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Money laundering and political corruption in Marbella, Gibraltar and Liechtenstein

In April the Spanish government took the unprecedented step of dissolving the town council in Marbella. The town's mayor and several officials, lawyers and businessmen are implicated in a multi-million euro corruption scandal. Juan Hdez.Vigueras explains how this mafia-style activity in the Costa del Sol is part of a web of corruption linked to tax havens.

In March 2005 Operation *Ballena Blanca* (White Whale), a police operation to combat the laundering of profits from drug trafficking, concluded with several arrests and the seizure of property in the resort town of Marbella in southern Spain. Just one year later, political corruption uncovered there by the recently set up Anti-Fraud Office forced the Zapatero government to dissolve Marbella's town council. A caretaker administration will run the town until the next local elections.

Operation *Ballena Blanca*

Operation *Ballena Blanca*, the largest police operation against the laundering of drug money that Europe had seen (according to Spanish newspaper *El País*), exposed a mafia-style web of more than one thousand shell companies, linked to real estate investments and tax exempt status companies in Gibraltar. These were linked to other companies across Spain as well as in the United States and Canada. Some of the companies involved were linked with the troubled oil firm Yukos, which belongs to the Gibraltar-based Group Menatep.

Just a few details from the case give some idea of its scale and importance. As well as the seizure of 251 houses and hundreds of millions of euros in bank accounts, several planes and 42 luxury cars (Rolls Royce, Ferrari, Porsche…), the judge running the operation prosecuted several lawyers and three notaries accused of various crimes including money laundering and falsifying public documents.

For the first time in Spain's history, notaries – a profession that has long enjoyed a privileged position in society – were arrested and prosecuted. Notaries, like lawyers, are legally obliged to inform the authorities of any suspicions they have regarding

> **Political corruption uncovered in Marbella forced the government to dissolve the town council.**

Corruption issue

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Beautiful laundrette? Gibraltar town where much of the Costa del Sol's dirty money gets 'washed'. Photo: Jenny Fowler

money laundering. But in 2002 only 12 such reports were submitted and by 2004 the figure had fallen to just six, according to the SEPBLAC Report.

Despite being public officials, notaries legally earn their fees directly from private and corporate clients. In real estate transactions in Spain, it is fairly common practice for notaries to record a lower price than actually paid by the buyer in order to reduce the amount of tax due. The Zapatero government has tried to do away with this practice, but with insufficiently tough measures.

Marbella council dissolved

In April 2006 fraud investigations led to the arrest of Marbella's mayor Marisol Yagüe along with several town councillors and one high-ranking council official, Juan Roca, who had accumulated a fortune estimated at tens of millions of euros. The media has reported Roca's flashy display of wealth to include a Miró painting hanging in the bathroom of one of his homes, helicopters, thoroughbred horses and numerous properties. According to published information, this amassed fortune was largely the product of commissions (kickbacks) Roca earned from granting building licenses for land officially protected from development.

For years the regional government of Andalucia had been trying to put an end to the corrupt practices in Marbella. For 15 years the town was governed by a small 'independent' right-wing party, the GIL (Grupo Independiente Liberal). The GIL's late leader, Jesús Gil, who enjoyed the support of sheikhs, the Russian mafia and the international jet set, was convicted for financial offences involving his presidency of football club Atlético Madrid.

Political corruption and money laundering are intimately linked.

But with the latest scandals, Marbella's residents had had enough. At the end of March, about 10,000 people turned out onto the town's streets to protest against corruption. In April, following the arrest of Marbella's mayor together with several town officials, the Zapatero government ordered the town council to be dissolved and put a caretaker administration in to run the town until the next local elections in the middle of 2007.

Corruption and offshore

Many of the activities uncovered during the recent investigations have shown how political corruption and money laundering are intimately linked. And while corruption and money laundering know no borders, democratic governments are constrained by national boundaries. Three issues in particular have been highlighted:

• These days, political corruption stemming from financial crime always has an international dimension.

• Money laundering and corruption always appear to be linked with one or more tax havens (mainly Gibraltar in the case of Marbella).

•The globalisation of financial markets has left some – albeit limited – space for nation states to act. But even citizen pressure does not appear to be enough to convince national governments to take sufficiently tough measures.

According to police information, a law firm in Marbella arranged the incorporation and registration of tax-exempt status companies in Gibraltar with nominee directors included. In 2001, Gibraltar committed to co-operate with the OECD to end harmful tax practices by 2005. Yet in 2005, Gibraltar reached agreement with the newly appointed European Commission for the continuation of the exempt status company until it gets phased out at the end of 2010. This despite the fact that the existence of this regime violates EU competition policy (the state aid rule).

The identification of the real owners of Gibraltar-based companies is also complicated because the law allows for the director of a company to be not only a person but also another company (corporate director) which could, in turn, be registered in another tax haven. So more than one year on from the end of Operation *Ballena Blanca*, the judicial investigations to determine those responsible are obstructed by lack of co-operation.

Tangled web of corruption

Recent news reports hint at the extent of political wrongdoing in Marbella over the last few years, with lawyers and financiers with connections in Liechtenstein owning local real estate businesses. The Spanish newspaper *El Mundo* claimed that British multi-millionaire and Marbella resident and landowner Judah Binstock (who has been the subject of a public prosecutor's office investigation) managed a vote of no confidence against the previous mayor of Marbella, Julian Muñoz (who has also been investigated), in order to protect his interests. The ousting of Muñoz gave way for the election of the now-disgraced Yagüe. Binstock counted among his acquaintances the lawyer Engelbert Schreiber, who was accused by the USA of laundering al-Qaeda money in Liechtenstein where he has his office.

Juan Hdez. Vigueras is the author of the 368 page book *Los Paraísos Fiscales: Cómo los centros offshore socavan las democracias. (Tax Havens: how offshore centres undermine democracy).*

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Letter from the USA

Raymond Baker has been on a thirty-city tour with his book on illicit money and corruption. Here he shares some of his experiences.

