The Cayman Islands And Offshore Finance: Where Are We Headed?

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Rivers know this: There is no hurry. We shall get there some day - Winnie The Pooh

BUT CLEARLY THAT DAY was not 10 October 2019 when a Ms. Gillian Tett of the Financial Times asked, "What the heck is happening in the Cayman Islands?" That is often a question asked in relation to corporate tax. Recently, for example, the OECD called for an end to the loopholes that let global companies cut their tax bills in places like the British Overseas Territory."[1]

Even by the sometimes casual journalistic standards of the Financial Times, it is rarely that we can observe such succinct and complete confusion in just three sentences. Before we can answer the question as to the future direction of the Cayman Islands, we need to answer, at least better than Tett manages, the question of what is currently going on? Firstly, there is nothing "murky" about the Cayman Islands. Any hardworking journalist would find the relevant statistics are publicly available. Not only because regulated banks, and as far as the Cayman Islands is concerned they are all regulated, consolidate their fi gures which are available to the IMF, but because the statistics for Cayman Islands' open ended funds are also publicly available, if, you know where to look[2], as are overall capital inflows and outflows.

Secondly, Tett is not the only problem. In recycling irrelevant clichés, journalists no doubt feel they play immediately to a public perception. But it is not just lazy journalists who do so. Mr. Gabriel Zucman, who we learn from The New Yorker[3] is the architect of Democratic presidential front runner, Elizabeth Warren's wealth tax proposals, has, it seems, good arguments for "abolishing billionaires". But why does he feel obliged to spoil those arguments by making nonsensical reference to the amount of money moving through "small economies" like the Cayman Islands[4].

The amount of money moving through Cayman is the economy (or at least 50 per cent of it) and why shouldn't a jurisdiction with world-leading transparent legislation focused on specialist financial structures not have an economy based on adding value to perfectly legitimate capital flows? Zucman seeks then to support his argument by making tired and spurious references to Enron, an entity which failed entirely as a result of toxic financial engineering undertaken by the Chewco, Raptor and LJM partnerships in Delaware, established by a reckless (and criminally so) board of directors based in Houston where the company was notionally audited. He then tries to imply that, in some way, billionaires are avoiding tax because Cayman Islands' structuring is "poorly documented and regulated". The billionaires' money,

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he suggests, is "stored" in the Cayman Islands. "Tax havens," he continues, "seem like black holes sucking so much wealth that it warped the global economy". This "black hole" theory is palpable nonsense and for someone claiming to be a leading economist, laughably so.

All monies invested in Cayman are onward invested and bear tax in the jurisdiction of investment. President Obama was fond of the same smear. Mitt Romney, he implied, was a wrongdoer for having had investments in a Cayman Islands fund. Really? If Senator Romney had been undertaking tax evasion or unlawful avoidance, why is he not now serving time in prison, given that the IRS has the unrestricted ability to investigate any matter related to any Cayman Islands investment account? Very possibly, I suggest, because Senator Romney was acting in full compliance with United States' tax law, as he was entitled to do, and paid full US tax on his investments there.

So Zucman is talking nonsense. Not, possibly, the bit about the wealth tax. Ms. Warren can make her case on that, although if I had my "two cents," I would look very closely at the effectiveness of these proposals in other places. But that is not the present point. The point is that as an offshore financial centre, the Cayman Islands is now perfectly satisfactorily transparent; in fact, more so, than any onshore financial centre, and certainly more so than the US centres[5]. And given the transparency and the automatic income and capital reporting now introduced by FATCA and the Common Reporting Standard, we know for a fact that millionaires and billionaires do not avoid or evade tax in the Cayman Islands. They may, though, invest monies in the Cayman Islands through various vehicles which are established there because of the excellence of the legal regime for pooling funds and the superior returns.

But the blindingly obvious point, even to a Financial Times journalist, is that every one of these dollars has to be invested in onshore markets and, as such, these flows are fully documented and indeed, the profits and gains on every investor's account are reported to the tax authority in that investor's jurisdiction of residence. It is verging on criminal incompetence of the OECD to suggest that "there are loopholes that let global companies cut their tax bills" in places like the Cayman Islands when the OECD full well knows (or, at least, we hope it knows) that it is its hopelessly flawed Double Tax Treaty Networks within the EU that enabled the aggressive tax avoidance in Europe by the major US corporates. There may be some tax deferral remaining on the books of subsidiaries of major US corporates trading globally consequent upon the Tax Reform and Jobs Cut Act 2017 after the payment of Global Intangible Low Tax Income (GILTI) , but that goes to say no more than that if the US legislators wish to confer a tax benefit to render the global operations of US corporations more competitive, the Cayman Islands can perfectly properly assist them in that endeavour by legitimate fully disclosed structuring. The OECD has confused Tett. It is talking about US legislation.

Evidently enough, and ironically, Tett and Zucman's unsound clichés will not stand the test of the new international transparency. And if not, we may suppose that the future for the Cayman Islands, the international capital flows through which are fast reaching pre-2008 financial crisis levels, looks extraordinarily bright. But that would be too simplistic a conclusion and ignores the threat posed by the EU's extraterritorial tax initiatives coupled with the extraordinarily docile response of the Cayman government. The Cayman Islands government, under the threat of spurious EU "blacklisting", is in danger of snatching defeat from the jaws of victory not only by unnecessarily having introduced the ridiculous "economic substance" legislation but also now, with that ink not yet dry , by tampering with the elegance of the foundation Cayman legislation and regulation on fund structuring at the insistence of the EU Code of Conduct Group. So this new initiative is intended to bring closed ended funds within an unnecessary and inappropriate regulatory framework which again seeks to solve for a nonexistent problem Not to mention the fact that Cayman funds are almost never marketed in the EU because Cayman lacks the ESMA approval for passported securities .

