

PREDICTION: TAX HAVENS TO EMERGE AS HUGE DUE-DILIGENCE ISSUE

One issue recently has risen to the top of the list that due-diligence professionals worry about: international tax evasion. Evidence of this is that due-diligence investigators assigned to check the backgrounds of parties to a transaction are increasingly being asked to look at their *money's* background as well; in effect, not just, "Who is this Russian gentleman?" but also, "How did his \$100 million get to Cyprus?"

In this, our third edition, *Global Fact Gathering* predicts that cross-border tax evasion will join terrorist financing and money laundering as a front-line enforcement, compliance and due-diligence concern in the coming months and years, if it hasn't already.

We devote this issue of our newsletter to the subject of tax havens, and explore the new state of tax evasion and enforcement worldwide (see map, pages 2-3):

- For the first time European and U.S. prosecutors, with help from informants, are peering behind the curtain of confidentiality around some of the world's most notorious tax havens; more such cases are coming, and some could cast tax-advantaged deals as money-laundering.
- A number of European and Latin American governments are clamoring for an end to the offshore havens' financial secrecy and lack of regulation.
- Members of Congress are pressing for draconian steps against offshore practitioners, and appear to have an ally in President Obama.
- The global financial crash spotlights how astoundingly complex mortgage-backed assets that have crippled the world economy can disappear without a trace, along with taxes due on the assets, behind secrecy walls.

Let's begin our prediction of what's coming with a look at two cases - the largest criminal tax-evasion investigations in history - that have tax-shelter practitioners nervously jiggling their wingtips. The first is the February 18 agreement by Swiss-based UBS AG, the world's largest private bank, to pay \$780 million to the U.S. and to reveal the identities of 250 of its 19,000 U.S. account-holders, so it can resolve the Justice Department's criminal fraud allegations. The revelation is unprecedented, and calls into question Switzerland's tradition of bank secrecy. A day later, Justice filed suit demanding UBS disclose the names of 52,000 U.S. depositors, a larger group than had been known of before. The bank is resisting that demand.

The second criminal tax case is a sprawling investigation by numerous governments into banks in Liechtenstein, including LGT Bank, owned by the royal family. The probes started when Heinrich Kieber, a bank computer technician, sold CDs with incriminating bank data to German authorities. The case has inflamed the German public, which now sees how many



With money-laundering charges in the air, the great game of global tax evasion, in which billions of dollars disappear and reappear elsewhere, is about to become less fun

prominent Germans shield their income from tax collectors. At least a dozen other countries started their own probes using data from Kieber, whose lawyer said he is now in "deep witness protection."

Moreover, billions of dollars invested with accused conman Bernard Madoff were routed through offshore tax shelters. U.S. prosecutors working on the Madoff case and some offshore cases are considering a rarely used step of bringing not only tax evasion charges against tax-avoiding offshore investors, but also the more serious charge of money laundering, the *New York Times* said.