Over the last few months, *Capitalism's Achilles Heel* has taken me all over the United States as well as to England and Europe. I thought I'd hit the jackpot when, driving in the Midwest, I saw a roadside advertisement that said, "Oil Leases for Sale." Imagine my disappointment with the phone number—1 800 DRY HOLE. Earlier in the Southwest, my attention was riveted when I saw an official highway sign cautioning, "State penitentiary 10 miles ahead. Do not pick up hitchhikers!" I knew I was in Bush country at my first speaking engagement in Texas. A gentleman asked me, "How do we convince our young people that everything the United States is doing around the world is right?" With a very long pause and a deadly serious countenance, I replied, "That's . . a . . really . . tough . . question."

I spoke mainly to foreign policy organisations, business groups, and students. The foreign policy types clearly understood my message and reacted extraordinarily well. Business groups were generally sympathetic. One person in San Francisco tried unsuccessfully to put up a spirited argument for the status quo. Some undergraduates had a bit of difficulty grasping the issues, but graduate school and law students got the points quickly.

Every audience was stunned by the loopholes in US anti-money laundering law. While it is illegal to bring into the United States proceeds generated abroad from drugs, corruption, and terrorism, it is legal to bring in the proceeds of racketeering, handling stolen property, counterfeiting, contraband, slave trading, alien smuggling, trafficking in women, environmental crimes, tax evasion, and more. In my book, the first tipping point I call for is closing these loopholes in US law. In March of this year, Senator Charles Grassley (R-Iowa) Chairman of the Senate Finance Committee and an endorser on the back of my book, submitted a bill that would shut down every one of these holes, making foreign proceeds subject to exactly the same restrictions as domestic proceeds.

Two years ago my colleague Jennifer Nordin predicted that the messages contained in *Capitalism's Achilles Heel* would likely resonate better in Europe than in the United States. After several talks and media appearances in London and on the Continent, I would say that this proved correct. The highlight of all my experiences was a speech and Q&A at the Royal Society of Arts in London, chaired by Lord Daniel Brennan, head of the Caux Round Table of global business leaders. With a lengthy format, I included comments on the way we have perverted the original underpinnings of capitalism laid out by Adam Smith and embraced instead the "greatest good for the greatest number" espoused by Jeremy Bentham. Encouragingly, no one rose to Bentham's defence. Perhaps capitalism is ready to bury the gross distortions of recent decades and move into a more just future. At least that's what keeps many of us thinking, working, hoping.

Raymond Baker is the author of *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System*. He is a Guest Scholar at the Brookings Institution and a Senior Fellow at the Center for International Policy.

The tax sins of Prime Minister Thaksin

Earlier this year thousands of Thai people took to the streets accusing Prime Minister Thaksin of corruption and demanding his resignation. In April he was forced to dissolve parliament. Chanida Chanyapate and Alec Bamford unravel the complex story of Thailand's political crisis, showing how Thaksin and his family abused their position for personal gain.

Ruangkrai Leekitwattana was once an official in Thailand's Office of the Auditor-General (OAG). And he noticed something fishy about share transactions among members of Thai Prime Minister Thaksin Shinawatra's family.

Thaksin's share dealings had already been in the limelight when he became Prime Minister in 2001 and his declaration of assets was challenged by the National Counter Corruption Commission. They charged that he had hidden assets by transferring huge blocks of shares in his family's corporate empire to his maid, driver and gardener (who made that year's list of top Thai share owners). Thaksin escaped punishment after a bizarre ruling by the constitutional court: seven voted guilty, four not guilty and four said "I don't think we should be hearing this case".

Shin Corp: a family affair

Thaksin was Thailand's richest man through his Shin Corporation stable of companies dealing in mobile phones, satellites and property. He and his wife, Pojaman, had repeatedly given shares, or 'sold' them at below-market prices, to their children and other family members, many of whom were office holders in their companies.

The share transaction that Ruangkrai had spotted was 4.5 million Shin shares, originally belonging to Pojaman. In 2002 they were transferred as a 'gift' from the Thaksin family's maid to Pojaman's adopted brother, Bhanapot Damapong. (Bhanapot later acquired another 26.82 million shares at a book value of 10 baht (US25c) apiece direct from Pojaman as another 'gift'.) Section 40(4) of the Tax Code says that the buyer in such cases incurs no profit until the shares are later re-sold. Tax becomes payable only then. Phaitoon Phongkesorn, Deputy Director General of the Revenue Department, was adamant in claiming that there was no tax to be paid on these transactions, since they were a 'wedding present' from one sibling to another. Except that Bhanapot had been married for years.

Ruangkrai left the OAG and took a job as an accountant with the Bangkok Expressway Company. He got his dad to buy some shares and then 'gift' them to him at 10 baht per share when the market price was 21 baht. He was duly billed by the Revenue Department for 21,000 baht (US$525) tax on capital gains he hadn't yet realised.

> **Thailand's top tax expert concocted a complex web of deals involving an offshore holding company with the splendid name of Ample Rich.**

A quick word here on taxation of shares in Thailand. As a measure to promote investment, individuals (but not corporations) are exempt from tax on capital gains from share sales on the exchange. Deals made outside the exchange, such as the 'gifts' we are looking at, are not exempt, nor are dividends or other income from shares. Stock options to executives, directors, employees or advisers are also taxable. Note that this does not promote the efficient allocation of capital but rather a casino mentality that churns shares in the hope of quick gains.

Ruangkrai took his case to the Senate Anti-Corruption Committee. There seemed to be a clear case of discrimination. The Senate agreed and demanded that the Revenue Department bill Bhanapot for 47 billion baht (US$117.7m) in tax. The Department agreed that the cases were equivalent, but instead chose to give Ruangkrai his 21,000 baht back. Since Ruangkrai had asked the Revenue Department to tax Banaphot rather than return his tax payment, this became the first time in history that the Revenue Department had repaid a taxpayer without the taxpayer asking for the money.

As a Department official commented at the time, every case is unique. And some are clearly more unique than others.

