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A quick introduction to the offshore world

Rodrigo Fernandez

3 methods to identify an offshore financial center (OFC)

- Compliance based
  - EU blacklist of non-cooperative tax jurisdictions (EU)
- Activity based
  - Size of non-resident financial flows (IMF)
- Authority based
  - Ability of sovereign states to facilitate a legal regime for non-residents

Activity based definition of OFC: transactions with non-residents

- *"An OFC is a country or jurisdiction that provides financial services to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy."* **IMF 2007**

- "*An OFC may be defined as a jurisdiction in which transactions with non-residents far outweigh transactions related to the domestic economy*" **Bank of England 2001**

Authority based definition of tax haven: parallel legal regimes

- Offshore jurisdictions effectively cultivate **two parallel legal regimes**.
- On the one hand, we have the standard regulated and taxed space for domestic citizens in which we all live.
- On the other hand, we have an ‘extraterritorial’ secretive offshore space exclusively maintained for foreign businesses and HNWI, or *non-resident* capital.

Authority based definition: The commercialization of sovereignty

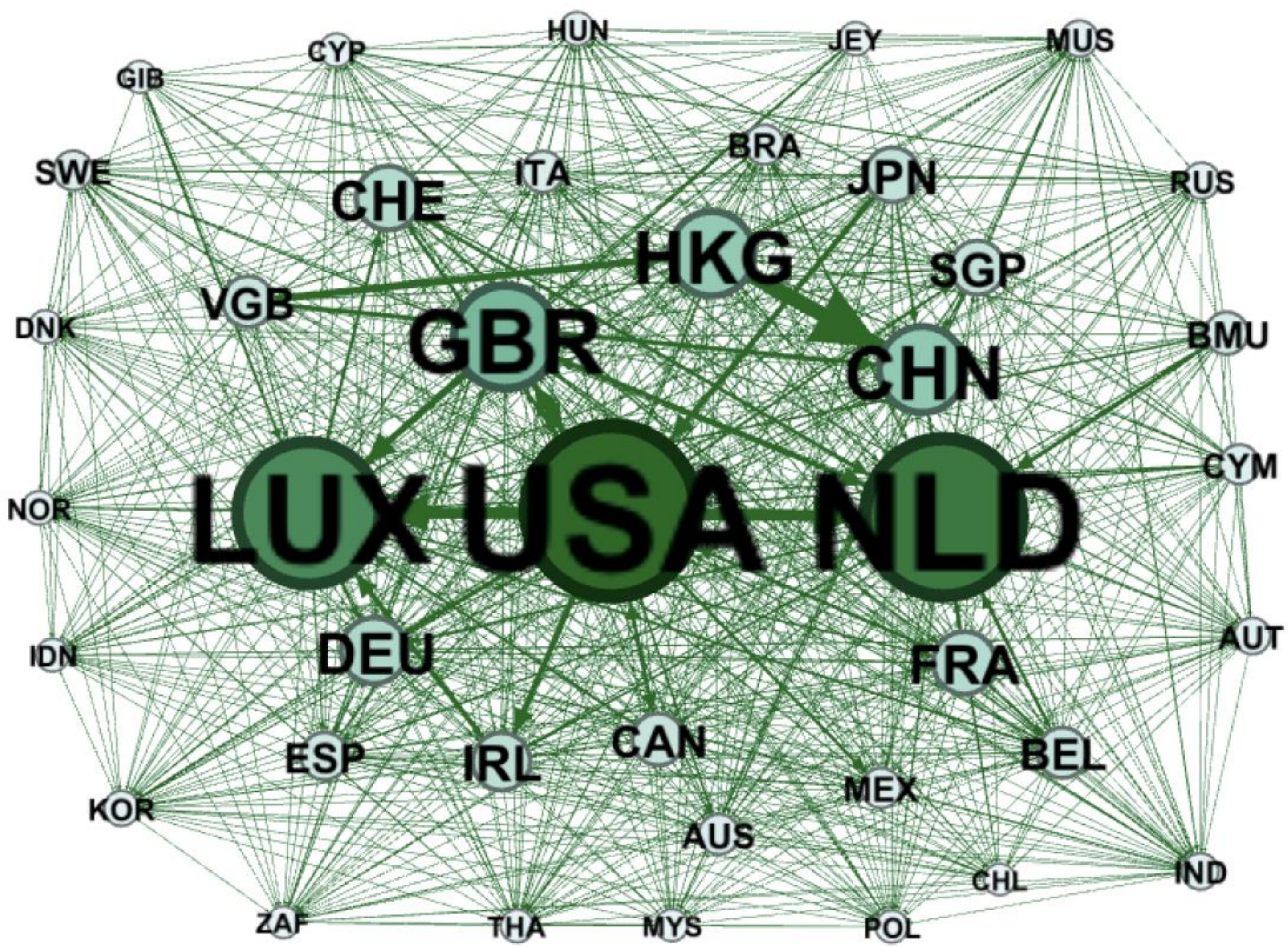
- According to this definition, tax havens are:

