

# CONFIDENTIALITY IN OFFSHORE FINANCIAL LAW

SECOND EDITION

ROSE-MARIE BELLE ANTOINE

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Great Clarendon Street, Oxford, OX2 6DP,  
United Kingdom

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First Edition published in 2002

Second Edition published in 2014

Impression: 1

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Published in the United States of America by Oxford University Press  
198 Madison Avenue, New York, NY 10016, United States of America

British Library Cataloguing in Publication Data  
Data available

Library of Congress Control Number: 2014938495

ISBN 978-0-19-969344-3

Printed and bound by  
CPI Group (UK) Ltd, Croydon, CR0 4YY

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# 1

## THE NATURE OF THE OFFSHORE FINANCIAL CENTRE

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### A. Introduction—Confidentiality and Disclosure Norms in a Changing Environment

Literature on the subject of offshore investment and finance which emphasizes the economic aspects of the offshore sector or seeks to advise readers where and when to invest is now fairly common. In contrast, too little priority has been given to the complex and intriguing legal issues involved in this sphere of finance. This book attempts to redress this imbalance in an area which can be described as virtually unexplored. It examines what can be described as a dynamic and context specific law of confidentiality and its parallel, disclosure, in offshore finance. **1.01**

Offshore confidentiality is one aspect of a still emerging jurisprudence which can now be appropriately termed ‘Offshore Financial Law’. This writer’s definition, adopted by Moore J in the case of *Re Credicom Asia Ltd* is the following:<sup>1</sup> Offshore financial law may loosely be defined as legislation, legal practices and law concerned with investment, financial arrangements and entities created by non-residents of a particular jurisdiction but structured within that jurisdiction. Such investments or arrangements are typically focused on some business advantage, tax avoidance, protection from creditors and judgment debtors or privacy. **1.02**

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<sup>1</sup> No 20 of 1999, decided 30 July 1999 at 31. Moore J adopted the definition from the article ‘Obtaining Mareva Injunctions and Related Orders Against Offshore Assets’ (1998) 8 Carib LR 212.

- 1.03** The principle of offshore financial confidentiality is a controversial but fundamental issue in offshore financial law. The debate wavers between two extremes. On the one hand, offshore jurisdictions view confidentiality in financial matters as an essential ingredient in the offshore industry which deserves to be protected. On the other, onshore states are increasingly hostile to confidentiality and have been willing to take drastic measures to undermine it. This book examines the contentious issues surrounding confidentiality to determine the extent to which it should be protected given the conflicting interests at stake.<sup>2</sup> Its parallel, the obligation to disclose, has increasingly become an important and complex subject of itself. Consequently, a proper appreciation of the modern offshore financial centre requires an in-depth understanding of both confidentiality and disclosure principles in what remains a unique legal environment.
- 1.04** While many have seen the increasing disclosure obligations as sounding the death knell of the confidentiality principle in offshore finance, this writer does not subscribe to that view. The confidentiality principle in finance and commerce generally, and offshore finance specifically, remains both valuable and sustainable in itself. Despite the several erosions in favour of disclosure as described in this book, very recent cases where comity is in issue, even in the face of challenging legal norms of disclosure, such as exchange of tax information treaties, give support to this view. The practitioner and academic alike must be versed in the now several legal principles which mandate disclosure – for example, to support law enforcement ideals such as against money laundering, and rightly so. However, this should in no way be translated to mean that residual duties toward confidentiality in offshore law are absent.
- 1.05** Because of the importance of confidentiality to offshore law, the offshore practitioner or potential investor must consider carefully the several ground rules relating to offshore confidentiality. Many of these, in the modern context, have to do with the erosion of confidentiality in favour of disclosure, given the increasing pressure being placed on offshore financial centres to dilute strict confidentiality legal norms.
- 1.06** In the first edition of this book I alerted readers consistently to what I described as the ‘erosion’ of the confidentiality principle in offshore finance. In this new edition, I reflect on the reality of an emphasis on disclosure of financial information.
- 1.07** Confidentiality and disclosure also have implications for several other areas of law. These are examined with a view to forging some coherent legal principles in

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<sup>2</sup> The terms ‘*offshore* countries or jurisdictions’ are used here for convenience to describe countries which engage in offshore finance. It is not intended to suggest that such countries do not have viable traditional well-established, legal and economic financial structures in place. Conversely, *onshore* countries or jurisdictions merely signify countries which do not engage in such activity in any significant way. See the definition of offshore financial centres at para 1.18.

the creation of an offshore jurisprudence. They include the appropriate parameters of bank regulation within the context of the prevention and detection of certain undesirable or criminal activities, such as money laundering and tax evasion. Relevant, too, are issues concerning the comity and sovereignty of nations in international law, mutual legal assistance and constitutional issues such as the right to privacy, the privilege against self-incrimination and arbitrary search and seizure. The list is not exhaustive. These subjects are examined against the backdrop of business efficacy and economic reality as measured against the potential for abuse. The proposition that confidentiality is legitimate, albeit in measured form, will be discussed against the background of such notions.

The preceding paragraphs address important policy issues which inform current international debate on confidentiality within the context of the existence of offshore jurisdictions. These are exciting times for confidentiality and disclosure. Here is a jurisprudence which is continually expanding and which is instrumental to the broader questions of transnational investment such as offshore finance. This can rightly be treated as a subject on its own both because of its unique legal principles and norms and because it impacts so heavily on almost every other subject in offshore finance. The principle of offshore confidentiality itself has spurred an indigenous jurisprudence, which is an important aspect of offshore financial law. Yet despite the seeming importance of confidentiality to the offshore sector, it is neither wise nor possible to be insular in an increasingly integrated financial world. Thus, the arguments for and against confidentiality and disclosure must be examined within a global context. **1.08**

In recent years, a concerted assault has been launched on financial confidentiality in offshore jurisdictions.<sup>3</sup> Yet, it remains a grounding principle, central to the existence and development of such jurisdictions. An examination of the characteristics of such offshore jurisdictions is central to locate the principle of offshore confidentiality. Thus the following section explains the aims and functions of the offshore financial centre. **1.09**