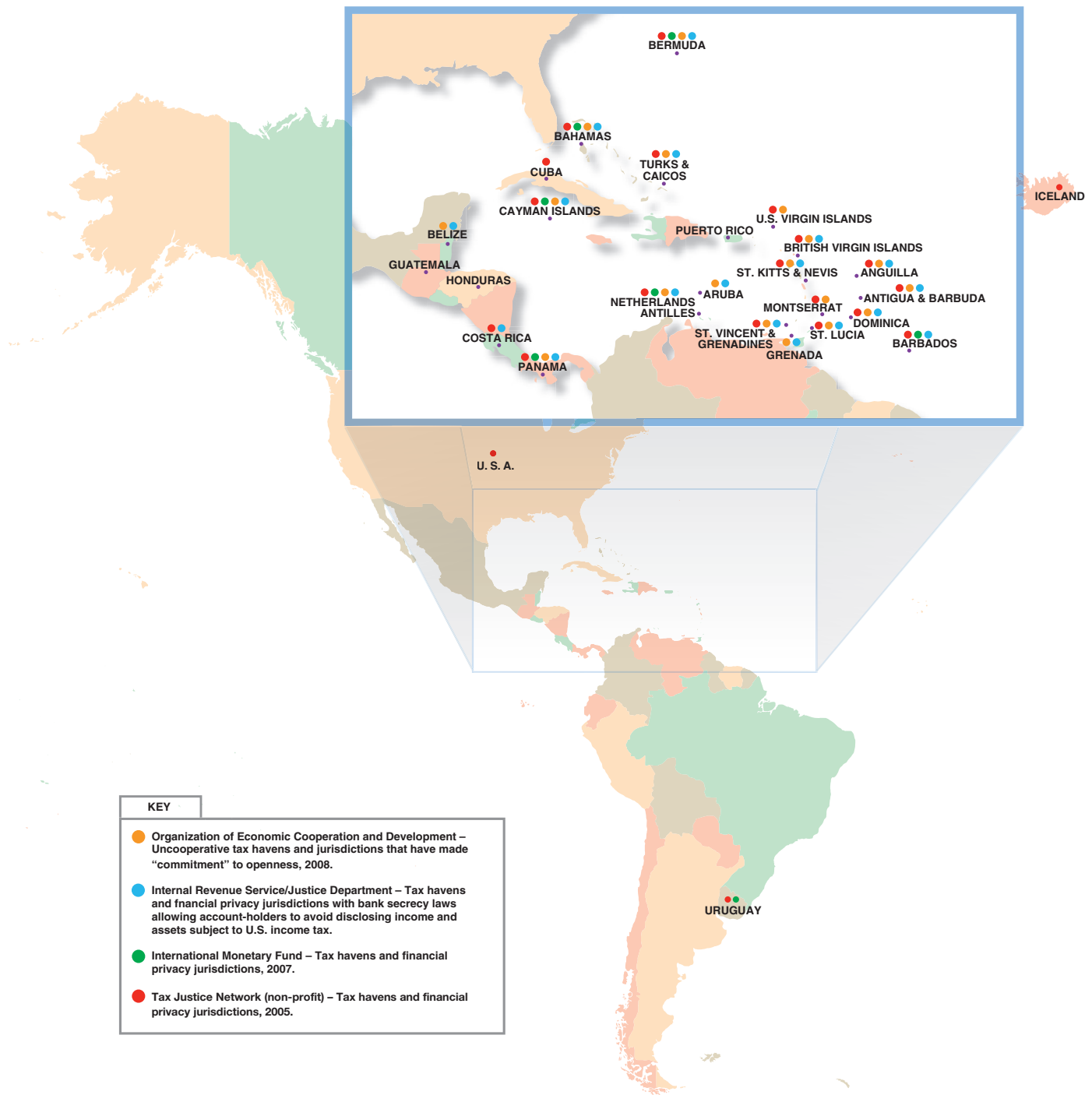
Many members of Congress are pushing for new laws to clamp down simultaneously on both the tax haven industry and the hedge fund and derivatives businesses, much of whose money is stored offshore. "Perhaps the most glaring regulatory gap of all involves offshore jurisdictions," Sen. Carl Levin (D-MI) said in a statement. "Offshore tax havens have declared economic war on honest U.S. taxpayers."

Behind the headlines, a group of nations - led by Norway, Germany, France, Spain, Brazil and Chile, in alliance with NGOs they partly fund - have quietly started a global campaign to crack down on tax havens. Like all governments nowadays, they are foraging for new tax revenues because of the global financial crash. But the reformer nations also want to direct more desperately needed aid funds to sub-Saharan Africa by trying to end some African leaders' theft of aid money, and diversion of it into offshore accounts. (The African Union says yearly capital flight from Africa is about \$148 billion; globally about \$1.6 trillion goes offshore each year.)

The anti-offshore countries such as France and Norway are pressing hard within the World Bank, the United Nations and other bodies for such reforms as automatic sharing of bank information among nations.

A possible turning point in the history of tax havens is anticipated at the upcoming London meeting of the G20 (a forum of the world's largest economies) in April. French and British leaders have said in recent days that in view of the world's financial crisis, they plan a coordinated campaign there to bring supervision to the unregulated financial markets that caused the credit crunch, as well as tax havens. French President Nicholas Sarkozy said earlier this month that "we want results" at the G20 on regulating tax havens, hedge funds and other opaque financial institutions. "The margin of negotiation is zero."