"*places or countries that have sufficient autonomy to write their own tax, finance, and other laws and regulations. They all* ***take advantage of this autonomy*** *to create legislation designed to assist non-resident persons or corporations to avoid the regulatory obligations imposed on them in the places where those non-resident people or corporations undertake the substance of their economic transaction*."

A typology of OFCs: an hierarchical network

- OFCs do not operate in isolation but are part of a **hierarchical network** of OFCs and financial centres.
- This network developed in the age of financial globalization from the 1970s onwards
- Financial flows move between these different OFCs – together they act as an **integrated supra-national offshore structure**
- The global offshore structure represents the **re-scaling of finance**, strengthening the structural power of capital

Figure 7. Network of FDI Positions Based on the CDIS



A typology of OFCs: an hierarchical network II

- At the centre of the current offshore world we find New York and London (NYLON).
- A second layer is a network of **conduit centres**, - pass-through centres – with extremely large in and outflows of capital. Examples are: Ireland, Luxembourg and the Netherlands
- A third layer are ‘**sinks**’, or final destinations, mostly ‘traditional’ tax havens. Examples are: BVI, Cayman Islands, Channel Islands etc.

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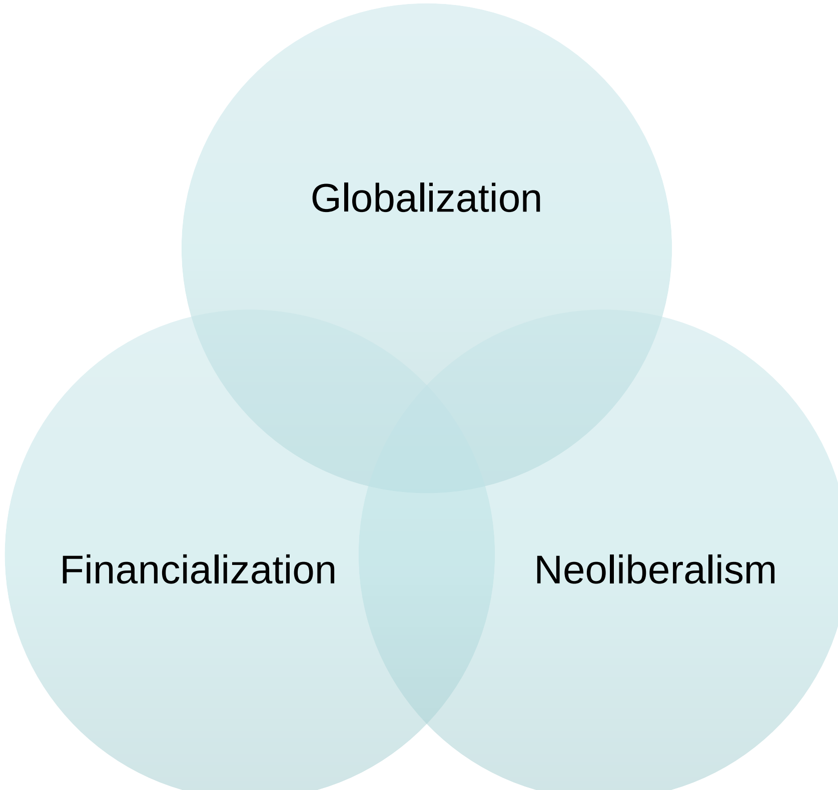
The historical context:



Motives to use an OFC

- Tax avoidance
- Tax evasion
- Illicit financial flows
- Secrecy, wealth protection
- Regulatory arbitrage
- Shadow banking
- Create layers of complexity
- Round tripping
- Investment protection (BIT)
- Independent jurisdiction in a merger

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The historical roots of the current offshore system

Historical origins of the tax avoidance industry

- The contradiction between national states (sovereign territorial ‘enclosure’) and capital mobility lies at the core of the offshore world.
- This contradiction triggered legal innovations
  - In the previous period of globalization (1870-1930).
  - Emergence of Eurodollar market (1960-1980)
  - Tax avoidance by multinational companies (1990-…)
  - Shadow banking (2000 - ….)