Ample Rich

Bhanapot eventually sold his Shin shares on 23 January this year as part of what is known in Thailand as the Deal of the Century. The Shinwatra-Damapong family sold all their Shin shares, amounting to 49 per cent of the corporation's capital, to Temasek, a holding company controlled by the Singaporean government and run by Ho Ching, the wife of Singaporean Prime Minister Lee Hsien Loong.

The family earned 73.4 billion baht on the deal (US$1.8 billion). And paid no tax. Bhanapot walked away with about 19.9 billion baht (US$0.5 billion), but the biggest beneficiaries were Thaksin's son, Panthongtae and eldest daughter, Pinthongta. Since they were selling shares that had previously been gifted to them, common sense, and most Thais, reckoned they were now liable for the tax they escaped when they acquired the shares. Not so, declared the tax collectors. Since the shares had been sold on the stock exchange by individuals, they were exempt from capital gains tax.

The outcry was loud and strong. The Finance Minster was accused of acting as the Prime Minister's personal tax advisor. This was in fact quite unnecessary since he had already engaged the country's top tax expert, Suvarn Valaisathien, who had concocted a complex web of deals involving an offshore holding company with the splendid name of Ample Rich, registered in the British Virgin Islands. With the help of Suvarn's 'explanations', the trail quickly became so tangled that the finest legal minds in the country were hard pressed to figure out who had done what and with what and to whom. The Securities and Exchange Commission eventually found Thaksin's son guilty of minor infractions of disclosure rules and fined him six million baht (US$150,000).

And there, as far as the compliant authorities are concerned, the matter rests. But reality is much richer.

Protests force a general election

The huge tax break earned by the Shinawatra family sparked street protests that culminated in Thaksin calling a snap general election on April 2. This was so badly mismanaged by the Election Commission of Thailand in favour of Thaksin's party that the courts eventually annulled the results. The Election Commissioners were the subject of court suits, pressure from the palace and daily vituperation from the media. In the middle of this, the embattled chief Commissioner decided to take a holiday in Australia. The press got hold of the passenger list. Sitting in the next seat, both there and back, was Phaitoon, the Deputy DG of the Revenue Department who had been so vehement in defending Thaksin's tax-free status. A complete coincidence, claimed both parties.

But there is a happy ending. Among the many questionable shenanigans of the Thaksin administration, one was to find, two years after the fact, a minor irregularity in the appointment of Jaruvan Maintaka as Auditor General. In those two years she had been getting far too interested in corruption in the construction of Bangkok's new airport. She was suspended, but she carried on. Her pay was stopped, but she carried on. Eventually they changed the locks on her office and chose her successor. But this needed Royal approval, which wasn't forthcoming. Eventually, they gave up and Jaruvan was allowed back in her office. One of her first acts was to offer Ruangkrai his old job back.

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Enron - why the convictions were important

In May, a jury in Texas found two former chief executives of bankrupt energy corporation Enron guilty on several counts of fraud and conspiracy. Richard Murphy looks at what this means for corporate governance and argues for tougher measures to curb offshore.

The financial world heaved a collective sigh of relief when Kenneth Lay and Jeffrey Skilling were found guilty for involvement in the downfall of Enron. The charges ranged from conspiracy and fraud, to making false statements and insider trading in the case of Skilling alone. But it is important to see why there was such relief, and where things move from here.

It would have been disastrous for the development of corporate governance if the two had been found not guilty. The Sarbanes Oxley structure put in place since Enron would have been proven unnecessary, and far too many people have too much invested in that system for a not guilty verdict to have been anything but a disaster. So, a serious setback was avoided by these convictions, even though ultimately these systems will not stop those determined to commit fraud.

More importantly, though, the trial was a benchmark. Senior executives were held to account for their actions and were found to be responsible for them. That was vital. Anything otherwise would have sent out all the wrong signals.

More than that though, the trial was by jury. Lay and Skilling were not found guilty by a professional body or a regulatory board hearing; they were found guilty in a criminal court. And despite the complexity of the numerous charges and the length of the trial, the jury was asked to determine guilt on the basis of a simple test – did the defendants know that their actions were wrong? That is not a technical test. It is an ethical test. And the jury convicted on that basis.

Not enough has been done to stop people believing that offshore, secrecy and tax avoidance pay.

This is an important victory for two reasons. In some countries there has been an over-emphasis on basing fraud and corporate malfeasance cases on the basis of technical evidence. This has allowed defendants' lawyers the opportunity to present technical defences, extended the length (and cost) of trials, and led to claims that juries cannot understand these issues. The Enron case provides a useful lesson. The jury were, of course, presented with evidence of wrongdoing in breach of the law. That is essential to secure a conviction. But by including conspiracy charges it was possible to ask questions about Lay's and Skilling's motivation and intention in undertaking those transactions i.e. did they intend to break the law? By doing this the issue became comprehensible, because technicalities, whilst still significant, are of much lower importance. This also reduces the prospect of a successful appeal on the basis of a technicality.

It is this test that I find most important about the Enron trial. It seems to say technical compliance with the law is not enough to act as a defence: you must have been actively seeking to comply with it as well. And of course, that is what we have argued for some time in the area of tax. It is good to see it being reflected in this case.

So where next? That's hard to say, unless you are Lay or Skilling as I expect them to spend some time in prison. My guess is this. First, this case will reinvigorate the shockwaves driving enhanced compliance in the USA. The convictions will remind those in Europe who argue for lower states of regulatory checking that those processes are put in place for a purpose. And rather like the impact of the collapse of Andersen and the fines on KPMG and trial of KPMG partners, this will act as a sharp warning to those considering wrongdoing.

But will that be enough to change the culture of the corporate world so that such practices cease? Sadly, I doubt it. Change does not come from the fear of prosecution, it comes from the belief that good practices produce better outcomes.

As yet not enough has been done to stop people believing that offshore, secrecy and tax avoidance pay. Until that is changed another Enron is inevitable, no matter how much regulation is in place, and offshore will remain a cancer in the corporate world as it was at Enron.