## **B. The Development of the Offshore Financial Centre**

The development of the offshore financial centre is one of the most significant and fascinating legal and socioeconomic phenomena in contemporary times. This has occurred with, and complemented by the dramatic advances in technology and **1.10**

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<sup>3</sup> See paras 11.01–11.02, 11.04–11.11.

communication, the equally spectacular growth of the transnational company and the development of transnational banking. As Allen put it:

[T]he financial services sector is rightly to be seen as one of the most dynamic sectors of commercial activity. And understandably so, because all other commercial activities have some expression in the financial services sector, and it is a sector which is trading heavily on the rapid and dynamic advances in telecommunications technology.<sup>4</sup>

- 1.11** The popular notion of 'offshore' conjures up an image of unethical, illegal, or even criminal activity. It is an image that is due in large part to propaganda. However, this is a myopic view of offshore activity and issues relevant to offshore finance go beyond that of illegal activity such as tax evasion, insider dealing, or money laundering. Instead, the thrust of offshore finance is to ensure compliance with internationally accepted norms and practices. The creation of offshore financial structures and the resulting law is a legitimate phenomenon in itself.
- 1.12** There is still a misconception that the offshore financial centre, or international financial centre, in its embrace of confidentiality concerns only taxation. This is not so. Several recent cases involving trademark challenges in the context of bank confidentiality and comity dispute that claim.
- 1.13** The legal study of offshore finance is a multi-faceted discipline, bringing together several variant subject areas, often in creative expressions. These include the law on new, unique, forms of the trust, tax planning vehicles, mutual funds, company laws, revenue law, banking law, and captive insurance. It further embraces the subject of the conflict of laws and other areas of legal inquiry not often met in commercial matters, such as constitutional law. The principle of offshore confidentiality can be viewed as an important common denominator in all of these several diverse subject areas.
- 1.14** While the subject of offshore financial centres has obvious international dimensions, the writer focuses primarily on offshore financial centres in the Commonwealth, in particular, the Commonwealth Caribbean as they relate to the United Kingdom and the United States. This is a justifiable approach as the Commonwealth Caribbean is one of the oldest and most successful offshore financial regions in the world. The bulk of its investors originates in the United Kingdom and the United States and, to a lesser extent, Canada. Further, offshore financial centres tend to borrow heavily from each other such matters as legislative content, legal policy, style, institutions, norms, and philosophy. In addition, most of the litigation and literature on the subject originate from offshore centres located in the Caribbean. Further, confidentiality issues (like broader offshore law

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<sup>4</sup> Minister of Finance of The Bahamas, Sir William Allen, Bahamas Financial Services Board, News Detail, 2 October 2001. The term 'financial services sector' is often used interchangeably with 'offshore sector'.

issues) are similar to all offshore jurisdictions, although laws may not be identical. To this extent, the Commonwealth Caribbean nations have been instrumental in defining the way forward internationally for the offshore financial sector.<sup>5</sup>

The demand for offshore financial services was driven by several factors. Offshore financial centres aim to supply this demand to increase revenue. They take advantage of what, increasingly, is becoming a mainstream financial sector, devoid of yesteryear's unsavoury images of criminal activity and financial abuse. Modern offshore financial centres facilitate tax planning by offshore investors, succession and asset protection vehicles such as innovative trusts, modern and sophisticated banking, mutual funds, and dynamic investment. They target mainly international corporate investment portfolios and investment portfolios of high net-worth individuals. The offshore financial sector is also a main contributor to economic development in the countries where it exists.<sup>6</sup> **1.15**

### **The origins of the offshore financial centre**

The offshore financial sector developed on a phased basis. The basic structure of the 'tax haven' was upgraded to the sophisticated entity of the 'offshore financial centre', with its divergent financial products. The movement of financial institutions offshore resulted in an unprecedented scale of offshore bank deposits. It led to the establishment of a network of onshore external financial centres and onshore-related offshore finance centres which were interlinked spatially by telecommunications and air travel. A 'new invisible secondary trading system, global in scope, was thereby forged, and a new tier of circuitry provided to facilitate the global velocity of international funds.'<sup>7</sup> **1.16**

The term 'offshore' within the context of finance and business, is thus no longer confined to the rather unsavoury image of the 'tax haven', which allows the big players in the world of international business to evade the legitimate grasp of the **1.17**

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<sup>5</sup> Indeed, the first International Business Companies statute was drafted in the British Virgin Islands by Lewis Hunte (1984) and is now a standard feature in offshore jurisdictions. In the case of *Mcdoel Investments Ltd et al v The Federal Republic of Brazil* [2007] JCA 069, Jones, JA said: 'We are conscious that, as the Court of Appeal of Jersey remarked in *Durant and Others v Attorney General and Another* [2006] JCA 039, "Over the last half-century, Jersey has become a major financial centre, providing trust and banking facilities for an extensive international clientele...."'

<sup>6</sup> For example, in The Bahamas, the offshore sector constitutes 20% of the economy in 2014, [www.centralbankbahamas.com](http://www.centralbankbahamas.com). The leading sectors are offshore banking, with over 400 banks and assets worth more than US\$150 billion, mutual funds of US\$75 billion and offshore trust management and shipping: Bahamas Government Statistical Office, September 2001. In 1996, in the United States Virgin Islands (US VI) there were already over US\$50 million from foreign sales corporations alone: William Stief (1996) *Caribbean Week*, 26 October–8 November 78. In the Cayman Islands, there are over 580 banks with more than US\$500 billion in holdings. In 2011, the sector was worth 68,505 million dollars, Cayman, [www.eso.ky](http://www.eso.ky). In St Kitts and Nevis, there were 9,000 offshore financial companies, and in the Channel Isles and the Isle of Man, over US\$525 billion in assets: US Department of Treasury, Financial Crimes Enforcement Network (FINCEN), FINCEN Advisory, Issues 14–26 (2000).