Mailbox companies and the commercialization of sovereignty

- One such innovation was the ‘shell company’ or special purpose entity (SPE) with little or no material substance.
- The legal assembly of SPEs opened Pandora’s box, as multinationals could henceforth domicile or **incorporate themselves in another jurisdiction *without* physically relocating** their activities.
- Such ‘fictional relocation’ – for reasons of asset protection or tax minimization – lies at the core of ‘**converting sovereign rights into marketable products**’.

- Another legal building block was the *bilateral* allocation of tax rights between jurisdictions, anchoring cross-border capital mobility in a set of tax treaties during the 1920s.
- These treaties distinguished between <u>'host country'</u> – the jurisdiction of actual economic activity – and <u>'home country'</u> – the domicile of the owner, investor or corporate headquarters.
- This arrangement divided tax rights between <u>capital importing</u> and <u>exporting</u> states, reflecting power relations at the time, with the United Kingdom and United States as leading capital exporters.

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Facts and figures: size matters

Empirical dimensions of OFCs

- FDI
- Foreign portfolio equity investment (FPEI)
- Relational banking statistics
- Corporate density
- Functional categorization

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FDI

Country	inward FDI stock in $ Billions	percent of total global inward FDI	global inward FDI ranking	GDP in $ Billions	Inward FDI stock as percentage of GDP
United States	4,626	12%	1	20,953	22%
Netherlands, The	4,512	12%	2	914	494%
Luxembourg	3,644	9%	3	73	4967%
United Kingdom	2,220	6%	4	2,760	80%
Singapore	1,625	4%	5	340	478%
Switzerland	1,425	4%	6	752	189%
Ireland	1,347	3%	7	426	316%
Germany	1,130	3%	8	3,846	29%
France	964	2%	9	2,630	37%
Spain	866	2%	10	1,281	68%
Cyprus	477	1%	16	25	1938%

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Country	Inward FDI stock from Russia in $ billions	Percentage of total Russian outward FDI stock
CYPRUS	185	48.58%
NETHERLANDS	25	6.48%
SWITZERLAND	22	5.81%
UNITED KINGDOM	14	3.66%
SINGAPORE	10	2.72%
GERMANY	9	2.42%
TURKEY	6	1.71%
SPAIN	6	1.63%
UNITED STATES	6	1.62%
KAZAKHSTAN	4	0.94%

