarisation is most evident in relation to tax matters. Offshore and onshore states do not always share the same views on the matter of classification of criminal offences or litigation techniques. Consequently, offshore states are unlikely to view as appropriate, onshore countries' unilateral attempts to thwart confidentiality for such purposes.

Disclosure initiatives raise questions as to the extent to which a jurisdiction can compel openness about banking information in another country where confidentiality laws are in effect. The outcome of this question, centred around comity, hinges on the legitimacy of offshore confidentiality. Some countries, particularly the USA, follow a 'wide approach' to confidentiality. They pursue disclosure aggressively, even where conflicts of law are apparent. While offshore jurisdictions do not deny that there are

61 Antoine, above n 10, 275-8.

circumstances where confidentiality is inappropriate, typically they adopt a 'narrow approach'. These differences in perspective have evolved into a situation where those onshore countries pursue a unilateral solution to perceived problems.[62]

It is not apparent that onshore courts have properly considered offshore interests in their determinations under the comity principle. The fact that confidentiality is one of the pillars of the offshore industry, and that the offshore industry is essential to the economic and political survival of such nations, is largely ignored. As have been previously noted, offshore nations which make breaches of bank confidentiality statutory and/or criminal offences, are typically countries with limited natural resources and are dependent on finance and banking.[63] Their domestic law has been tailored aggressively to encourage the formation and operation of businesses within their territories. It is therefore logical that they should protect their economic well-being in the same way that other countries, including the USA, protect their economies.

Onshore courts, primarily USA courts, explicitly recognise their objective in undermining confidentiality as part of their wider economic and political interest in obtaining tax revenue and law enforcement. Yet, mention in the literature is hardly ever made of offshore states' equally important, or perhaps greater, interest in upholding confidentiality as a means of protecting the offshore financial sector, the primary means of economic development. This is the major difficulty with the comity principle applied in offshore law.[64]

Nevertheless, there is no common front on the part of the major onshore countries on the question of anti-confidentiality policy, for as yet there is no consensus as to the degree of intervention which is permissible by the country desiring information. The wide USA approach is not in line with other onshore countries, 'such as the UK'. The difference can be traced in part, perhaps, to the economic and political losses which the USA suffered as a result of offshore investment.[65] This has been reflected in legal

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62 Ibid.

63 I Paget-Brown, 'Bank Confidentiality and Criminal Matters: Cayman Islands and United States: Cooperative Development' (1988) 20 *Case Western Reserve Journal International Law* 369, 374.

64 Antoine, above n 10, 273-5.

65 US loses an estimated $70 billion in tax revenue each year because of assets being hidden in offshore tax havens. The Bush administration has shifted the US focus in dealing with tax haven countries away from an international effort to overhaul tax structures and toward negotiated treaties that allow easier US pursuit of suspected cheaters. See J Richard

policy which often appears to be self-centred in terms of the comity question.[66] Consequently, there is no uniform standard on the extent to which the confidentiality principle should be protected where conflicts of laws issues are at stake.[67]

Conclusion

It has been argued that offshore states are under no moral or legal obligation to assist onshore states in their law enforcement efforts in fiscal matters. That fiscal matters form the bulk of the subject matter of disclosure requests is not helpful to onshore cases.

Hence, it is one view that the confidentiality principle must sometimes be sacrificed to a greater interest in disclosure, when competing interests are balanced. This is so, for example, where serious international criminal matters are an issue, an opinion shared by offshore courts.[68] However, on the other hand, seeking an appropriate balance does not mean a carte blanche denial of the confidentiality interest in all circumstances where there are conflicts of laws, as sometimes appears to be the present judicial practice. Rather, offshore jurisdictions must be given the opportunity to define the limits of their confidentiality laws fairly. It is, therefore, argued that they should not be forced into surrendering to greater political and economic powers disguised as legal interests as represented by the OECD et al. A just appreciation of the comity principle allows such an exercise by ensuring the consideration of the interests of both onshore and offshore states. It is only within such a construct that the extent to which the offshore confidentiality principle is justifiable and that inappropriate pressure on less developed nations, to adopt compliant tax regimes, can it be truly appraised.[69]

Duke, 'Cayman Exchange of Information Agreement' (2002) Trusts & Trustees <http://www.trusts-and-trustees.com/trends/td_v8_iss2.html> at 28 April 2004.

66 Walter and Dorothy Diamond, 'The United States as an Offshore Centre?' (2002) Trusts & Trustees <http://www.trusts-and-trustees.com/trends/td_v8_iss2.html> at 28 April 2004.

67 Antoine, above n 10, 274-7.

68 *British Virgin Islands' Mutual Legal Assistance (USA)* Act 1990 (No 5 of 1990) and *Criminal Justice (International Co-operation) Act 1993* (No 8 of 1993). *The Bahamas' The Mutual Legal Assistance (Criminal Matters) Act 1988*.

69 Antoine, above n 10, 273-8.