<sup>7</sup> RA Johns and CM Merchant, *Finance Centres: British Isle Offshore Development Since 1979* (Pinter, London, 1993) 15.

tax collector. The modern offshore financial centre is a complex creature, not solely, or even primarily, concerned with maximizing attempts at tax avoidance. Instead, it includes a wide spectrum of financial and business rationales, resulting in the evolution of a range of niche products to meet the requirements of modern finance and business. It operates in an increasingly transnational context.

### C. Defining the Offshore Financial Centre

**1.18** The variety of uses and the scope of the offshore financial centre make it difficult to define the phenomenon. Even the very term 'offshore financial centre' defies a conclusive description. It has also been called 'international financial centre', 'world financial centre', 'international banking centre', and 'offshore banking centre'. There is a consensus, however, that the term 'tax haven' is now obsolete when one is describing offshore functions from a holistic perspective. McCarthy defines the term 'offshore banking centres' as:

cities, areas, or countries which have made a conscious effort to attract... non-resident foreign currency-denominated business... by adopting a flexible attitude where taxes, ... and regulations are concerned.<sup>8</sup>

**1.19** The term 'offshore' is a qualitative term, referring to

either investment located purposely in specific foreign jurisdictions... the legislative and tax frameworks and regulatory authorities of which are less restrictive in comparison with their home-base... specifically designated facilities or financial 'free' zones, available to... [investors] which are exempted from all or specific regulatory controls/taxes on international... activities that otherwise apply in the rest of the local economy.<sup>9</sup>

**1.20** Using these parameters, surprising results may be obtained. It is possible for 'offshore' facilities to be located in tax regimes which are usually viewed as having strict financial regulatory environments in relation to their own nationals, but make exceptions for non-residents. This would encompass countries such as the United States or the United Kingdom which, in the deregulating period of the 1980s, instituted 'international banking facilities'.<sup>10</sup> Yet too wide a definition of the offshore phenomenon necessarily robs it of its inherent character and, indeed, ignores the reality of what the financial world understands as such. Nevertheless, the fact that onshore countries which are hostile to offshore financial centres can and do offer financial services similar to offshore financial centres is an important element in any discussion on the legitimacy of the offshore sector. Indeed, the companion

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<sup>8</sup> Quoted in Park and Essayard (eds), *International Banking and Financial Centres* (Kluwer, 1989) 4.

<sup>9</sup> LJ Kemp, *A Guide to World Money and Capital Markets* (McGraw Hill, London, 1981).

<sup>10</sup> LJ Kemp, *A Guide to World Money and Capital Markets* (McGraw Hill, London, 1981). See also I Baxter, who defines the UK as a tax haven: 'The UK and Tax Havens: A Comparative Comment' (1985) 33 AJCL 707, 711.



text to this book now devotes an entire chapter to these legal regimes that exist without challenge or criticism in the US, a country that has been extremely hostile to offshore financial centres elsewhere.<sup>11</sup> This writer has labelled such regimes onshore offshore financial centres.

A realistic definition of an 'offshore financial centre' or any other activity referred to under the umbrella description of 'offshore', is the following: It refers exclusively to a regime which has chosen as a main or important path to development, legislative, financial and business infrastructure which is more flexible than orthodox infrastructure and which caters more specifically, and often exclusively, to the needs of non-resident investors. As indicated previously, this legislative framework includes innovations in trust, banking, fiscal, insurance, financial, and company law.<sup>12</sup> **1.21**

The offshore phenomenon thus refers to more than peripheral financial, tax, and banking arrangements which may, either occasionally or on a continued basis for a small sector of the economy, be introduced by capital exporting developed countries. **1.22**

### **Developmental aspects**

In theory, the offshore financial centre is not limited to developing countries seeking to capitalize on financial profit flows from capital exporting countries. Yet, in the main, it is in such countries that the major offshore centres are located. An appreciation of the developmental aspect of the offshore phenomenon is thus crucial to understanding the socio-economic and legal evolution of the sector. It also underlines the complex problems posed by the existence of such an industry. Arguably, this is a factor in analysing the rather hostile attitude taken by some developed nations to offshore jurisdictions and the latter's response to this attitude. **1.23**

Some economists make the distinction between offshore activities by capital exporting countries and those of developing countries by referring to 'traditional' and 'new' international financial centres respectively. These 'new' centres lack financial autonomy.<sup>13</sup> **1.24**

The transformation of the 'tax haven' into the offshore financial centre has evolved into a global pattern compatible with the four main business time zones, namely: **1.25**

- (1) the Caribbean/Central American basin, serving the North and South American continents, largely within the New York time zone longitude;<sup>14</sup>

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<sup>11</sup> See Chapter 4 of the companion text, Rose-Marie Belle Antoine, *Offshore Financial Law, Trust and Related Tax Issues* (2nd edn, OUP, UK, 2013).

<sup>12</sup> This definition does not contradict the fact that a few offshore financial centres, such as The Bahamas and the Cayman Islands, have no direct tax regimes, thus, in this narrow sense, both residents and non-residents enjoy fiscal benefits.

<sup>13</sup> Xavier Gorostiaga, *The Role of the International Financial Centres in Undeveloped Countries*, (St Martin's Press, 1984). The term 'traditional' describes centres such as New York and London.

<sup>14</sup> These include Panama, Anguilla, Antigua, Belize, Barbados, Bermuda, the Cayman Islands, Grenada, Virgin Islands (US and British), the Turks and Caicos Islands, St Vincent, Costa Rica, Dominica, St Lucia, and The Bahamas. The Bahamas and the Cayman Islands are two of the oldest financial centres in the world.