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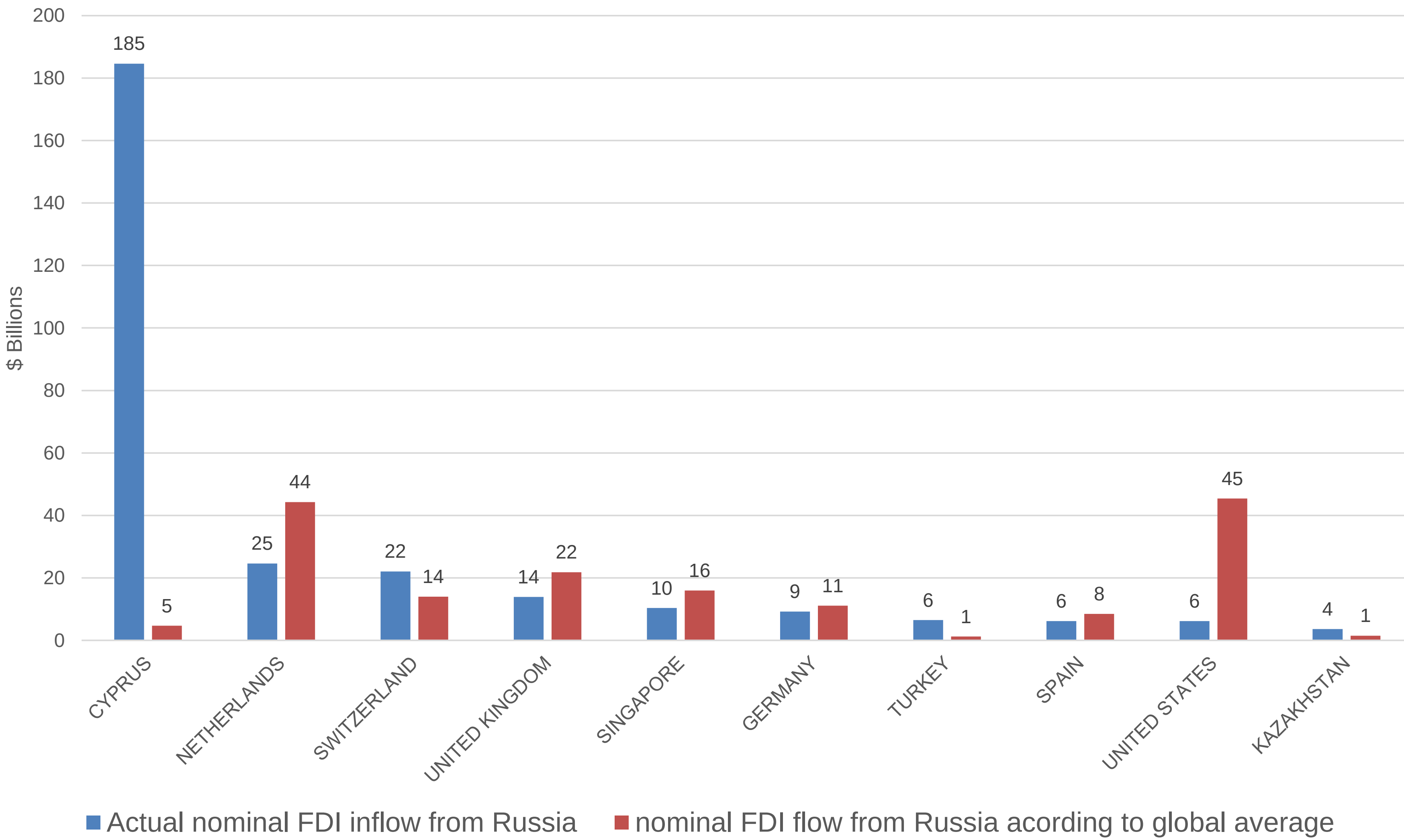
Outward FDI from Russia compared to global distribution of FDI stock in 2021



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FPEI

Country	Inward FPEI stock in $ Billions	as percentage of total
United States	19,226	25.13%
Cayman Islands	5,848	7.64%
Luxembourg	4,995	6.53%
United Kingdom	4,867	6.36%
France	4,194	5.48%
Ireland	3,428	4.48%
Germany	3,345	4.37%
Japan	3,153	4.12%
Netherlands, The	2,768	3.62%
Canada	2,272	2.97%

