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Committee of Inquiry into Money Laundering, Tax Avoidance and Tax Evasion

PANA MEETING

Exchange of views with Professor Joseph E. Stiglitz

Wednesday, 16 November 2016 (11h00 - 12h30)
Brussels

Draft list of written questions

1. At the time of accepting your assignment to the Panamanian Inquiry Committee on the Panama Papers, did you have to sign a confidentiality declaration with the Panamanian government which obliges you to not reveal any facts or findings that you discovered during your assignment to the Committee?

No

2. Could you explain the reasons of your resignation from the Committee?

We (Mark Pieth and I) had demanded at the beginning of our deliberations that our Report be made public, whatever its findings, after giving the government suitable time for formulating a response. We had left it to the government to decide on how much time they felt was necessary. When the government refused to provide those assurances, we felt we had no choice but to resign. We believed that a report on transparency that was not itself transparent would simply not be credible. We had to lead by example.

3. Did you meet with Mr Mossack or Mr Fonseca during your three months assignment to the Committee? If yes, what was the main outcome of this meeting? If not, did the Committee intend to meet them?

No. Committee had not proceeded far enough in its deliberations to answer last question.

4. Has the Panamanian government changed its legislation since the revelations of the Panama Papers? If yes, could you please indicate how?

Panama was already engaging in legislative reforms ahead of the Panama Papers revelations. Stronger banking regulation reforms, for example, Know Your Customer rules, were introduced in 2012 (see Executive Decree No. 55 of 1 February 2012). In April of 2015, Panama required custodianship of bearer shares and disclosure

of beneficial ownership for newly incorporated entities. Under this law, financial and legal institutions identify and record beneficial owners/beneficiaries of their clients; and in the event that the final beneficiary is found to be a legal person, the law requires that identification process continue until a natural person is identified.

Since the revelations of the Panama Papers, Panama has agreed to automatic exchange of information by 2018 and has recently signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, although it was rated by the Global Forum earlier this month as 'non-compliant'. This highlights the importance of enforcement, stressed by the Pieth-Stiglitz Report.

5. Without entering into the details of specific cases, could you briefly describe the main schemes that were used to hide tax revenues or launder money? Is there a typology in the schemes used or do your findings reveal that each case is specific? What are the main findings revealed by the Panama Papers?

The Panama Papers revealed that the Mossack Fonseca law firms in question—operating on a worldwide basis, including in other offshore centers as well as large traditional financial centers—opened and serviced shell companies, trusts, private foundations, and other entities to serve as integral components of so-called "structures" through which money flows. These complex constructions are composed of companies with unknown owners and beneficiaries (hidden behind nominee directors and bearer shares1) with multiple bank accounts in jurisdictions with strong bank secrecy legislation and little likelihood of cooperation with foreign authorities. The structures are organized by what are referred to as fiduciaries, mostly lawyers, who are typically under-regulated, and who use their attorney-client privilege to mask the identity of their clients.

Much of this was known before the publication of the Panama Papers, but the papers illuminated and graphically illustrated the process. The Panama Papers also shed light on a number of egregious abuses enabled by these structures: apart from straightforward tax fraud by private persons and companies, another group of cases indicates that officials, ministers, and even heads of state used these structures to cover up conflicts of interest or even graft, corruption, and embezzlement. A third group of cases exposed the use of these structures in laundering proceeds from organized crime. In a particularly disturbing case, one client of the Panamanian law firm was the alleged ringleader of a child prostitution ring in Russia, whose members kidnapped, raped, and sold orphan girls. The ICIJ reported that when the firm discovered accusations of its client's involvement, it determined that it was not legally obligated to report them. Thus, these structures have enabled and in fact incentivized such heinous abuses of the most vulnerable.

6. Did you encounter obstacles (legal pressure etc. in your work? Have you felt pressure during your three months in the Committee? If yes, could you please explain?

Our work was at a very preliminary stage at the time it became clear that the Panamanian government would not provide the necessary transparency assurances.

However, the Government of Panama was totally uncooperative in providing us with the modest support we requested.

7. Mossack Fonseca is at the centre of the Panama papers. Could you please indicate its role in setting up shell companies? What was the role of banks and financial intermediaries that worked with Mossack Fonseca? Which conclusions would you draw on the role of - on the one hand- advisors and - on the other hand- banks?

Though typically the managers of the banks, the lawyers who put together the impenetrable web of corporations and the public officials who pass laws ensuring secrecy may think of themselves as just "doing business" and helping them, their employees, and their country prosper, more properly these secrecy havens could be viewed as co-conspirators in these crimes.

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1 ***Bearer shares*** are negotiable instruments that accord ownership in a legal entity to the person who holds the bearer share certificate. See Glossary of FATF Recommendations, available at http://www.fatf-gafi.org/glossary/a-c/.

8. On the basis of this, in your view, should the regulations on tax advisors and auditors be strengthened? Should the regulations on banks and financial intermediaries be strengthened? If yes, would you have any suggestions on how this could be done? Would you consider the rules in place sufficient? Would you think there is a problem in the implementation or law enforcement of the rules?