- (2) the European sector, including 'self-regulated' islands;<sup>15</sup>
- (3) the Persian Gulf states serving Middle Eastern oil-surplus countries;<sup>16</sup>
- (4) the Asian Pacific region.<sup>17</sup>

### **Background to the development of the offshore financial centre**

**1.26** Economists like Gorostiaga<sup>18</sup> argue that the offshore financial sector is the beginning of a new state of international capitalism. He traces the evolution of the rise of the sector from the growth of transnational companies to the corresponding growth in international banking to the modern phenomenon of capital which transcends national frontiers. When one examines the political tensions in terms of the sector, in particular, the deficiencies between the pro 'big business', small government approach of the Republican party in the US, as against the Democratic Party which has been traditionally more hostile to the offshore financial sector, this argument has resonance. Similarly, Johns notes that the new variants of trade organization flowing from the increased multinationalism of firms largely precipitated the advancement of the offshore sector. The concomitant revolution in computer technology and telecommunications gave impetus to this trend. This permitted global accessing of worldwide market information, thereby creating a capacity for global reach managerial control.<sup>19</sup>

**1.27** The environment which successfully spurred the offshore financial sector was one in which:

many national financial systems were individualistic and had become established in an ad hoc historical sequence of often ill-conceived measures, the arcane and often arbitrary elements of which, in their unreformed state, were inhibitors of business innovation, frustrated national and external financial intermediation requirements, and thereby distorted resource allocation internationally.<sup>20</sup>

Several constraints existed under the traditional domestic and international financial sectors which created a fertile environment for offshore activity. These included:

- (1) the extension of national tax bases;<sup>21</sup>
- (2) intermittent fiscal and monetary instabilities;
- (3) the existence of foreign exchange controls and fluctuations;

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<sup>15</sup> In particular, the Isle of Man, Jersey, Switzerland, Liechtenstein, Luxembourg, the Republic of Ireland, and Guernsey.

<sup>16</sup> Including Lebanon, Liberia, and Bahrain.

<sup>17</sup> Hong Kong, Singapore, and Vanuatu.

<sup>18</sup> Gorostiaga (n 13).

<sup>19</sup> Johns and Merchant (n 7).

<sup>20</sup> Johns and Merchant (n 7).

<sup>21</sup> To include, inter alia, capital gains taxes and more comprehensive taxation of accumulated wealth and its transfer.

- (4) limiting cross-border controls, for example, over the ability of economic actors to switch investments at will, to disinvest and to reinvest the proceeds;
- (5) conservative banking laws and other limiting financial regulations with regard to foreign and domestic industrial entry, systems of supervision and liquidity requirements, constraints on the issue of foreign and domestic bonds, the admission of securities to capital markets, stock exchange, and insurance regulations; and
- (6) company laws which restricted business;

### **Lack of international fiscal rules and policy**

In addition, a significant factor was the lack of a coherent set of international fiscal principles and laws in which the transnational firm could with certainty operate across borders. The differentials in fiscal policy at an international level include variations in anti-international tax-avoidance legislation, design of corporate tax systems, and jurisdictional policy attitudes with regard to the emigration of business. Conflicts and uncertainties were created by the extraterritorial assertions made by national tax and legal systems toward business and financial activities. Thus, 'cross-border economic activities and income flows are extremely complex, divergent and sometimes inhibiting, as there is no overarching set of cross-national common taxation policies'.<sup>22</sup> This is particularly true where a concurrence of jurisdiction occurs, and the problem of conflict of laws arises. Indeed, this factor serves as an important justification for the offshore tax function. This tax motive is particularly important to the discussion on confidentiality as many objections raised to offshore confidentiality are linked to the tax function, perceived or real, in offshore jurisdictions. As companies became transnational and relocated offshore, banks followed, in part to better serve their major clients. **1.28**

The development of the offshore financial centre is usually described from the perspective of its tax and banking functions. More recently, however, other constraints onshore have served as catalysts to offshore investment and have enhanced the importance of that investment. These include: **1.29**

- (1) the need to provide for what is seen as the vulnerability of professionals and investors to potential creditors;
- (2) the desire to avoid onshore laws which mandate the reservation of assets to spouses and heirs;
- (3) the need for a savings and investment vehicle for ordinary persons; and
- (4) the saving of costs associated with onshore probate and related processes.

There has also been a shift in offshore investment, from big companies to ordinary individuals. **1.30**

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<sup>22</sup> Johns and Merchant (n 7) 5.

### **Offshore financial services**

- 1.31** The offshore financial centre is thus a varied service sector which facilitates specific onshore commercial needs. The main types of offshore financial services may be identified as:
- (1) international banking services;
  - (2) dynamic investment functions and funds;
  - (3) tax planning services and other financial services associated with transnational business; and
  - (4) employment savings to avoid costly employment protection, social security or pension requirements.
- 1.32** These include innovative and diverse entities and 'products' such as succession and asset protection vehicles like offshore trusts, mere incorporation facilities or what is known as 'paper companies', active companies, captive insurance, offshore shipping registers, fund flotations, offshore pensions, now commonplace investment vehicles such as investment bonds or unit trusts, and the international business company. One version of the latter may actively engage in manufacturing or other operational activities in the host offshore country, in exchange for tax holidays and concessions.<sup>23</sup>
- 1.33** With respect to the tax function, there are essentially three models of offshore financial centres. These are centres:
- (1) with zero-tax—here, even residents do not pay personal taxes;<sup>24</sup>
  - (2) with low-tax;
  - (3) which impose tax at normal rates but grant exemption, or other preferential treatment, to non-resident investors or investment for certain categories of income and within double taxation regimes.<sup>25</sup>
- 1.34** Although this categorization emphasizes only the tax aspects of offshore activity, it loosely identifies the focus of the centre. Under category (3) initiatives aimed at manufacturing relief and incentives, such as occurs in Ireland and Barbados, may be placed. Countries which levy normal taxes are often not as contentious in the eyes of onshore countries, perhaps because the relationship is more reciprocal in relation to tax offences. Consequently, a notable distinction between category (3) and the former two categories is that jurisdictions under category (3) may be able to negotiate extensive networks of double taxation agreements with major capital exporting countries.<sup>26</sup> Such treaty jurisdictions tend to be less protective of offshore confidentiality.

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<sup>23</sup> Similar to an export processing company, eg in Barbados, under the International Business Companies Act 1991 (Barbados).

<sup>24</sup> The Bahamas and the Cayman Islands are prime examples.

<sup>25</sup> See *Tolley's Tax Havens* (Tolley, UK, 1991) 3.

<sup>26</sup> As in St Lucia and Barbados.

