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Tax havens in the Pacific

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Developing small states continue to find themselves in dire financial straits. No wonder, they seek new venues for raising revenue.

Pacific island countries (PICs) are no exception.

Sluggish economic recovery in the industrialised nations and its effects arising out of stagnant growth in exports of poor countries have renewed pressures on PICs to step up revenue mobilisation.

New taxes or raising tax rates on incomes and value added tax are ruled out as the recent 2014 budgets of two major PICs reveal. Same time, pressures on governments are mounting to provide social welfare benefits and step up investment in social infrastructures, including education and health.

In these circumstances, the measures needed are strengthening revenue collection and avoiding ministerial discretionary tax exemptions and waiving of tax arrears. Additional efforts are now under way for curbing the growing menace of corruption in tax collection and imposing stringent controls on money laundering and illegal tax avoidance transactions.

Tax havens

Yet one of the age old mechanisms to attract capital inflows is still continuing. This is the practice of setting up and encouraging offshore financial centres (OFCs) to attract funds at low or no interest rates but at fees for protecting the secrecy of transactions.

Funds, avoiding taxes, flow from high tax friction countries to those countries which have either low tax rates or no tax at all. The OFC institutions are given special status and facilities by the sponsoring countries.

Many independent island countries in the Caribbean which have no land or mineral resources can attract capital inflows only in this fashion, as there is no other obvious way of attracting foreign capital, except in tourism related activities including hotel resorts.

Tax dodgers from industrialised countries, mafia groups and corrupt politicians all over the world have been seeking such countries for more than hundred years. Governments hosting OFCs have taken special measures including secrecy protection.

The Swiss banks and island nations with OFCs in the Caribbean, namely Cayman islands, St. Kitts -Nevis and Bermuda were well known in this sphere of secret tax haven activities.

In the Pacific, Vanuatu, called New Hebrides before its independence in 1980 is one of the rarest: a pure tax haven, since it has no direct taxation of any kind either on its citizens or resident expatriates.

Impact of OFCs

Studies show impact of OFCs on PICs growth and development is insignificant. The funds received do not enter the domestic banking system. They do not add to domestic savings. They are not used for any investment, except for office equipment and facilities. The OFCs transfer funds to high interest earning centres such as Singapore and Hong Kong. The transfer is instantaneous, thanks to electronic communications. For the same reasons, employment in OFCs has dwindled. Introduction of computers has dispensed with clerical staff over last two decades. A single office under one copper plate can handle transactions of about 30 offices indicating minimum transfer of any notable technical or management skills.

Until 2001's 9/11 terror attack, OFCs were tolerated by industrialised countries as long as they were supervised by the island nations and the investigating countries into suspicious illegal transactions and were provided full access to information and documents. After 2001, OFCs came under heavy scrutiny since it was feared that terror groups would be using OFCs for funding their activities.

All countries with OFCs, "the good, bad and ugly" were asked to strengthen their supervision and regulatory measures to ensure the legality and legitimacy of their operations. Guidelines were prescribed at maintaining tax haven reputation while adopting regulations to keep it in line with "international anti-money laundering/counter-terrorist financing (AML/CFT) standards".

"Ugly" tax havens

The industrialised countries led by America decided to "name and shame" some OFCs which in their opinion were not cooperative in "diluting secrecy provisions" in the general interest of safety. Some island nations were identified and listed: the Bahamas, St. Kitts-Nevis, and St. Vincent in the Caribbean and Niue, Nauru, the Cooks and Marshall Islands in the Pacific; and others including Panama and Liechtenstein.

Some graduated out of the list by adhering to standards.

Similar to governance index, we now have a financial secrecy index (FSI) issued by Tax Justice Network (TJN), a group promoting greater transparency in OFC activities, "located in secrecy jurisdictions". A secrecy jurisdiction is defined as the one providing facilities that enable entities escape or undermine the laws, rules and regulations of other jurisdictions elsewhere, using secrecy as a prime tool.

TJN uses 15 indicators for computing the secrecy scores. They include banking secrecy, disclosure of company ownership, maintenance of records of local trusts and foundations, exchange of information, and anti-money laundering legislations.

The ranking of countries is based on a combination of a country's secrecy score and a scale weighting based on their share of the global market for offshore financial services.

In the 2013 FSI issued this month, Switzerland, followed by Luxembourg, Hong Kong, Cayman Islands and Singapore are top ranked countries which fare well in terms of strict supervision and regulation.

Closer to home

Fiji does not have an OFC, as its current banking regulations do not permit.

Vanuatu accounts for 0.002 percent of global funds flowing OFC activities, with Marshall Islands at 0.022 percent. Samoa's share is much less and is ranked at 88, just ahead of Vanuatu, both at the end of the FSI ranking.

TJN says the low ranked PIC must make major progress in offering satisfactory financial transparency.

"If it wishes to play a full part in the modern financial community and to impede and deter illicit financial flows, including flows originating from tax evasion, aggressive tax avoidance practices, corrupt practices and criminal activities, it should take action on the points noted where it falls short of acceptable international standards.", the TJN concludes.