So the prosecution is welcome. A changed attitude to offshore from those governments that continue to tolerate it, including the USA, would be even more welcome.

Richard Murphy is Director of Tax Research LLP.

Enron: a failure of corporate governance

The scandal that culminated in the trial of Lay and Skilling has its roots in the suspect financial and accounting methods Enron had been using for years. During the 1990s Enron became a byword for innovative financing strategies. In 2000 Enron's share price hit an all-time high and, by the time of its collapse, the company was the seventh largest in the USA. But it later came to light that Enron had used offshore special purpose vehicles to borrow huge sums of money through derivatives deals, to hide millions of dollars of the company's debt and to vastly inflate profits. Here is how the scandal unfolded:

October 2001	Enron reports huge losses and writes down shareholders' equity by US$1.2 billion. The US securities and exchange commission begins a fraud investigation and the price of Enron's shares drops dramatically.
December 2001	Enron files for bankruptcy. Enron employees lose their jobs and life savings and thousands more are affected through pension plans holding Enron shares.
July 2002	The Sarbanes-Oxley bill is introduced in the USA in response to corporate scandals such as Enron and US telecoms company Worldcom. The new law introduces tighter regulation and enhanced disclosure for publicly-owned companies.
August 2002	Former Enron auditor Arthur Anderson surrenders its license to practice in the USA.
January 2004	Former Enron finance chief Andrew Fastow pleads guilty and testifies that former chief executives Kenneth Lay and Jeffrey Skilling had encouraged him to commit fraud.
May 2006	Lay and Skilling are convicted of conspiracy and fraud. Sentencing will take place in September 2006.

Corruption and the role of tax havens

Corruption is a global problem and it has risen in scale in recent decades. But our perceptions of corruption are largely shaped by Northern attitudes and media, and have consequently been distorted to fit an agenda which is insulting and harmful to the South, writes John Christensen.

Transparency International has played a lead role in shaping the global campaign to counter corruption and has highlighted the huge cost to business of doing business in countries where bribe taking is regarded as the norm. Africa in particular has come under the Transparency International spotlight, accounting for almost half of the bottom 20 per cent of the TI 2005 Corruption Perceptions Index (CPI). Famously, Chad, a small land-bound state which has recently joined the ranks of the hydrocarbon exporting economies, was ranked as the most corrupt country in 2005. Nigeria held that illustrious position for many years, but now comes sixth from the bottom, scoring a mere 1.9 on an index which ranges between 10 (highly clean) to 0 (highly corrupt). Small wonder then that US and European politicians feel entitled to lecture African leaders on the need to get their house in order. But before doing this they should turn the spotlight through 180 degrees and take a closer look at the other end of the corruption spectrum.

Only one African country, Botswana, is ranked amongst the least corrupt 20 per cent of the CPI for 2005. Almost all the remainder are OECD states. And 40 per cent of the countries ranked as least corrupt according to Transparency International's vision of the world are tax havens, including major centres such as Singapore (ranked 5th overall), Switzerland (7th), United Kingdom (11th), Luxembourg (13th), Hong Kong (15th), USA (17th), and Belgium and Ireland (jointly 19th). For good measure Barbados and Malta, both tax havens, rank 24th and 25th respectively. Iceland, also a tax haven though only a minor player, ranked as least corrupt country in 2005.

In focussing on the 'demand side' of 'petty' corruption, i.e. the extortion of bribes by public officials, as the main indicator of corruption, TI has played a key role in distorting public perceptions of corruption thereby reinforcing negative images of Africa whilst distracting from the higher level corruption of major companies and governments from the North. This is not to downplay the harm caused to Africa by bribery, but the steady growth of petty corruption in recent decades has at least in part been driven by IMF and World Bank conditionality which pegs civil service salaries at an arbitrary percentage of wholly inadequate government budgets. However, as Raymond Baker has so convincingly demonstrated in *Capitalism's Achilles Heel*, bribery represents only around 10 per cent of the massive dirty money flow out of developing countries, with proceeds of crime and illicit commercial transactions being of far greater importance. By widening the definition of corruption to include embezzlement, larceny and crimes involving illicit commercial transactions used for facilitating capital flight and tax evasion, we gain a far more complete picture of corrupt practices in action, and of the importance of the 'supply side' in encouraging and facilitating global corruption.

The City of London. International banks play a key role in establishing and maintaining the offshore financial systems which enable dirty money to flow from South to North with relative ease and impunity.
Photo: Paul Jackson

According to the recently published report of the Africa

All Party Parliamentary Group (AAPPG) of the UK government, the supply side covers both the persons and institutions offering the bribes, and – crucially – the financial systems which launder the proceeds of corruption. Companies from the industrialised countries have been guilty of offering bribes to secure contracts and special treatments, including tax incentives, and frequently this happens even when bribes have not been solicited. But more importantly, international banks and other financial intermediaries have played the key role in establishing and maintaining the offshore financial systems which enable dirty money to flow from South to North with relative ease and impunity. According to Baker, illicit commercial transactions involving mispricing, abusive transfer pricing, and fake transactions, account for approximately 65 per cent of cross border dirty money flows originating from developing and transitional economies. In the case of Africa:

> "As much as 60% of trade transactions into or out of Africa are estimated to be mispriced by an average of 11%, which translates into annual capital flight in excess of $10 billion. Fake transactions are estimated to account for a further $150-200 billion."
> Tax Justice Network in written evidence to the AAPPG, quoting from *Capitalism's Achilles Heel* (2005).

The vast majority of this illicit trade is laundered via tax havens linked to the international banking system, and it generally remains offshore to be managed by the plethora of banking businesses (largely from the North) offering wealth management services to their high net-worth clients. With 2005 seeing record growth in the numbers of people in Africa and Latin America with liquid assets exceeding US$1 million, largely on the back of surging commodity prices, it is not surprising that the offshore financial services industry turns a blind eye to what the AAPPG report describes as 'rampant kleptomania'.