The decision to locate business offshore may also be motivated by non-commercial motives, such as the need for privacy. Similarly, offshore financial centres may be used to alleviate the devastating effects of political instability. **1.35**

Despite its changed outlook, the offshore financial centre remains a service industry. Not accidentally, many offshore financial centres are also tourist sectors. Thus, certain prerequisites are essential for their successful formation. These include: **1.36**

- (1) a well developed domestic financial services sector;
- (2) a stable political environment;
- (3) efficient infrastructure, particularly communication services;
- (4) a complementary and supportive non-interventionist legislative framework;
- and
- (5) stable local currency and lack of foreign exchange controls.

#### **D. Anatomy of an Offshore Legal System**

Since the evolution of the offshore financial sector was partly motivated by restrictive business and financial legislation and the interventionist fiscal policies of onshore jurisdictions, it is not surprising that the model offshore jurisdiction focuses on tailor-making its legal regime to suit the needs of international business and finance. Changes in the legal infrastructure and psyche of the offshore base are necessitated. **1.37**

The metamorphosis of the legal infrastructure of the offshore jurisdiction typically requires a transformation and 'repackaging' of banking laws, particularly banking confidentiality, company laws, trust rules, tax policy and insurance legislation. The latter mainly involve the establishment of a captive insurance company industry. Often these innovations are fashioned to offer new routes to onshore tax planning. These changes, when juxtaposed with the myriad of domestic legislative measures, international agreements and regulations aimed at alleviating the effects of tax avoidance, to which the offshore financial sector must respond, underline the degree of dexterity its legal framework must attain. This remains a goal of offshore financial centres despite the continued hostility of onshore jurisdictions. **1.38**

#### **Changes to company, insurance, and trust law**

Generally, the offshore financial centre will require company laws which allow the maximum degree of convenience, flexibility, and variety and are consistent with modern commercial practices. Such laws will typically contain a minimum of incorporation procedures. Previously, reporting requirements were minimal.<sup>27</sup> **1.39**

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<sup>27</sup> Offshore companies, unlike onshore companies, were exempted from filing and audit requirements which fulfil the need for confidentiality. See, eg, the International Business Companies Act

However, with the several changes driven by international pressures, this is no longer a feature of offshore financial regimes, albeit reporting requirements remain, in the main, reactive, instead of proactive, once basic central authority checks, which are themselves confidential, are performed. There are also speedy company formation and enabling legal provisions which allow for a range of company activities and categories in order to maximize revenue to the offshore entity.<sup>28</sup> Amendments may also be necessary to existing company law to allow recognition of entities such as limited partnerships or open-ended investment companies, which are often restricted onshore.<sup>29</sup>

- 1.40** Key concepts relevant to international business companies may be liberalized. For example, the interpretation given to the term ‘residence’ may include companies merely licensed in the offshore country or incorporated there. Such innovations simplify difficult situations, such as where a foreign company establishes a branch in the offshore country. Previously, such a company could be involved in the fiction of holding two annual meetings in one year so as to satisfy the requirements of ‘residence’ for both jurisdictions.<sup>30</sup> This, while largely successful, is not a foolproof method, as recent cases demonstrate.<sup>31</sup>
- 1.41** The provision of secondary companies and ancillary services is an essential element of offshore financial centres and is facilitated by legislation.
- 1.42** The ingenuity of offshore company law is well illustrated by the hybrid legislative entity of Antigua, designed to be a mixture between a trust and a limited liability company<sup>32</sup> and the private trust company, described in the companion text. Indeed, multi-layered companies, associated with trusts, are typical.<sup>33</sup>
- 1.43** The transformation of the offshore legal landscape involves laws that create new forms of the trust. The offshore trust is, in reality, a mutant designed specifically to meet the needs of offshore investment. Orthodox trust law rules have been modified to make the trust more commercially viable and mobile. These include laws relating to bankruptcy and enforcement of creditors’ claims which preserve the integrity of offshore assets, provisions specifying the governing law of the trust

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1984 (BVI) and the International Business Companies Act 1991 (Barbados), which has also abolished the ultra vires concept.

<sup>28</sup> Yet, offshore companies must be recognized in other jurisdictions as having separate legal personalities and as affording the protection of limited liability to their shareholders. *Tolley’s Tax Havens* (n 25) 8.

<sup>29</sup> Obstacles to commercial activity, such as archaic usury laws which prevent interest-rate flexibility and restrictive business practices, may also be voided.

<sup>30</sup> See, eg, the Barbados legislation.

<sup>31</sup> See, eg, *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 on the residence of a trust under a double taxation treaty between Canada and Barbados, discussed in detail in the companion text.

<sup>32</sup> Under the International Business Company Act 1997 (Antigua).

<sup>33</sup> See the companion text, n 11.

and jurisdiction, 'reversible trusts', anti-Bartlett trusts, and the 'purpose trust'. The offshore trust is often closely linked to other offshore companies and, consequently, there exist changes to company law complementary to the offshore trust. The legal source for the offshore trust is statutory. The offshore trust itself, like its international business company or offshore company neighbour, is bound by confidentiality rules, in some cases, special rules of confidentiality which attach to the trustee.<sup>34</sup>

The captive insurance company is an insurance company formed by an organization or group of organizations to handle all or part of the insurance needs of the owners and thereby generate substantial savings. Its purpose is to insure and/or reinsure, selected risks of the parent company and its subsidiaries. It may achieve considerable tax benefits by being placed offshore.<sup>35</sup> **1.44**

### Mobility of offshore structures

One of the attractions of offshore investment is its inherent mobility and flexibility. An offshore company may choose to relocate for a number of reasons. It may be a response to political instability, increasingly restrictive laws in the offshore jurisdiction, other adverse event, or merely the advent of more favourable offshore conditions elsewhere. More important, it may wish to escape the enforcement of an onshore judgment or the reach of the onshore jurisdiction. In recognition of this, redomiciliation provisions within the offshore legislative framework facilitate movement either to or from other jurisdictions. Such provisions or 'flight clauses',<sup>36</sup> enable the incorporation of the company to be transferred automatically to an alternative location. The redomiciliation of companies or trusts raises a number of complex legal issues.<sup>37</sup> In relation to confidentiality, such flight clauses exacerbate the risk of the dissipation of assets and have led to more favourable decisions toward disclosure and restraint orders.<sup>38</sup> Further tensions in offshore law may arise as offshore jurisdictions may discourage outflows while encouraging inflows, for example, companies transferring into the jurisdiction. Further, parity of laws on transferability of companies may not exist. **1.45**

The existence of redomiciliation provisions underscores the already fickle nature of offshore investment. As with other forms of foreign investment, offshore companies often have no real loyalty to the offshore country. **1.46**

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<sup>34</sup> See the companion text, n 11.

