

# Tax Havens and Illegal Funds of India

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# Tax Havens

- These are foreign jurisdictions that offer financial secrecy laws in an effort to attract investment from outside their borders. These jurisdictions are commonly referred to as “tax havens”, because in addition to the financial secrecy they provide, they impose little or no tax on income from sources outside these jurisdictions. [Source: Internal Revenue Service of United States Department of Treasury-

<http://www.irs.gov/businesses/small/article/0,,id=106568,00.html>

# Tax Havens -2

- Tax haven service providers and their clients know their actions are veiled from tax authorities by banking and commercial secrecy laws and by lack of tax treaties or tax information exchange agreements. They create paper entities to disguise the real parties to the transactions, and many are willing to create false documents to disguise the real nature of transactions. [Source: Internal Revenue Service of United States Department of Treasury]

# Tax Havens-3

- There are more than 70 tax havens .At least forty countries aggressively market themselves as tax havens. Some have gone so far as to offer asylum or immunity to criminals who invest sufficient funds. They permit the formation of companies without any proof of identity perhaps even by remote computer connections. Generally though such extremes are found in emerging nations where the stability and security of the financial, legal, political systems is questionable
- The largest concentrations of assets are attracted to the stable secure environments of the established tax havens -those that have existed a number of years and enjoy the diplomatic protection of former colonial powers. [Source: International Development Centre for Financial Systems

# Tax Havens Examples

- Andorra, Anguilla, Antigua, Antilles, Aruba, Australia, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Canary Isles, Canada, Cayman, Cook Isles, Costa Rica, Cyprus, Dominica, Gibraltar, Greece, Guernsey, Ireland, Isle Of Man, Jersey, Latvia, Liechtenstein, Malta, Mauritius, Monaco, Panama, Switzerland, Thailand, Turks-Caicos, Vanuatu, W. Samoa.

# The type of Benefits

- The concessions and benefits may come in different forms. It may be a zero income tax for all (British Virgin Islands Business Companies), a complete tax exemption for all international business operated by non-residents (Seychelles or Belize International Business Companies), an ultra-low income tax for international businesses (Seychelles Special License Companies pay 1.5% tax), local tax exemption for non-residents of that jurisdiction (Gibraltar, Channel Islands); zero tax on receipt and distribution of dividends (holding companies in Cyprus, Denmark, Netherlands), tax holidays for certain types of investments (Portugal, Iceland); favorable tax treatment through treaties and agreements with the investor's home country (Cyprus, Netherlands, Malta).
- In addition, some countries offer superior legal protection from creditors and potential litigants who might attempt to seize an individuals' wealth. This is the other most important reason why offshore jurisdictions are so popular –

# What is Common Across these Tax Havens

- Very stringent privacy laws,
- Secrecy laws and Non-disclosure policies
- Do not release account information to other governments and law enforcement agencies
- Do not have any financial information exchange policies except where drug trafficking and terrorism are suspected
- Most of these Tax Havens have a legal system based on the British common law

# Why hasn't this been curbed?

- Internet and communication technology improvement
- Tax havens thrive on the financial services sector (it accounts for about one third of the income in the Principality of Liechtenstein) and largely unregulated
- Several nations have largely escaped the global crackdown on tax havens and are not on OECD's blacklist
- Measures being taken to improve the

# Treaty and Non-Treaty Jurisdictions

- The offshore jurisdictions qualify into treaty jurisdictions and non-treaty jurisdictions. Treaty jurisdictions have a network of double-tax avoidance treaties concluded with other countries, inclusive many high-tax countries. A double-tax avoidance treaty basically removes or reduces levels of taxation on certain transactions, taking place between residents of both member countries. The most common and tangible benefits granted by a double-tax avoidance treaty are usually the reduction of withholding taxes on the payment of dividends and royalties between the contracting states – thus, great for a targeted establishment of offshore holding companies. Treaty jurisdictions often portray a non-offshore image – usually offering reduced levels of tax instead of a complete exemption. This obviously may provide a better “image” of the jurisdiction. Malta is a typical treaty jurisdiction.

Non-treaty jurisdictions are “classic” in the offshore sense. They would usually have zero corporation and income taxes anyway, so there is not much to reduce and no interest for any other countries to negotiate a double-tax avoidance treaty anyway. British Virgin Islands is a typical non-treaty jurisdiction.