Like many who have studied corruption in Africa, I have concluded that the problem is largely stimulated by the supply side. The ease with which proceeds of crime and illicit commercial activities can be laundered into secret bank accounts and offshore companies owned by offshore trusts inevitably encourages criminal behaviour and protects it from investigation. Working with corporate investigators and journalists covering major crimes in Africa and elsewhere in the South, I have noted how investigations have almost invariably led to accounts held in Switzerland, Luxembourg, the British Crown Dependencies, the Cayman or similar tax havens. This is typically where the investigations have ended, because, despite all the international conventions put in place in recent years, these offshore territories do not cooperate with legitimate investigations and refuse to publicly disclose even basic information about ownership or basic financial accounts. This determination to protect secrecy, even in the light of massive evidence of abuse, suggests that western governments are still not serious about wanting to remedy endemic corruption, despite ample evidence of its inevitably harmful social and economic consequences. As one witness told the Parliamentary Group during the course of its enquiry:

> "With one hand, the West has pointed the finger at corrupt African leaders, with its other hand, its bankers, lawyers, accountants, art dealers, health authorities, universities, estate agents and embassies have been actively or passively encouraging wealth out of Africa into the West's economies."
> Dr Patrick Darling in written evidence to the AAPPG.

The Other Side of the Coin: the UK and Corruption in Africa, AAPPG, March 2006, available online at:

www.africaappg.org.uk

The UK Government and corruption

John Christensen

The UK Government response to the report on corruption by the Africa All Party Parliamentary Group, *The Other Side of the Coin,* was generally positive but failed to adequately address the concerns expressed to the Group by TJN representatives.

On the plus side the Government appointed Hilary Benn, Secretary of State for International Development to tackle international corruption and coordinate policy coherence across UK Government departments. The Government also committed to working with international partners to establish a review of international safeguards against trade mispricing and capital flight, but fell short of making explicit commitments to TJN's proposal to introduce mandatory price-related signatures from buyers and sellers for all cross-border transactions exceeding approximately €15,500 (£10,000) in value.

The Government committed to establishing a police task force to focus on bribery and money laundering issues. Details of exact lines of responsibility will not be published until later this year, but it is likely that the Economic and Specialist Crimes Unit of London's Metropolitan force will focus on money laundering issues.

On the minus side, however, in reply to the AAPPG's proposal for disclosure of beneficial ownership of companies, the Government claimed that any requirement to disclose beneficial ownership "would be legislatively impractical and impossible to enforce", but would be ineffective in combating corruption "since criminals would either not disclose their identity or ensure they did not own, directly or indirectly, the shell companies they were controlling." This response is wholly inadequate and suggests that the UK Government remains committed to supporting the tax evasion industry which operates at the core of the City of London.

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The full text of the Government's response to the AAPPG report is available on the news section of the TJN website:
www.taxjustice.net

A code of conduct for banks

TJN believes a code of conduct for banks is urgently needed. Lucy Komisar proposes some initial ideas on what this code might look like and invites feedback from TJF readers.

International banks are the institutions that facilitate the global tax evasion system. Most of the subsidiaries in the world's tax havens are not run by fly-by-night operators that nobody's ever heard of. Those shifty 'shady folks in sunny places'. Sure, there are some of those. But most offshore banks are the subsidiaries of the world's major 'reputable' financial institutions, directed by the fellows who wear Armani suits and are accepted in the best of company.

The Tax Justice Network agreed at its May meeting in Athens to establish codes of conduct for banks and companies that should be adopted internationally. Here is a suggestion of what we might consider when we draw up the code for banks. Readers are invited to comment and add their own ideas so that we can come up with standards on which to campaign.

The heart of the matter, of course, is the offshore bank and corporate secrecy system. That's where banks hide the money of tax evaders, drug and arms traffickers, dictators, terrorists, corrupt officials, corporate fraudsters and the like.

So, we make these demands. Some of them are based on the fact that 'offshore', in the day of computers and internet, is often a convenient fiction. Accounts 'exist' wherever the banks say they exist, even if the actual management is handled by staff sitting in offices in Hong Kong, Frankfurt, Paris, London or New York.

'Offshore', in the day of computers and internet, is often a convenient fiction.

- Banks must abjure offshore secrecy by making account information in all their locations available to law enforcers and civil court plaintiffs seeking information for criminal or civil cases. If offshore venues protest that this violates the law, the banks must contest the rulings and, if necessary, close those offshore subsidiaries.

- Banks must not use subsidiaries in offshore secrecy jurisdictions as registries or booking vehicles for transactions arranged and managed from onshore.

- Onshore staff must not manage (by computer or otherwise) accounts registered offshore and then tell law enforcers, civil complainants or other legitimate investigators that the records are offshore and not accessible.

- Banks must not open correspondent accounts for banks that operate under offshore secrecy rules.

- Banks must stop advertising and promotions aimed at wealthy clients that use language about 'tax planning' or other euphemisms to sell tax evasion.

- Banks must not advise or help clients move their money into accounts abroad, through private banks or other special services, for the purpose of evading taxes. They should supply to home countries information about the accounts of those countries' residents set up abroad.

- Banks must not set up shell companies for clients that do not have real functions other than the secret movement of money. They must not sell ready-to-go 'off the shelf' companies for immediate use for such purposes. They must not set up companies whose owners are kept secret from law enforcement or civil plaintiffs. They must not supply their own staff as sham directors for offshore companies.

• Banks must never register accounts or companies in false names, straw men or the names of the owner's lawyer, accountant or other representative. They must print and mail regular statements to the owners of all accounts to their homes countries. They must not engage in surreptitious behaviour to help clients hide their banking activities from home authorities.

• Banks must not engage in 'structured finance' when that is a euphemism for deceiving investors and the public about a client's financial situation or when it is used to enable a company to evade taxes.