<sup>35</sup> For an in-depth discussion of such companies, see M Finney in *Tolley's Tax Planning* (Tolley, UK, 1993).

<sup>36</sup> Also called 'escape' or 'Cuba' clauses.

<sup>37</sup> Particularly in relation to trusts. The new jurisdiction may not recognize such 'flight clauses'. Alternatively, where relocation occurs, the status of the entity under conflicting laws in the new jurisdiction may be contentious.

<sup>38</sup> See Chapter 7 for a further discussion on the significance of 'flight clauses' as they relate to the restraint orders, paras 7.05 and 7.27–7.30.

### **Regulation of offshore finance and banking**

- 1.47** The offshore financial centre must be regulated sufficiently to give the assurance of respectability and integrity while not compromising the commercial advantages of the offshore location. The transnational nature of the industry, with the resultant problems of jurisdiction, makes supervision and regulation difficult. Confidentiality norms exacerbate this.
- 1.48** Often, the reason for going offshore is to enable the investor to carry on a particular type of commercial activity that he cannot do, or do efficiently, in the onshore country. In response, onshore jurisdictions may initiate counter legal measures. These onshore countries attempt to minimize what they view as the negative economic and social effects of offshore business operations and profits. Where such attempts at regulation have resulted in international treaties, as increasingly they do, they form part of the offshore legal framework and must be analysed. Equally significant is the fact that offshore jurisdictions have, partly in response to pressures from onshore countries, enacted legislation to regulate potential offshore abuses, particularly with respect to money laundering or bank fraud. The majority of such treaties and legislation involve offshore confidentiality and disclosure mechanisms and are therefore important topics in this book.

### **E. Main Themes in Offshore Law**

- 1.49** Four central, and often interrelated themes emerge in this book. They are:
- (1) the creation of an innovative jurisprudence;
  - (2) the question of legitimacy;
  - (3) the notion of hybridity; and
  - (4) the effects of duality.

#### **The creation of an innovative jurisprudence**

- 1.50** The legal issues which arise from the emergence of the offshore sector are, in certain respects, quite distinct from those onshore. Even where there are obvious similarities, these have assumed a particular character which often conflicts with the more traditional onshore legal norms and practices. While some issues discussed are not necessarily unique to offshore financial centres, they are magnified by the offshore phenomenon. This is seen, quite clearly, in financial confidentiality and disclosure principles, the latter often created particularly to counter offshore financial arrangements.
- 1.51** The main reason for the uniqueness of 'offshore law' stems from the provision of what may be viewed as an alternative legal infrastructure in the offshore sector,



existing, in the main, for foreign commercial interests.<sup>39</sup> This legal construct is not merely a replica of domestic legal institutions elsewhere, although it has borrowed much from it. Rather, the offshore world has developed and continues to develop its own unique legal norms and practices which challenge orthodox legal principles. One may arguably describe the phenomenon as a legal subculture. How is this subculture to be judged? Are the traditional legal rules in the relevant legal disciplines, be they banking, revenue, or constitutional law, either sufficient or desirable to address offshore issues? The answers to these questions are leading to a jurisprudence peculiar to the needs of the offshore legal regime.

### **Legitimacy of offshore financial regimes**

While there is no presumption that legality is equal to legitimacy, the offshore phenomenon creates a credible and enduring legal system. The issue of legitimacy emerges even in the way in which the offshore sector defines itself, that is, as an entity for economic survival. The very *raison d'être* of the offshore sector is questioned under this theme as the sector serves as an alternative legal structure to facilitate corporate and economic endeavours. The question must be asked, how far is the existence of this alternative structure legitimate and viable, albeit highly advantageous to individual business interests and to the offshore economy? The very existence of the offshore sector may depend on encouraging legal entities and principles which have great potential for abuse, although not always abusive in themselves. One sees this, for example, in the exploiting of loopholes in tax mechanisms and the expansion of bank confidentiality norms. Practices such as tax avoidance may be legal, but not necessarily legitimate activities. **1.52**

The subject of legitimacy is also conspicuous in the discussion of constitutional and ethical issues relevant to the offshore legal phenomenon. Thus far, legal judicial thinking has not fully addressed the morality (used in a broad sense), of offshore financial law, although this issue has always been present from the point of view of the layperson. For example, the emergence of offshore trusts which are designed to hide assets, often from future creditors or potential heirs, poses serious ethical questions about the use of the trust function for such a purpose. This is of particular concern as confidentiality is often a vehicle used for such purposes. **1.53**

More recently, in response to concerns on morality and ethics, onshore courts have been challenging offshore structures under the wide rubric of public policy. Public policy concerns now inform case law on confidentiality, offshore trusts, tax avoidance, constitutional issues, and the conflict of laws.<sup>40</sup> **1.54**

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<sup>39</sup> However, in some jurisdictions, such as in the Cayman Islands or The Bahamas, there is no taxation for either residents or non-residents so that the tax regime, but not other aspects of the offshore sector, is identical for residents and non-residents alike.

<sup>40</sup> See, eg, paras 3.44–3.48.

- 1.55** Ultimately, the question is this: To what extent can or should onshore legal systems embrace or tolerate the offshore legal regime which undermines the traditional parameters of the onshore legal system in favour of individual and commercial interests? The issue of legitimacy is a highly emotive one, and calls into question controversial policy questions. Nowhere is this more apparent than offshore confidentiality and disclosure imperatives. As will be illustrated, there are important justifications for offshore law and legal policy which are adequate responses to questions about legitimacy where offshore confidentiality is concerned.