# Switzerland

- One-third of the world's private fortune resides in Swiss banks
- Banking is the pillar of its economy – 11% of GDP in 2006 as against 5.8 per cent in 1990
- Share of assets deposited in Switzerland by resident and non-resident clients is roughly equal
- Various tax exemptions/reductions available to Swiss companies doing business abroad, or foreign persons resident in Switzerland.
- Taxes not harmonized
- Considerable differences in income tax rates between the different cantons and municipalities
- Tax rates are used as a way of improving the popularity of a location.
- Bank secrecy is among the strictest in the world
- Violation of secrecy remains punishable even when employment has been terminated
- **Since July 1, 2005, Switzerland has charged a**

# Estimates-- Global

- **OECD suggests an upper bound of USD 11.5 trillion in all tax havens.**
- **In 2006, the most recent year of the Global Financial Integrity-[GFI] study, developing countries lost an estimated \$858.6 billion to \$1.06 trillion in illicit financial outflows.**
- **Even at the lower end of the range of estimates, the volume of illicit financial**
- **flows coming out of developing countries increased at a compound rate of 18.2 percent over the 5 year period analyzed for the study.**
- **On average, for the five-year period of this study, Asia accounts for**
- **approximately 50 percent of overall illicit financial flows from all developing countries.**
- **Financial flows in the context of this report includes the proceeds from both illicit activities such as corruption (bribery and embezzlement of national wealth), criminal activity, and the proceeds of licit business that become**

# Estimates --India

- **This report shows that the average amount stashed away from India annually during 2002-06 is \$27.3 billion. It means that during the 5 year period the amount stashed away is  $27.3 \times 5 = 136.5$  billion. It is not that all these amounts had gone to Swiss. It has gone to different tax and secret shelters. The share of Swiss banks in dirty money being a third of the global aggregate,[ and at least 30 percent of Indian money would be in Swiss banks due to historical/geographical reasons]some \$ 45 billion out of the 136.5 billion stashed away from India would have been hoarded in these years in Swiss banks. [ Pp30 of the report].**
- **The important point is that this is only for 5 years. More amounts were stashed away during the Nehruvian socialist regime. So the loot for 55 years would be several times the about money. In fact in those days the Indian rupee commanded a better value per Dollar. So fewer rupee could get more**

# Estimates -India-2

- The International Narcotics Control Strategy Report -**Money Laundering and Financial Crimes** -March 2009—by US department of state suggests that 30-40 percent of the inflows may be by Hawala market -not accounted. During 2007-2008 according that report formal inflows were USD 42.6 billion and so 40 percent of this namely USD 1.8 Billion could be reflected as illegal “flows” not captured by the law. This sum could be paid for in rupees here but stored in tax havens abroad.
- The report also suggests integrating NGO funding [nearly Rs.65,000 crore from 1996 to 2006--Rs 12700 crore in 2006-07 ] regulations under MoH and other regulations pertaining to inflows. Out of nearly 34000 registered bodies

# How did it go?

**There are several methods /reasons.**

- **Under invoicing/over invoicing of exports and imports and getting the balance stored abroad.**
- **Kick backs from major defence/civilian contracts.**
- **Not bringing the earnings abroad.**
- **In the olden days smuggling of Gold and illegal money.**
- **Transactions done abroad and not reported here. Hawala funds.**
- **Funds earned by artists/ Entertainment industry /sports people and stashed abroad.**
- **When you want to indulge in Adharma**

# What does Swiss Government say?

- **Addressing a press conference to commemorate the 60 years of Indo-Swiss Friendship Treaty, [The Swiss Ambassador to India] said "Switzerland was accused of giving shelter to black money and there has been a lot of inflow of such wealth from India and other countries of the world," Dreyer said.**
- **The Ambassador said "I would not say it would be stopped 100 per cent (under a new law). But through this measure, it would be controlled up to a certain limit."**

# Can Tax Havens be used by Terrorists against India?

- **Even our NSA—M.K Narayanan has spoken about it in Berlin.**

See his speech “ Link between world of finance and terrorism: at Munich Security Conference -11-02-.2007)