• Banks must not set up shell companies that are used as facades to engage in fraudulent operations or otherwise 'cook the books' as Citigroup and JP Morgan Chase did for Enron in order to give Enron loans disguised as profits.

• Onshore staff must not manage (by computer or otherwise) accounts registered offshore and then fail to allocate the profits to the real places of management. They must declare profits where they are earned, that is, where accounts are actually handled. They must not use transfer pricing or 'head office fees' to move profits to lower tax jurisdictions.

• Banks must not engage in business the only purpose of which is to reduce their taxes in some jurisdictions.

• Banks must not keep double accounting systems that allow profits to be allocated to subsidiaries or individuals without that appearing on the official books of the banks in their home countries.

Photo: Paul Jackson

• Banks must maintain transparency about their own taxes by making them public. This would include pre-tax profits, levels of current and deferred tax, opening and closing tax liabilities, and payment of different types of tax including on 'capital' and 'people.'

The key to banks' behaviour must be transparency, public accountability and a decisive rejection of tax evasion.

Lucy Komisar is a New York based investigative journalist.

Comments and suggestions on the code of conduct for banks are welcome.

Please send to:
info@taxjustice.net

Capital flight and tax evasion as corruption

The International Financial Institutions should include capital flight and tax evasion in their definition of corruption and the IMF should focus on these issues, argues David Spencer.

An investor, an individual or a company resident in country A, makes a bank deposit or other interest bearing investment in country B. Country B is in many cases an onshore financial centre or an offshore financial centre. Country B does not tax the investor on the income on such investment. Further, country B has bank secrecy or other confidentiality laws, which means that it is unlikely that country B will inform country A of the investor's investment in country B.

What is the likely result? The investor does not declare to the tax authorities in country A, his/her/its country of residence, the income on the investment in country B. That is capital flight, and tax evasion in country A by the investor.

Capital flight and the resulting tax evasion is corruption, both private sector corruption and public sector corruption.

It is private sector corruption by the investor who evades taxes in country A, his/her/its country of residence. The investor is illegally diverting for his/her/its private use, funds, tax revenue, that belong to the public sector in country A.

But it is also public sector corruption by the government in country B. This is because the government in country B provides bank secrecy and other confidential treatment which it knows facilitates capital flight from other countries and tax evasion in those other countries (country A). Governments in onshore and offshore financial centres provide bank secrecy and other confidentiality treatment, knowing that because of that bank secrecy and other confidentiality laws, foreign persons (individuals and companies) will make investments in those financial centres, and not declare those investments in their countries of residence. In effect, the governments of those onshore and offshore financial centres are knowingly facilitating and encouraging capital flight and tax evasion, that is, knowingly facilitating corruption.

Governments in financial centres that provide bank secrecy and other confidentially treatment are knowingly facilitating and encouraging capital flight and tax evasion - that is, knowingly facilitating corruption.

In March 2005, the Tax Justice Network published a briefing paper, *The Price of Offshore*, which estimated that the amount of funds held by individuals in offshore and onshore tax havens, and undeclared in the country of residence, is approximately US$11.5 trillion. This estimates capital flight from all countries, and not only capital flight from developing countries. The briefing paper also estimated that the annual income on these assets, and the tax revenue lost on the undeclared and untaxed funds, could be approximately US$860 billion and US$255 billion, respectively. The latter figure approximates the annual funds needed under the UN's Millennium Development Goals.

Corruption has become a major issue.

Transparency International initiated and spearheaded the campaign against corruption and for transparency. Publish What You Pay and the Extractive Industries Transparency Initiative have focused on the extractive industries, arguing for greater transparency, in order to brake, and break, corruptive practices with regard to payments to governments with extractive industries. The World Bank and the International Monetary Fund (IMF) have joined the process, concerned about corruption in World Bank and IMF projects and programmes, and in general. And in December 2005, the United Nations Convention Against Corruption (UN Convention) came into force. The UN Convention does not explicitly define corruption, but does refer to both public sector corruption and private sector corruption, (Articles 12,13, and 21-24), the laundering of proceeds of crime and concealment.

On February 18, 2006 representatives of the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the European Investment Bank, the European Bank for Reconstruction and Development, the IMF and the World Bank (International Financial Institutions) "reached an unprecedented consensus on the broad polices and practices necessary to address both internal and external problems of corruption:"

> "The leaders agreed on the need to standardize their definition of corruption, to improve the

consistency of their investigative rules and procedures, to strengthen information sharing, and to assure compliance and enforcement actions taken by one institution are supported by all others. The leaders established a task force to report to them bi-monthly on progress made to develop a uniform Framework for Preventing and Combating Fraud and Corruption with the goal of concluding an agreement by the September Annual Meetings of the World Bank Group and the IMF.

"The leaders also agreed to work together to develop concrete proposals to assist countries over the longer term in strengthening their capacity to combat corruption and to improve co-operation with civil society and other stakeholders and institutions such as the press and judiciary with the goal to enhance transparency and accountability".
Heads of MDBs Joint Statement on Corruption.
Washington DC. February 18, 2006

In their efforts against corruption, the International Financial Institutions should include in the definition of corruption, capital flight and the resulting tax evasion, and should confront this issue. The IMF has the primary responsibility of monitoring and surveillance of international financial centres (both onshore and offshore). Therefore, the IMF should focus on this aspect of corruption.

David Spencer is a practicing attorney in New York, specialising in tax law and banking law.

Reviews and new research

Gaétan Breton
Faire payer les pauvres: Éléments pour une Fiscalité Progressiste (Let the Poor Pay: Elements of a Progressive Fiscal System)
Lux Éditeur, 2005

As you may gather from the title, *Faire Payer les Pauvres* deals with the erosion of the progressivity of income tax in the Province of Québec and in Canada generally.

Gaétan Breton, a professor of accounting at the Université du Québec à Montréal, describes the process as gradual, starting after World War II and accelerating in the 1980s. As in other OECD countries, this has been done through the reduction of the number of tax brackets, an increase in the rates paid by middle- and lower-income wage earners, a reduction of the rates paid by the rich, and a shift of the tax burden from corporations to individual salaried taxpayers. In parallel to the decreased progressivity of the income tax structure, the State has increasingly come to rely on regressive taxes as a revenue source.