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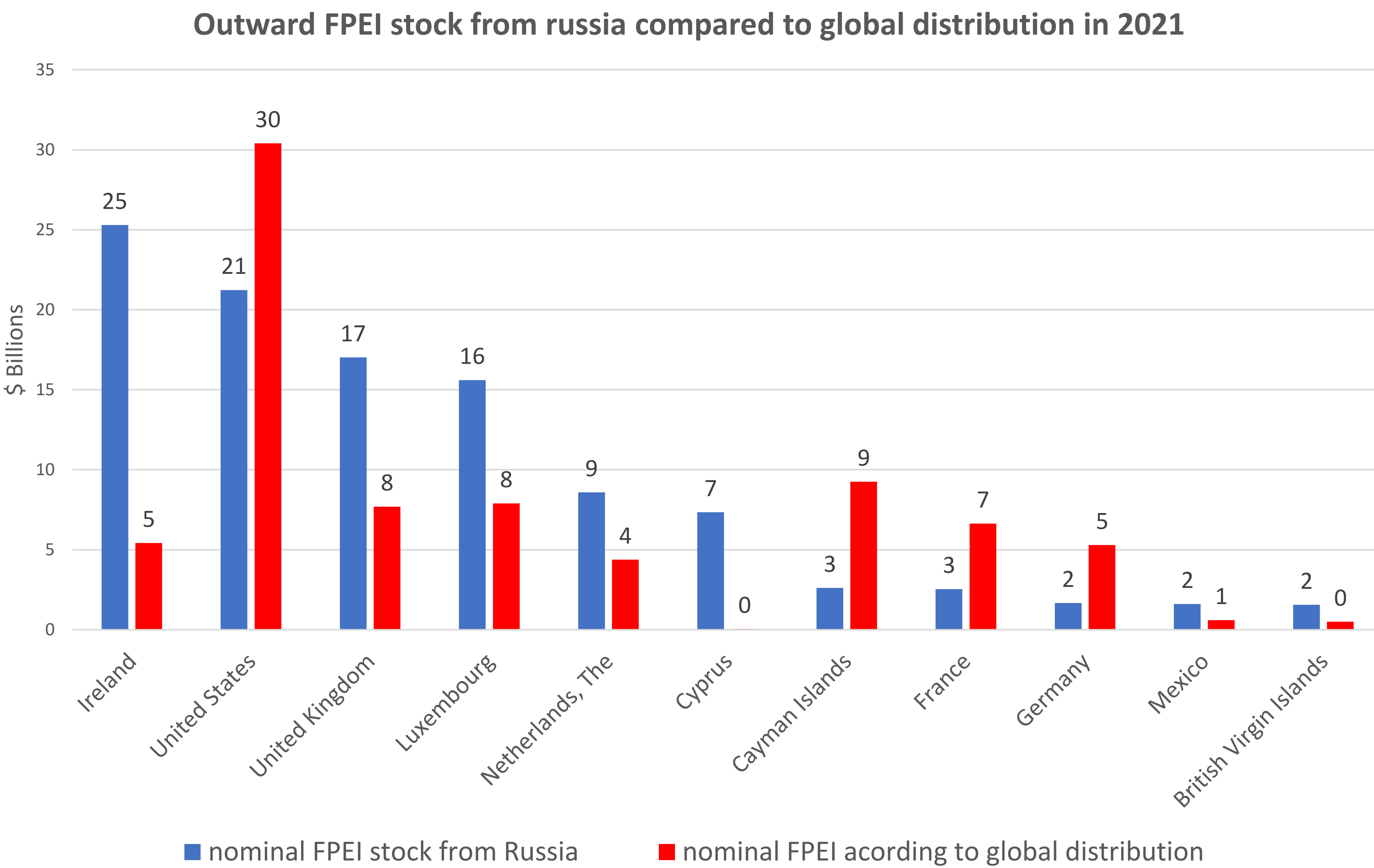

Relational banking statistics

- locational banking statistics – not consolidated
- Consolidated banking statistics