In our report, *Overcoming the Shadow Economy*, Mark Pieth and I present foundational principles for all countries in setting nationally appropriate regulations. The intention of our Report was not to present concrete legislative proposals, but rather to show the magnitude of the task before the international community, and to argue that the international community needs to take a comprehensive approach, going well beyond those embodied in standard practices today. I will now explain these principles and a more detailed set of recommendations can be found in the *Shadow Economy* report.

1. Secrecy has to be attacked globally—offshore and onshore. There can be no places to hide.
2. The collection and exchange of information related to taxation, ownership, and illicit activities is a shared global responsibility.
3. While the traditional gatekeepers of this information are financial institutions, addressing secrecy effectively will mean tackling the entire industry that facilitates secrecy—including the legal firms that have played a pivotal role in the creation of the web of corporations.
4. Knowledge of beneficial ownership of companies and bank accounts is fundamental, both to ensure taxation and also to prevent and prosecute crime and the money laundering that so often is associated with it.
5. Tax preferences are a privilege and not a right. Tax free zones provide opportunities for money laundering, and those operating in such zones should be held to a high standard.
6. Corporations, trusts, and foundations are creations of the state—and as such, they have no inalienable rights. They are created to facilitate societal welfare, and to ensure that they do so, they need to be globally regulated—regulated in ways which ensure full knowledge of beneficial ownership and full compliance with all tax laws.
7. Complexity contributes to lack of transparency. Those seeking secrecy understand this, and create complex webs of corporations and trusts, to make it more difficult for enforcement agencies to trace flows of illicit funds and to identify the true beneficiaries of illicit activities. This has two implications: (a) The international community should do what it can to impede the creation and maintenance of these complex webs; and (b) to effectively fight for transparency—to detect true beneficial ownership—requires resources beyond those available to enforcement agencies. In our Report, we suggest concrete ways that this may be done.
8. Transparency is a global public good, requiring global efforts. To facilitate these efforts, every country must maintain publicly searchable registries of the beneficial owners of each corporation, trust, foundation, or other entity. But even if such searchable registries are not made fully publicly accessible, they should be accessible by law enforcement agencies.
9. These financial centers (both onshore and offshore) are creations of globalization—and should not be allowed to engage in regulatory and tax arbitrage. Doing so undermines the positive effects of globalization. If secrecy-havens serve as centers for tax avoidance and evasion or in any way facilitate corruption or illicit activities, they are acting as parasites, and should be cut off from the global financial community.
10. What matters is not just passing laws and regulations, but enforcement. In the report, we elaborate on specific recommendations for legislative action, but emphasize that merely passing laws is insufficient.

11. Often these laws are modeled after other laws of seemingly respectable jurisdictions. Yet, some of these jurisdictions, even if they are "onshore," are themselves secrecy-havens. One should always be careful about "legal transplants." Even similar laws can have quite different consequences under different legal systems. Modelling one country's laws after another is not sufficient by itself, but must be complemented by a strong and impartial judiciary and regulatory institutions to administer and enforce the law. Such laws must also fit within the context of the country's legal system as a whole, as other laws may be needed to complement or support laws enacted to promote transparency—and other laws may have to be repealed. Further, the impact and interaction of laws should be monitored to determine necessary amendments. For instance, in some countries it is illegal to disclose information that is supposed to be secret—even if that disclosure itself would enable the enforcement of anti-corruption laws.

There is urgency: even if the "first best" framework cannot be immediately achieved, there are intermediate steps that can and should be taken. Throughout this Report, we have come down solidly on the side of "tough" sanctions, simply because there are many strong incentives for laxity. Those who benefit from secrecy and lax enforcement of the regulations designed to promote transparency will put pressure on governments not to enforce these regulations. The pressure is asymmetric: though societal benefits from transparency may be huge, there is no natural lobby group for transparency, and especially no lobby group with the resources of those lobbying for lax enforcement.

We also discuss tax preferences, which are the subject of a new report by the Independent Commission for the Reform of International Corporate Taxation, of which I am a member. Tax preferences, in the form of exemptions and incentives targeted to attract foreign investment, not only bring limited benefits in terms of promotion of long term sustainable growth, they also place domestic firms at a competitive disadvantage. More perniciously, tax preferences also combine with secrecy to enable and encourage tax avoidance and evasion on a massive scale, and in many instances play a role in attracting money laundering operations. Tax exemptions and incentives on profits from activities within special economic zones should be subject to tight scrutiny, establishing whether the profits booked within those zones are commensurate with the level of actual economic activities that have occurred, as indicated by employment and capital.

9. At the London anti-corruption summit in May 2016, representatives from the Cayman Islands, Bermuda and the Isle of Man warned that the 'hypocrisy' of the US was hurting the global push for greater financial transparency. They put pressure on the U.S. states of Nevada, Wyoming and Delaware to address their lack of corporate transparency. Could you please share with us your views on this? Would you consider that there is evidence of a lack of (corporate) transparency in these states?