The author describes the ideological background driving the transformation of the fiscal systems, which includes the promotion of inequality as a means of increasing productivity and scare tactics involving a distorted depiction of public debt. In addition to his description of the ways in which the Canadian and Quebec tax regimes have been perverted so as to make the less affluent pay for the running of the government apparatus, for the remnants of social programmes, and for the gifts to the business community by way of subsidies and low interest loans (some of which never get to be reimbursed), the author also deals with the other ways in which the poor and the lower-middle class get to pay for the resulting accumulation of wealth by the few.

Breton's treatment of the fiscal issues is informed by his awareness of the distorted accounting underpinnings of the gross national product (GNP), of the failure of markets to treat natural resources as finite, and of the omission in the GNP of activities which are not priced – while including destruction, waste and the costs of remedying disasters as integral components of the GNP. But the main thrust of the book is fiscal justice, emphasizing the social implications of taxation and the need for a tax system to be fair and structured and implemented so as to redistribute wealth. A guaranteed minimum income scheme does not attract universal support from all progressives, but Gaétan Breton makes a good case for it. He also favours a generally more active socio-economic role for the state.

Raymond Favreau

Greg Le Roy
The Great American Jobs Scam: Corporate tax dodging and the myth of job creation
Berrett-Koehler Publishers, 2005

The Tax Dodgers Are Coming! The Tax Dodgers Are Coming!

Fans of *Catch-22* will recall Major Major's father as "a long-limbed farmer, a God-fearing, freedom loving, law-abiding rugged individualist who held that federal aid to anyone but farmers' was creeping socialism". Well US variant socialism has shifted a long, long way since Joseph Heller wrote this in 1955, and welfare for big business has become a prominent feature of the US economy. The corporate subsidy system is now so embedded, and so deeply distortive of the free market system, that it largely boils down to an upside down welfare state geared to further enriching the rich at the expense of middle- and lower-income earners.

According to Le Roy's research almost every large US corporation has received tax breaks and subsidies to create jobs. In many cases the jobs already existed, or would have been created anyway, or somehow were simply not created even though subsidies were paid. On average US states grant more than 30 subsidies, including property tax abatements, sales and excise duty exemptions, low interest loans, loan guarantees, training grants, income tax credits, and so on and so forth. Subsidy packages routinely exceed US$100,000 for every job created, diverting public funds away from investment in education and infrastructure which would probably create more viable jobs in the longer term.

Subsidies are big business in themselves. US$50 billion a year is disbursed through a variety of public offices, spawning a mirror industry of consultants to advise on how to apply for subsidies; how to subsidy shop by playing one state off against another; and even how to buy and sell economic development tax credits.

And what benefits do the public derive from all this jiggery-pokery? Little or none is the answer. Whilst states compete blindly against one another to attract capital, real wages have stagnated or fallen, healthcare has become less affordable, pensions have shrunk in value and public infrastructure has drastically deteriorated. All in the name of a corrupted version of competition which pits state against state in a wholly unproductive race to the bottom.

Founder and director of Good Jobs First (www.goodjobsfirst.org), Greg Le Roy has authored a witty critique of the economics of corporate welfarism in the United States. And where the United States leads others are sure to follow. Le Roy's core arguments about the role of tax competition in reducing public welfare apply equally to other continents, not least Europe, where corrupt pork barrel politics also favours the rich at the taxpayer's expense.

John Christensen

Campaigns and TJN news

Raising the TJN profile

During the second quarter of 2006 TJN representatives held meetings with a variety of inter-governmental organisations and the Bretton Woods Institutions to introduce the Network and establish working relationships.

In April, John Christensen and Richard Murphy met with Michel Aujean and his team from the DG Tax and Customs Union of the European Commission to discuss the Savings Tax Directive and concerns about the tax policies of the British Crown Dependencies. Later that month John Christensen took part in a panel discussion at an ECOSOC side event organised by the Friedrich Ebert Stiftung in New York.

Lucy Komisar and Larry Bridwell (TJN-USA) at the UN in New York.

Speaking alongside John Williamson (Institute for International Economics) and Ricardo Ffrench-Davis (ECLAC), John proposed a variety of measures to tackle poverty by curbing capital flight and tax evasion. TJN was subsequently invited by the ECOSOC Secretariat to organise a side event at the forthcoming Substantive Session which is being held in July in Geneva.

Athens meetings marks next steps for TJN

John Christensen

Three years after its launch, TJN took two major steps forward at the annual Council and Open Meetings held in Athens in early May. First, after 18 months of consultation and discussion, the Council adopted a new Constitution to reflect the Network's increasingly globalised scope and activities. Second, participants at the Open Meeting agreed to support a shift from the past emphasis upon network building towards giving equal priority to high-level advocacy work, this shift being reflected in the formation of teams to focus on the major international financial institutions and inter-governmental organisations.

The new TJN Constitution adopted by the TJN annual Council Meeting in Athens on 2 May 2006, is based upon the formation of a Belgian registered International Not For Profit Association (International Association Sans But Lucratif) which is now in the process of being registered with the Belgian authorities. The Constitution lays out the accountability structure for the global network, placing overall power in the Tax Justice Council, and outlines the role, composition and powers of the International Steering Committees, the Board of Directors and the Scientific Council.

After agreeing the English, Dutch and French versions of the new Constitution, the Council ratified the membership of the Founder Members of the new Association and elected Sven Giegold, François Gobbe and Bruno Gurtner to serve as interim Board Directors pending final ratification of the Constitution by the Belgian Authorities. A permanent Board of Directors will be elected at the 2007 Council Meeting scheduled to be held in Nairobi, Kenya, in January 2007. The full text of the TJN Constitution and the Minutes of the Council Meeting in Athens, are available for download from the homepage of the TJN website (**www.taxjustice.net**).