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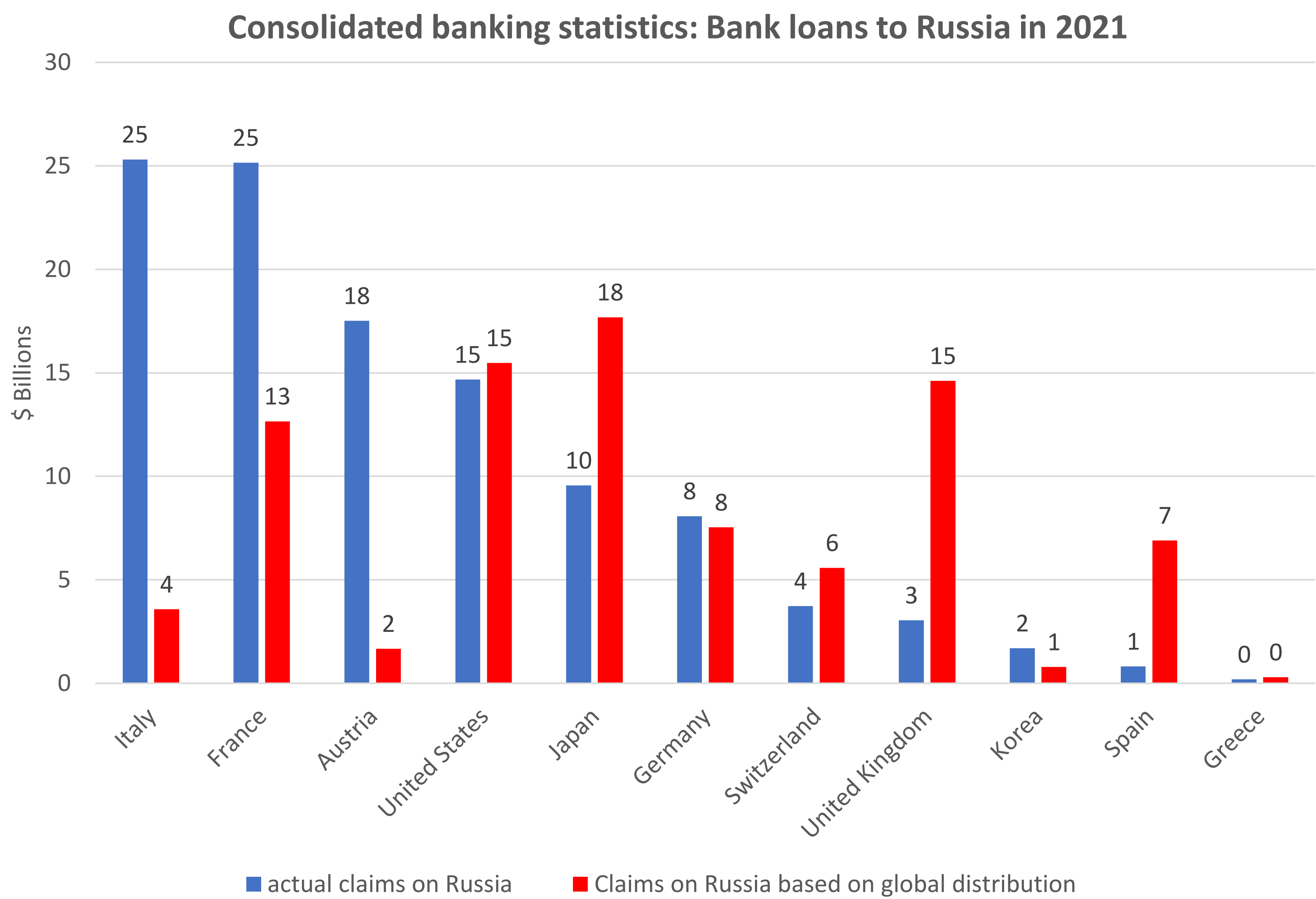