- [ <http://www.fedpol.admin.ch/fedpol/en/home>

# Lichtenstein Affairs

- Germany's intelligence agency seems to have paid an unnamed informer more than USD 6 million for confidential and secret data about clients of LGT group a bank owned by the Liechtenstein [notice that the Prince's surname is that of the country!] Prince's family.
- The revelations have already led to the resignation of the head of Deutsche Post—the former German mail service--- which is currently the world's largest logistics company in the world. The Lichtenstein leaders are furious and have focused all their ire at the theft of the data rather than on the facts of the case.
- The German Government has announced that it would share information on accounts held in the tax haven with any Government that wanted it.
- They had a list of 1400 clients of whom 600 are only Germans. The spokesman for the German Finance ministry Thorstein Albig has indicated that they would respond to such requests without charging any fees for the information. Finland, Sweden, and Norway have expressed

# Impact of Lichtenstein affair in Germany

- **Another interesting thing which is taking place is the results of the crackdown in Germany. An April 8<sup>th</sup> report by Reuters says that "A crackdown on tax havens that prompted Switzerland to loosen its banking secrecy is encouraging more and more Germans to come clean about foreign accounts they use to evade taxes.**
- **Berlin has waged a very public campaign to stamp out tax evasion since Klaus Zumwinkel, then chief executive of Deutsche Post and one of Germany's top businessmen, was arrested in a major tax probe last February.**
- **"Zumwinkel kicked off a bit of an avalanche," said Andreas Boehm, a lawyer based in central Berlin. "Afterwards, the number of people coming clean with us ... rose by about 400 to 500 percent. And that level has been maintained."**
- **This is a positive outcome of the LGT affair where India has been reluctant to grab the names of**

# Participatory Notes [PN] in Share

## Markets--

- The notional value of investment in PNs which aggregated to Rs.31, 875 crores in over 10 years up to March 2004 grew to Rs.3,53,484 crores by August 2007 - that is by over 11 times in just 40 months!
- The investment through PN constituted 20% of all FII investment in 2004. This increased to over 51.6% in August 2007. Thus in 2007 more than half the FII investments were through the anonymous PN formula.
- The sub-accounts created by the FII for these nameless entities not registered with SEBI to transact in the market are fraught with dangerous consequences and security risk. The sources of these funds are unknown; the investors are nameless; the billions of dollars invested through

# PN's are WMD in stock Markets

- The “Know Your Customer” norms, which the law makes it mandatory for opening of simple banks accounts by Indians in India, are not followed to permit billions of Dollars of investment into the stocks markets in India.
- The PN mechanism – through which unnamed investors are allowed to participate in our markets, invest and disinvest stocks for billions of dollars and make and repatriate profits – is thus a mystery wrapped in a puzzle, packed in an enigma, crammed inside a conundrum and delivered through a riddle.
- The clamor for this form of investment is intriguing if not outright suspicious. It was felt by many experts that PN's are the weapons of Mass

# Goldman Sachs case in PN

- SEBI wanted an undertaking that they are not dealing with Indian residents/NRI's/PIO's/OCB's
- GS prevaricates/SEBI imposes a fine of Rs 1 Crore
- GS argued that since there were no bar on the FIIs and their sub-accounts to issue/subscribe/purchase any PNs to/from Indian residents or NRIs/PIOs/OCBs, it would be “reasonable to presume” that many of them must have dealt with such persons in the course of their business activities.
- The SAT concurred with the observation of Goldman Sachs that as on that date [ 2008]-- there is no provision either in the Act or in the Regulations which debars FIIs or their sub-accounts from dealing in PNs with Indian residents/NRIs/PIOs/OCBs.
- FM says SEBI has all the details of PN holders
- How can SEBI have details when it does not have power to seek information from the regulated?

# UBS Case -India and USA

- Unfortunately the Government does not reveal the nature and identification of Foreign Institutional investors who are investing in the market nor the nature of origin of these entities.
- The Indian attitude to this serious issue is a contrast to how the US handles it for instance.
- The UBS which paid a penalty of over \$800 millions in US just now and also disclosed the secret account details of nearly 300 Americans as the US government wanted.
- But in India the same UBS paid a paltry penalty a Rs.55lakhs to the SEBI for not – yes for NOT – disclosing the names of the secret PN holders whose funds it had invested, and settled the case, a month back!