While the United States preach about the vices of the offshore centers, within their own borders there are pockets of secrecy where these bad practices continue. Although the United States recently adopted a Treasury rule (FinCEN) requiring financial operators to report the beneficial owner(s) of legal entity customers by 11 May 2018, this reporting is to government authorities only and no personal knowledge is necessary to verify the identity of the beneficial owner, only documentation. Additionally, the United States has yet to implement country-by-country reporting. There is a bill in Congress that requires this reporting through disclosures to the Securities and Exchange Commission, but it is still strongly opposed by business. And now with President Trump in office, the future of that bill is highly uncertain.

Having said this, though, the major players—US and EU countries—are key in tipping the balance toward transparency. These countries can effectively force others to comply with their standards, simply by threatening to cut off access to their financial system. And in fact, many in the United States have been calling for the government to break off all connections with jurisdictions not conforming to the global standards (even

secrecy jurisdictions within their own territories), effectively shutting down all secrecy-havens. There is a widely shared perspective that these havens only exist because the United States and Europe have looked the other way—influenced by their own one percent. These major players have yet to pull the trigger, partly due to the delay in putting their own houses in order.

But, as economic leaders, the United States and Europe have an obligation to force financial centers to comply with global transparency standards. That they have the instruments to do so has been forcefully shown in the fight against terrorism. That they do not do so in the fight against corruption and tax avoidance and evasion is testimony to the power of the interests of those who benefit from secrecy.

But while the US and EU must take a leadership role, each country must play its role as a global citizen in order to shut down the shadow economy.

10. Would you describe some countries as more problematic in terms of money laundering or lack of transparency for tax purposes?

The Financial Secrecy Index ranks jurisdictions according to their secrecy and the scale of their offshore financial activities and is compiled by researchers at Tax Justice Network. This index places Switzerland, Hong Kong and the US at the top, and two EU countries are in the top 8.

11. The investigative work of the international consortium of journalists (ICIJ) has shown the importance of bearer shares in order to maintain secrecy/anonymity. When the British Virgin Islands cracked down on bearer shares in 2005, Mossack Fonseca moved bearer share clients to Panama. Figures available on the ICIJ website tend to show that Mossack Fonseca stopped using bearer shares in its tax optimisation schemes (decreasing trend starting in 2005 with almost no use of bearer shares in 2015). Would you know why this happened? One of the reasons could be that countries all over the world have abolished bearer shares. Would you be able to enumerate countries that still have bearer shares? If Mossack Fonseca stopped using bearer shares, do you know by which other scheme they were replaced in order to keep anonymity?

As our Report emphasizes, bearer shares are only one mechanism for maintaining effective anonymity.

12. Figures show a decline of offshore companies incorporated by Mossack Fonseca since 2009. Could you perhaps explain why? Would you think this is a general trend due to changes in regulations or is it specific to Mossack Fonseca? If this would be a general trend, do you know where the activity has moved and why?

One of the problems of assessing the extent of activities of the Secrecy Havens is that their activities are cloaked in secrecy—it was only through the Panama Papers that we were able to glimpse the range of their activities.

13. What in your views could be an appropriate response by the EU legislator (Parliament and Council) to the Panama Papers?

The EU legislator should understand two things: First, the Panama Papers show us that this is a global, systemic problem. We cannot simply blame small countries and force them into following standards that the large players don't follow. As we draw up black lists, we have to put our own houses into order.

Secondly, we have to be tough. In a globalized world, if there is any pocket of secrecy, funds will flow through that pocket. That is why the system of transparency has to be global. Secrecy-havens should be treated like the carriers of a dangerous disease. If left unchecked, it can spread like a virulent virus. We know what to do with dangerous contagious diseases: quarantine. And so too for the secrecy-havens: they should be cut off from the global financial and economic system and we have the necessary means at hand:

- We can declare it illegal for any citizen of the “cooperative” countries to have an account in a non-cooperative jurisdiction.
- We can declare it illegal for an individual or a corporation in a cooperative country to be a shareholder, director, or trustee of any trust, corporation, or foundation in a non-cooperative country.
- We can declare it illegal for any bank to have any correspondence relationship or to interact in any way with any financial institution in a non-cooperative jurisdiction.

And the punishment for the violation of these laws should be severe. A bank or other financial institution violating these principles should lose its license to operate; a lawyer or other professional service provider violating these principles should lose their license to practice; a publicly created entity failing to report its tax and beneficial ownership information annually should be de-listed. The fact is that there is an ample supply of good actors; the international community does not need to encourage the bad actors.

Much is at stake: if we cannot show our citizens that globalization can be tempered, that it can be tamed for the benefit of the vast majority, there will be a backlash. And the first order of business in taming globalization is to make sure that the secrecy-havens are shut down. If we cannot do that, how can we expect our citizens to believe that we are able—or willing—to temper globalization, to make sure that it is working for all of our citizens, rather than for those at the top. It should be apparent that the political consequences of a failure to deal with the secrecy havens and their consequences could be severe.