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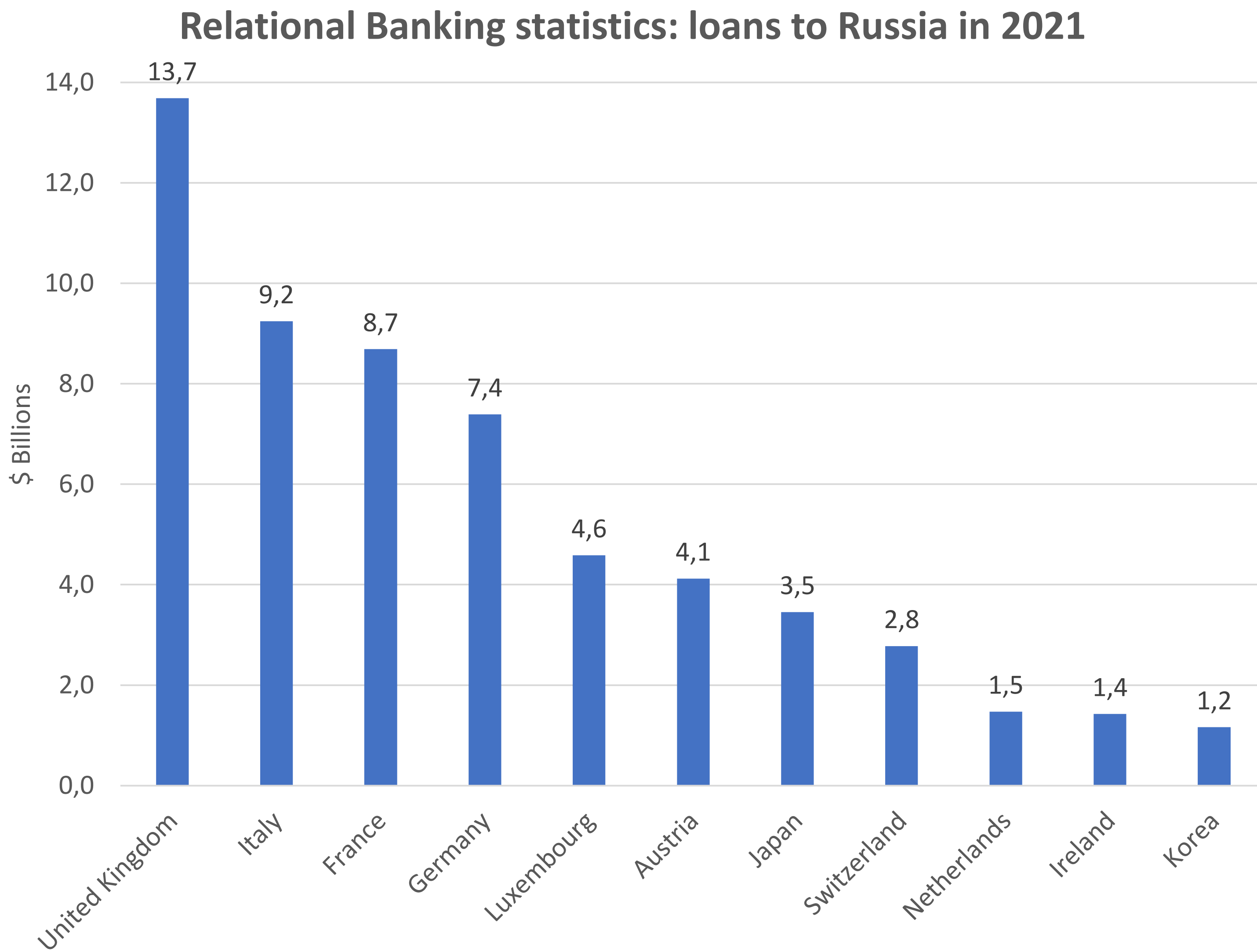

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Corporate density (orbis)

	Total	The Netherlands	Belgium	Cyprus	Ireland	United Kingdom	Switzerland	France	Luxembourg
Russian companies with an ultimate owner in …	9548	743	205	5257	97	1218	901	820	307
Percentage of total		8%	2%	55%	1%	13%	9%	9%	3%
Companies in ... with an ultimate owner in Russia	7566	151	88	2732	78	3616	487	140	274
Percentage of total		2%	1%	36%	1%	48%	6%	2%	4%
Russian state-owned companies with a subsidiary in …	180	21	6	62	14	30	20	9	18
Percentage of total		12%	3%	34%	8%	17%	11%	5%	10%