We can divide the truth deniers, the EU, the OECD, the FATF, Tett, Zucman and others who actually believe (or pretend to believe) the false narrative about the Cayman "black hole" into two groups. The first group ignores

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the facts and robotically repeats the irrelevant "black hole" cliché, (which we can call the Tett approach). This group is largely harmless, save that gullible UK legislators pick upon this narrative which is unhelpful. The second group is more menacing. The EU and the OECD, emboldened by the fallacy of "harmful tax competition", feel justified in misapplying and extending extraterritorial tax policy under threat of "blacklisting", the weapon of choice of Pierre Moscovici, the EU Tax Commissioner, and his statist colleagues at the OECD.

We can suppose that at some point, post 2000, the truth must have dawned within the EU and the OECD that transparency alone would not harm and was irrelevant to the well-structured offshore financial centre. New inventions were therefore required to prevent flows of capital in and through the Cayman Islands, accessing lower tax investment opportunities in the United States, and similarly tax enlightened jurisdictions, at the expense of the EU. And hence the "economic substance" initiative, the involvement of the EU Code of Conduct group, and further recent meaningless anti money laundering legislation from the FATF.

We can sense the EU and OECD frustration. They believed their false narrative. The transparency initiatives and the Common Reporting Standard automatic proactive tax reporting were supposed to be the offshore kill shot. But not only did they not signal the demise of the Cayman Islands, rather assets under management grew as a result. Poor Alex Cobham, Chief Executive of the Tax Justice Network, a self-styled but equally clueless tax watch dog group. He says of the beneficial ownership transparency proposals now suggested, "I think it does start to look like it could be a perfect storm for Cayman". But law enforcement and every relevant tax authority already had immediate access to the verified beneficial ownership record of every Cayman Islands corporate entity. And from the inception of that arrangement, Cayman Islands' assets under management have grown.

The truth is that, transparency notwithstanding, international investors and institutions choose to invest through Cayman and into the United States and PRC and Latin America rather than into Europe, where overly burdensome layers of regulation in the fund space have resulted in comparatively constrained investment returns for the EU fund product. And so, the EU's newly invented economic substance legislation was reverse- engineered specifically to target offshore financial centres. Possibly, the Cayman government adopted the appeasement option seeking sanctuary in the apparent agreement with the EU that the Cayman Islands' fund industry would be regarded as "out of scope". But if the Cayman Islands government thought the EU would rest there, they were much mistaken because, having already moved the goalposts to place fund management within scope, we now find the EU Code of Conduct Group seeks to require the Cayman Islands to introduce equally burdensome and unnecessary layers of regulation in the area of private equity funds and generally.

This follows hard on the heels of a great deal of unnecessary regulation introduced at the request of the Financial Action Task Force in relation to non-existent money laundering threats in Cayman best imagined by delusional FATF personnel and Dame Margaret Hodge. (Whatever happened to the initial FATF premise that regulated and licensed service providers in recognised jurisdictions with anti-money laundering regulations to the requisite standard would undertake the Know Your Customer (KYC) and due diligence at the original point of investment; and that any other service provider in the chain, whether or not cross border, could then rely on that due diligence?) We have now arrived at the ridiculous situation of duplicated and triplicated money laundering due diligence by every service provider involved in respect of the same dollar and where the approved list of jurisdictions has been dispensed with so that each fund, or service provider to a fund, must make its own evaluation as to what is a "high risk jurisdiction" (as if that matters; jurisdictions don't launder money) and an unsound source of funds, and requires that analysis to be replicated by all those involved in the investment chain.

It would be hard to propose a more ridiculous structure unless, of course, the intention of all of this is to so burden the offshore jurisdiction with costs that it is rendered uncompetitive. This then has become the real battleground for the future and top marks to the EU, the OECD and the FATF for outright dishonesty. There is no doubt, that many offshore jurisdictions will lack the infrastructure to cope with these new regulatory onslaughts. The point that there is no meaningful statistical evidence of wrongdoing or harmful tax practices in the Cayman Islands which supports their introduction appears lost. There is no doubt that, whilst some may not, the Cayman Islands has the professional infrastructure to manage the new waves of regulatory and administrative burden. Whether the clients will bear the increased costs of so doing now becomes the central question. In talking of the "resilience" of the Cayman Financial Services industry, the Cayman government mischaracterises the real point. The answer is that clients probably will bear the cost, unless and until a less expensive and equally sound alternative jurisdiction appears. When it does, they will not.

N.B. The illustration accompanying this article was commissioned by the author. The artist is Michelle Bryan.

Endnotes

1 Better Data on Modern Finance Reveals Uncomfortable Truths – The Financial Times, 10th October 2019

2 The website of the Cayman Islands Monetary Authority is a good place to start.

3 The French Economist who Helped Invent Elizabeth Warren's Wealth Tax - Benjamin Wallace-Wells, 19th October 2019

4 Zucman is wrong incidentally about "hundreds of billions of dollars". The figure in so far as the Cayman Islands is concerned would exceed US$ 6 trillion.

5 See 'The Laundromat' – Netflix