# Why Switzerland is in the eye of the storm?

- For instance a report dated 10<sup>th</sup> April 2009 by AFP mentions that "The head of the Organization for Economic Cooperation and Development, Angel Gurría, referred in a letter to Swiss President Hans-Rudolf Merz to the "inaccuracy" of charges of unfair treatment made by Swiss officials.
- "We only shared the criteria that have been approved by our committees and the jurisdictions that were adopting or not the OECD standard," he said. **"As you know very well, Switzerland does not yet have a single agreement on the exchange of tax information that conforms to the OECD standard."**

# What the Swiss are now doing?

- **Swiss private bankers are likely to reduce their exposure to wealthy Indian clients as they cut down their discreet banking services in countries like Germany, France and the United States, analysts say.**
- **As the worldwide crackdown on tax evasion gathered momentum following the recent G-20 meeting in London, several Swiss banks, including UBS, which is the world's largest manager of private wealth assets, have issued travel directives to their "client-facing" staff not to visit foreign countries for carrying out what are called offshore wealth-management banking services.**
- **UBS, for instance, has asked its wealth management staff not to travel abroad to meet clients. "This will also apply to India," said Serge Steiner, a UBS executive.**
- **"However, UBS India will continue to service wealth management for Indian clients," he added. In effect,**

# What the Swiss are now doing?--2

- **At present, Swiss banks manage around \$2 trillion offshore assets of clients from various countries. UBS, which is now mired in a major legal dispute with the US tax authorities, has passed information of over 300 accounts of wealthy American clients to the US Internal Revenue Service.**
- **But the IRS is not satisfied with UBS and it wants the Swiss bank to provide information on some 52,000 American clients.**
- **Besides, two UBS bankers were arrested in the US on the plea that they were involved in tax fraud, analysts said. Hence, UBS and other Swiss private banks are preparing ground to reduce their exposure to offshore banking services in a move to avoid further difficulties for the bank.**
- **Other Swiss private bankers too have been discreetly cautioned not to undertake visits in the wake of growing pressure from the G-20 leaders, especially Germany and France, who seem**

## G-20 meet -April --2009

- China forcefully argued in the meet for not disclosing Tax Haven list since it was worried Hongkong and Macao will be listed. Hence OECD list was noted by G-20. Hongkong and Macao were not there.
- India did not argue against tax havens in the meet or in the preparatory meet Perhaps worried that names of beneficiaries may be out!

# What about Domestic black money

- Domestic black or unaccounted money is definitely important.
- At least Domestic black money is used in our economy and to that extent it is productive.
- But the money kept in Swiss Banks is neither useful to India nor it benefits Indians.

# Outflows of Funds from India for JV's and Wholly owned subsidiaries

- On the other side we find more disturbing issues pertaining to out flow of funds from India.
- More than one third of outflows of a total of around 31000 million USD is to many of the well known tax havens like Channel island [5400 Million USD] ,Mauritius [2600 Million USD] Virgin Islands [1008 million USD] ;Cyprus [ 1361 million USD] Cayman islands [104 Million USD] .
- Indian business howsoever capable cannot think of investing 5400 million USD or around Rs 21000 Crore in Channel Island.
- These data are not available for FII's. nor in terms of who are the corresponding investors.

**Source:** Finance ministry web site on the country-wise approvals of Indian Direct investments in JV's and wholly owned subsidiaries during 1996 to

# Why now this issue?

One outcome of the Meltdown and terrorism

- The “privacy” and “secrecy” debate is over
- Because of Global pressure on Tax Havens the possibility of India gaining is High.
- The returns in India are attractive and hence many may want to bring it back.

# Can we get the funds

- Yes we can if there is a political will.
- Nigeria Got it; Italy got it in 2002; Phillipines got it; Jews got it.
- We must Put it on the Global Agenda. Put it in G 20 Put it in IMF Put is in EGMONT GROUP. We are members through FIU
- Financial Intelligence Unit-India (FIU-IND) has been admitted as the member of the Egmont Group at its recent Plenary Session at Hamilton, Bermuda.
- Membership of the Egmont Group, apart from meeting an important requirement of the Financial Action Task Force (FATF) will facilitate and enhance exchange of information by FIU-IND with its counterpart FIUs.
- Become full member of FATA—Currently only observer status.
- Also take a lead among all developing countries. Support US /German/French Efforts.