### Hybridity

- 1.56** The offshore legal regime includes numerous institutions which have been shaped by common law and civil law but which are different to each. One may argue that new, hybrid legal concepts have been created. Some offshore institutions have repudiated principles held to be sacred in onshore legal regimes. This is well illustrated by the phenomenon of offshore confidentiality.<sup>41</sup> Hybridity, both in legal form and substance, brings into focus the ability of traditional legal principles to address offshore legal regimes. This is made all the more problematic as often offshore legislation deliberately seeks to prevent the application of such rules.
- 1.57** The hybrid character and the dual nature of the offshore legal system present novel challenges to the application of private international law. Conflicts of laws arise on different levels. Problems relating to jurisdiction must be resolved first. Next must be decided whether the laws of the offshore jurisdiction or those onshore are applicable to any given situation, given the fact that the offshore entity is different from its offshore neighbour. Indeed, the notion of hybridity, permeating as it does, almost every aspect of the offshore legal system, is itself an essential aspect of the legitimacy theme.

### Duality

- 1.58** The presence of a separate legal regime for offshore investors existing parallel to the domestic and onshore legal regimes raises the theme of duality. Already, this dichotomy in legal systems has been a cause for concern for the Organization for Economic Cooperation and Development (OECD).<sup>42</sup> A number of issues arise. Does the very existence of the offshore legal system present a challenge to that of its onshore counterpart, contradicting and undermining it? Conversely, does it serve to develop further the onshore jurisprudence? There is a vast amount of litigation generated by offshore confidentiality and its opposite, disclosure. Certainly, the new frontiers of the subject will impact more generally on other forms of investment. This is already happening with the trust where some innovative forms of offshore trusts are being emulated in onshore jurisdictions.<sup>43</sup>

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<sup>41</sup> Note also the offshore trust.

<sup>42</sup> See para 11.21.

<sup>43</sup> For example, the purpose trust and the anti-Bartlett trust.

Questions of duality are also pertinent to the internal conflicts of the offshore country. Given that the offshore legal system exists alongside the domestic legal system (both offshore and onshore domestic systems), what implications will this have for the latter? Will, or should, offshore courts give effect to offshore economic and social policy or will they determine matters in a conservative and insular mode? The question is even more important when one considers that offshore judges, schooled in orthodox onshore legal principles, will have to judge offshore structures and law. Judicial precedents are emerging which support the latter stance, illustrating the internal tensions which may exist.<sup>44</sup> **1.59**

In the Commonwealth Caribbean, the problem may be more pressing. The Judicial Committee of the Privy Council is the final court of appeal for most states. It is located outside of the region, in England. It is not likely to be appraised of, nor sensitive to, offshore policy which might concern local courts. Yet, UK courts are less hostile to offshore interests than US courts. This may be due to the fact that several successful offshore financial centres are UK dependencies.<sup>45</sup> **1.60**

The duality issue may also be posed in the form of conflict of laws questions. Broadly, the prevalence of such conflict of laws issues springs from the juxtaposition of two independent legal regimes, one offshore, the other onshore. Often these contain different, and even antagonistic, legal principles, laws, and philosophies. This is compounded by dual loyalties and responsibilities which arise by virtue of the fact that offshore investors are, by and large, attempting to circumvent their own onshore laws in favour of those offshore. Offshore policies and laws deliberately encourage such transfer of loyalties.<sup>46</sup> Such laws and policies may generate hostility from onshore countries which produces political and legal conflicts. **1.61**

Further, the structure of the offshore financial centre is inherently transnational, with local offshore residents largely being excluded from legal provisions. It is difficult to classify the typical offshore company established, for example, by UK investors in The Bahamas, as British. Yet, it is just as difficult to classify it as Bahamian. The concept 'offshore' therefore transcends typical considerations of domestic or even international law, the latter because established rules of international law do not as yet sit comfortably with the phenomenon. **1.62**

These themes are interwoven into the discussions found in subsequent chapters. They bring a truer understanding of the mores of the offshore financial centre, **1.63**

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<sup>44</sup> See, eg, *South Orange Growers Association v South Orange Grove Partners* [1997–8] 1 Offshore Financial Law Reports 3.

<sup>45</sup> These include the Cayman Islands, Jersey, the Isle of Man, Anguilla, the Turks and Caicos Islands, the British Virgin Islands, and Bermuda.

<sup>46</sup> For example, laws which contain provisions that attempt to oust the applicability of onshore law, such as those relating to offshore trusts or international business companies (IBCs). This might mean, for example, laws which avoid the enforcement of judgments from onshore courts. See, eg, the International Exempt Trust Act 1997 (Dominica), s 17 and the Trusts Act 2000 (Belize), s 7.

thus helping to illuminate the principles relevant to offshore confidentiality and disclosure objectives.

## **F. The Problem Posed—The Abuse of Confidentiality and the Thrust Toward Disclosure**

- 1.64** A major obstacle to the goal of financial regulation is the ability of onshore governments, tax authorities and private individuals to overcome the confidentiality laws or practices of offshore regimes. This is often due to a reluctance on the part of offshore authorities to provide information relevant to taxation, banking and other financial matters.