The purpose of the Open Meeting in Athens was to review overall strategy of the Network at the international level and to agree strategic objectives for the next 18 months. After reviewing progress on major projects in hand, including preparations for the launch of Tax Justice for Africa in 2007, the Meeting discussed priorities under four principal headings: network building, advocacy, campaign work and research.

Until this year network building has been given highest priority, but the consensus view of the Meeting was that TJN has gained sufficient critical mass to be able to devote more resource to high level advocacy work. On the proposal of Bruno Gurtner, the Meeting agreed to create specialised teams including senior advisers to TJN, which will focus on the following institutions (team contacts in brackets):

- UN ECOSOC Committee of Experts on International Cooperation in Tax Matters (TJN contact: David Spencer)
- International Monetary Fund (TJN contact: TJN-USA Secretariat)
- World Bank (TJN contact: TJN-USA Secretariat)
- OECD (TJN contact: Bruno Gurtner)
- European Commission (TJN contact: International Secretariat)
- The South Centre (TJN contact: International Secretariat)

Meetings have been held with all of these institutions during the past six months and TJN is already widely recognised as representative of civil society's interests in tax policy matters relating to harmful tax practices.

The Minutes of the Open Meeting in Athens on 2/3 May 2006 are available on request to the International Secretariat: **info@taxjustice.net**

Madrid conference on globalisation, tax havens and poor countries

Juan Hdez. Vigueras

On 25 and 26 May a conference on *Globalisation, Tax Havens and Poor Countries* took place in the Escuela Julián Besteiro of the UGT (*Union General de Trabajadores* or General Workers' Union) in Madrid. The event was organised by Attac and *Economistas sin Fronteras*, and sponsored by the Spanish Secretariat of State for International Cooperation (SECI).

Ricardo Gª Zaldívar speaking at the Madrid conference.

The conference drew attention to the devastating impact of tax havens on poor countries. Speakers included: the Director General of SECI; Arcadi Oliveres, professor of economics at Barcelona University; Juan Hdez. Vigueras, TJN steering committee member; John Christensen, director of the TJN International Secretariat; Sven Giegold, TJN steering committee member; Bernard Cassen, ex-director of *Le Monde Diplomatique*; and Attac Spain members Ricardo Gª Zaldívar y Soledad Milán.

Conference participants stated that much higher tax revenues will be needed in order to meet the globally adopted targets to reduce poverty by 2015 contained in the UN's Millennium Development Goals (MDGs). TJN estimates that the amount of funds held by wealthy individuals in tax havens globally could generate additional tax revenues of US$255 billion per year – enough to finance the MDGs.

The launch of the Nordic Tax Justice Network

Nordic TJN wants Nordic countries to highlight tax responsibility
Jorma Penttinen

The Nordic social model, renowned globally as a positive development strategy, is not compatible with harmful tax practices. Therefore tax activists in Norway, Sweden and Finland decided to form a Nordic Tax Justice Network (NTJN) to promote good tax practices.

The launching event took place in Oslo, on 10 June, where tax activists spent three days formulating the role of NTJN. John Christensen from TJN's International Secretariat offered ideas on how the Nordic countries could approach the debate on coherent development policy, and how Nordic companies could take their tax behaviour into account when creating corporate social responsibility (CSR) policies.

A portable tax haven. Campaigners in Oslo take a break during the launch of Nordic TJN.

The Nordic tax model is based on transparency and redistribution, and on financing universal public goods and high quality services. This model has strengthened social cohesion, welfare and economic competitiveness.

The Nordic countries thus have an excellent opportunity to take an active role in international cooperation and work with key institutions (OECD, EU, UN) to tackle cross-border tax avoidance and evasion, and to resist tax competition. Just recently the Nordic finance ministers decided to have common Nordic treaties on exchange of information with some 30 tax haven jurisdictions. This is, of course, a feeble attempt to curb tax haven activities, but it shows that there is a common will to act on these issues.

Some Nordic companies have a strong sense of social responsibility, even though tax matters have traditionally been ignored. Nordic TJN plans to have a dialogue with the business community and create positive CSR recommendations in which corporations' responsibilities cover their whole impact on a society. No Nordic country would approve of a company that doesn't pay taxes but in developing countries big companies can, in many cases, operate virtually tax free.

The Nordic Tax Justice Network expects tackling harmful tax practices to be brought in to the international arenas as a top priority. This can effectively be done through Nordic co-operation. The Nordic countries have a great opportunity, and responsibility, to promote sustainable global social and economic development.

The network will also work on national basis, pressing each of the countries involved – at the moment Finland, Norway and Sweden – to adapt the best tax practices and legislative innovations from each other.

Nordic TJN's website can be found at: **www.taxjustice.net/nordic**

Calendar 2006

July 1
Finland's EU Presidency begins.

July 6-7
Workshop at Essex University, UK: Tax, poverty and finance for development. Organised jointly by the Association for Accountancy & Business Affairs and TJN.

July 6-7
Ministerial conference of the Leading Group on Solidarity Levies to Fund Development, Brasilia, Brazil. Lucy Komisar (TJN-USA) and David Hillman (Stamp Out Poverty) to represent TJN.

July 15-17
G8 Meeting, St Petersburg, Russia.

July 24
Side event 'International Cooperation on Tax Matters' at the Substantive Session of the Economic and Social Council. Organised by the Financing for Development Office/DESA and TJN.

August 30 - September 1
Royal Geographical Society annual conference, London, UK.
Key theme: The geography of corruption. Guest speaker: John Christensen (TJN).

September 19-20
IMF and World Bank Annual Meetings, Singapore.

October 17
Global White Band Day.

October 19 - 22
Nordic Social Forum, Oslo, Norway. TJN to launch its code of conduct on tax policy for business.

November 15-18
International Anti-Corruption Conference (IACC), Guatemala City and Antigua, Guatemala. Organised by the IACC Council and Transparency International.

December
First conference of State Parties to the United Nations Convention Against Corruption, Jordan.