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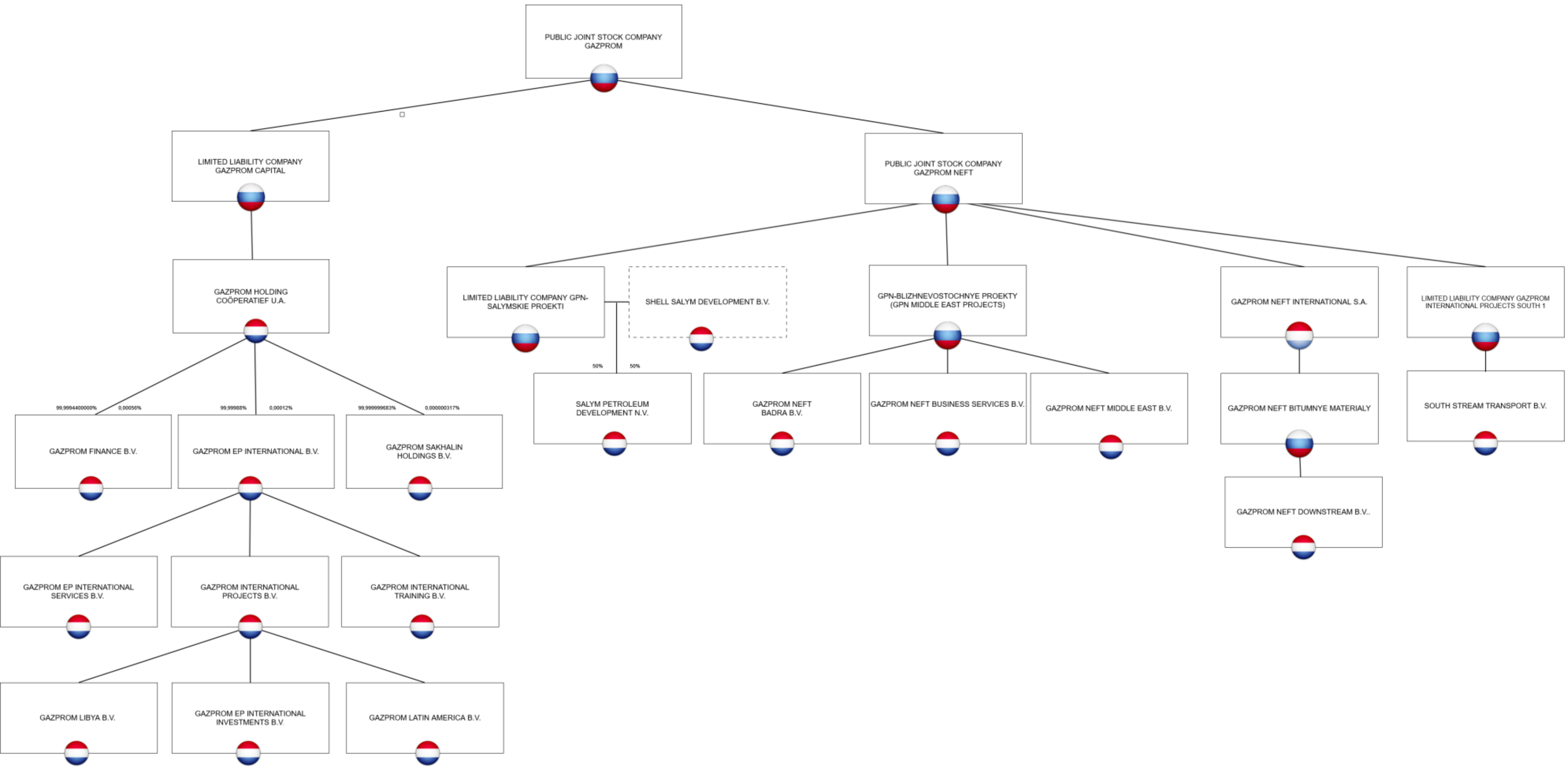

The End

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The rise of the Dutch offshore system

The Dutch OFC: The Colonial Roots

- The first modern Dutch TNCs – Shell, Unilever and Philips – were created between 1880 and 1920.
- The rising cross-border nature of their economic activities led to the need to develop an appropriate international taxation framework to prevent double taxation. **This laid the foundations of the current Dutch tax regime**.
- From the late 1970s onwards, this legal framework – set up to facilitate "genuine" cross-border investment flows from domestic TNCs – transformed into a framework to process financial flows connected to the tax avoidance of non-residents.

The Dutch OFC: After Bretton Woods

- The complete liberalization of capital movements in 1983 led to the doubling of the number of SPEs registered in the Netherlands from **2,000 in 1983 to 10,000 in 1999**.
- Alongside the increase of SPEs, gross flows (inward and outward) of capital routed through the Netherlands increased from about EUR 800 billion in 1996 to a staggering EUR 4.5 trillion in 2001 (**1,000% of GDP in 2001**).

The Trust Sector is Part of a Broader System

- At the heart of the large capital flows that move in and out of the Netherlands are SPEs domiciled in the Netherlands that provide access to the Dutch tax facilities.
- an extensive network of tax treaties
- a favourable tax regime that includes tax rulings by the tax authority
- **a competitive cluster of corporate service providers** (CSPs).

- This cluster consists of
  - tax advisers
  - accountants
  - corporate law firms
  - trust firms
  - banks
  - notaries.
- Together, they provide the services that facilitate large-scale tax avoidance through the Netherlands within the legal and regulatory framework.

The political economy of the Dutch OFC

- The Dutch OFC shows how the re-scaling of finance can become a hegemonic project at the national scale.
- All political parties in the centre support the OFC complex
- DNB at FSB
- Ministry of finance at EU commission
- Tax authority and Shell
- Russian oligarchs

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Thank you