### **The danger of confidentiality**

- 1.65** Confidentiality, while being one of the major tools of the offshore industry, is also its greatest enemy. It is the Achilles heel of the industry and is perhaps the factor which has most often called into question the very existence of the offshore sector. It is true that confidentiality in commercial affairs, and banking confidentiality in particular, is important and often contentious even outside the offshore sector. Indeed, the extent to which financial confidence is protected can determine the levels of investment in a country's financial institutions and consequently affect the stability of its economy. Nevertheless, because of the importance which confidentiality assumes for the offshore world, the various controversial issues relating to such confidentiality are often magnified. This is particularly the case in relation to bank confidentiality.
- 1.66** There is little doubt that, while confidentiality of itself may be a desirable objective, it has sometimes been used to conceal illegal activity, both onshore and offshore. It is this capacity of confidentiality to obstruct the collection of taxes and hinder the monitoring and detection of money laundering, assets due to creditors, profits of crime, and other illegal or unethical activity, which has underlined the efforts to undermine confidentiality. In one view:

Offshore secrecy laws in an ever increasing number of cases prevent US law enforcement officials from obtaining the evidence they need to convict US criminals and recover illegal funds... the use of offshore haven secrecy laws is the glue that holds many US criminal operations together.<sup>47</sup>

If confidentiality laws are allowed systematically to obstruct law enforcement investigations, they could lead to an erosion of the public's confidence in criminal justice systems worldwide, as many criminal activities, such as money laundering,

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<sup>47</sup> *Crime and Secrecy: The Use of Offshore Banks and Companies*, Senate Report No 99-130, 99th Congress, 1st Session (1985) [the 'Senate Report'] 1.

which may thrive on secrecy, including offshore secrecy, are international in scope. It is unsurprising that many onshore governments, with the US being the primary initiator, have sought to establish a link between international crime and offshore secrecy havens.

Bank confidentiality is the cornerstone of offshore confidentiality and its most controversial component. Legal rules and customs on banking confidentiality, where both the identity of account holders and the amounts held in their accounts are often confidential, are serious obstacles to financial regulation. Further, it is bank confidentiality more than any other principle which has the potential to hinder the efficient investigation and interdiction of onshore criminal activity. The entrenched principle of bank confidentiality also makes it difficult for adequate bank supervision to take place.<sup>48</sup> **1.67**

Confidentiality laws not only pose problems for those who are concerned with fighting international crime; of equal concern to many governments is the increasing use of 'secrecy havens' by companies and ordinary citizens, 'otherwise law abiding',<sup>49</sup> to avoid paying taxes or to shield assets from creditors.<sup>50</sup> Such functions may or may not be legal, but are often undesirable to governments. It is thus easy to see why confidentiality is one of the most controversial subjects in the offshore industry. **1.68**

Clearly, while strict laws of confidentiality may provide security to bona fide investors, they may also be used to camouflage or facilitate crime and undesirable activity. This point must be conceded in any discussion of offshore confidentiality. But such potential abuses do not justify the total repudiation or rejection of the confidentiality principle itself. **1.69**

### **Legitimate degree of confidentiality**

Confidentiality cannot be absolute in offshore business. Equally, total confidentiality is not essential to the survival and viability of the offshore industry. Nevertheless, the opposing view that confidentiality has no legitimate place in contemporary offshore commercial relations when examined, should be rejected. Confidentiality is vital to offshore countries, and given the kinds of pressures onshore to undermine it, the issue of confidentiality becomes a question of degree. **1.70**

An attempt is made in this book to locate confidentiality or secrecy norms in the offshore sector in the wider search for legitimacy. This is by no means an easy task given that the confidentiality issue has provided the impetus for many of the **1.71**

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<sup>48</sup> Infamous examples include the Noriega scandal and the commodities broker who used Swiss bank accounts to evade US\$48 million in taxes, *Re Marc Rich & Co v US* 707 F 2d 663 (2d Cir cert. denied 103 S Ct (1983)). See W Gagnon, 'International Banking Secrecy: Developments in Europe—Prompt New Approaches' (1990) 23 *Vanderbilt J of Transnational L*, 653, 655.

<sup>49</sup> The 'Senate Report' (n 43) 4.

<sup>50</sup> Creditors are shielded by the use of the offshore trust.

questions surrounding offshore activity and the catalyst for much litigation. The conflicting legal issues of confidentiality and disclosure must, therefore, be considered within the context of the regulation of the offshore industry as a whole. The need to balance these competing interests and locate a baseline for confidentiality is particularly important in offshore law, given the competitiveness of the offshore sector in the world of international finance.

### **Sovereignty concerns**

- 1.72** One factor to be considered in the debate, and one which is not to be underestimated, particularly in relation to comity issues, is that governments of offshore countries make no apologies for laws which establish and uphold confidentiality. They pursue the preservation of confidentiality as a legitimate objective in itself. Questioning offshore confidentiality laws is more than a mere legalistic inquiry. To some extent it is also questioning the right of sovereign governments to create laws in harmony with their own nationalist and developmental perspectives.<sup>51</sup> Courts in offshore jurisdictions perceive the protection of confidentiality as part of their wider duty in the public interest, albeit in the exercise of jurisdiction conferred by law. It is thus not simply a matter of questioning the validity, efficacy, and morality of contemporary domestic legal norms on confidentiality derived from a common law perspective.
- 1.73** This is a point brought out by responses to the threats to confidentiality posed by the OECD in its 1998 Report amidst concerns about money laundering and terrorism.<sup>52</sup> In truth, this is an opportune time to be reassessing offshore confidentiality.
- 1.74** Just as new restraints are being placed on confidentiality, so too new and powerful 'friends' of confidentiality are emerging emphasizing the 'rights' issues involved, in particular, privacy and the privilege against self-discrimination. Indeed, it is instructive that soon after the adrenalin of the terrorist attack on the United States subsided, voices of dissent in America were raising concerns about fundamental freedoms, including privacy. Such concerns cannot be ignored in any analysis of confidentiality and disclosure. Thus, the concept of financial confidentiality is constantly being redefined.
- 1.75** Political issues also impact on the understanding of what is essentially the legal concept of confidentiality. It might appear that financial confidentiality as expressed in small developing offshore nations attracts more criticism and hostility than the idea of confidentiality elsewhere, even in other offshore jurisdictions.<sup>53</sup> An objective look at this phenomenon is warranted to determine whether it is supported by solid legal principle or whether it cloaks motives which have more to do with fears of lucrative market share in the financial sector.

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<sup>51</sup> See paras 10.05, 10.14, 11.13–11.15.

<sup>52</sup> The terrorist attack on the United States on 11 September 2001 brought with it fresh concerns about confidentiality and its capacity to conceal terrorist funds. This is explored in the chapter on money laundering: see paras 6.95–6.102.

<sup>53</sup> See discussion in paras 11.02, 11.21–11.22, 11.24–11.26.