THE WORLD'S TAX HAVENS/SECRECY ZONES: HERE'S WH



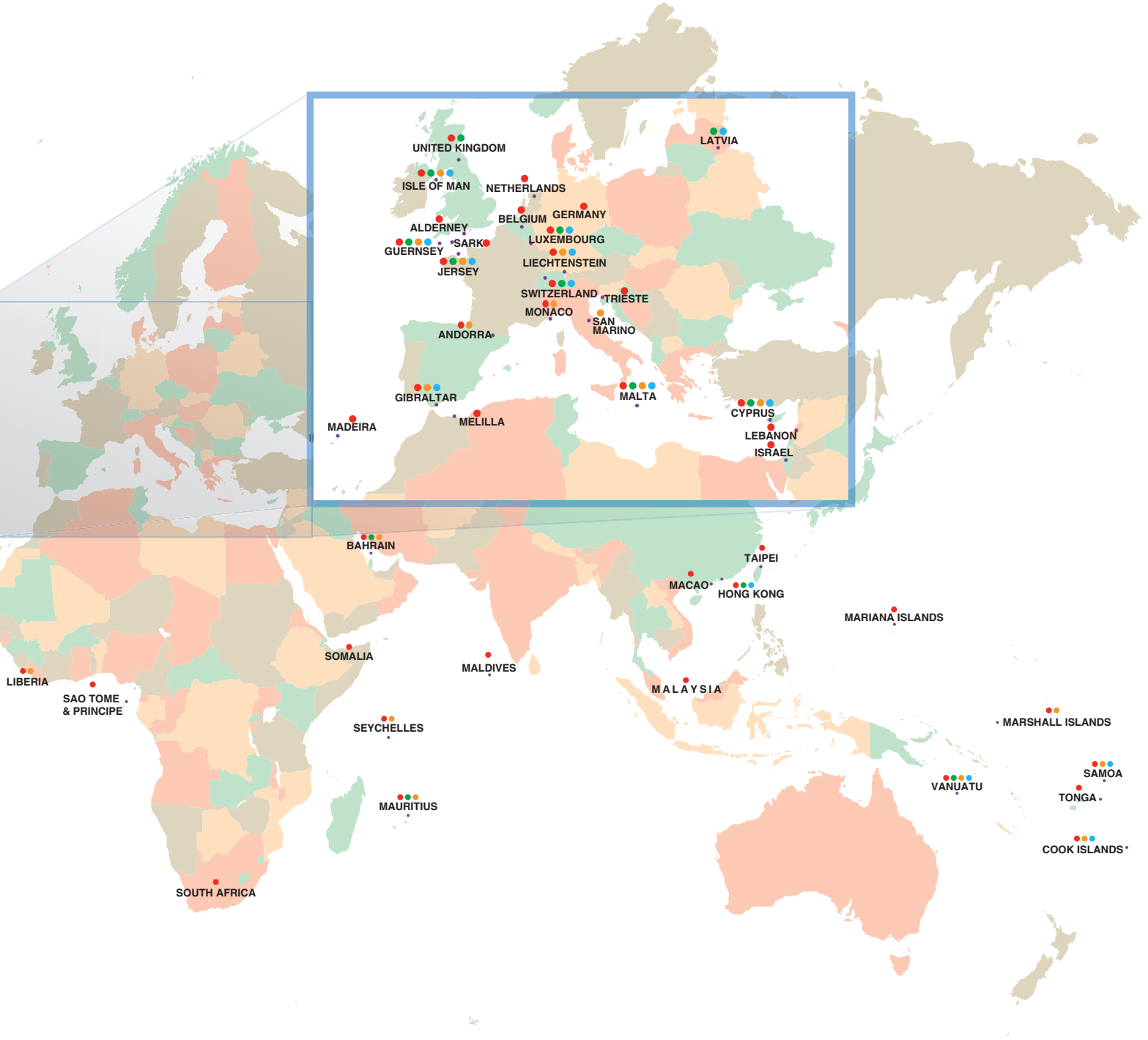
KEY

- Organization of Economic Cooperation and Development – Uncooperative tax havens and jurisdictions that have made “commitment” to openness, 2008.
- Internal Revenue Service/Justice Department – Tax havens and financial privacy jurisdictions with bank secrecy laws allowing account-holders to avoid disclosing income and assets subject to U.S. income tax.
- International Monetary Fund – Tax havens and financial privacy jurisdictions, 2007.
- Tax Justice Network (non-profit) – Tax havens and financial privacy jurisdictions, 2005.

British Prime Minister Gordon Brown wants the spotlight on Switzerland, where many Britons have squirreled their funds. But experts say he will face pressure to clean up offshore British territories such as Jersey, whose tax activities London has protected. In his February 6 statement, Sarkozy said France would review its dealings with neighboring havens such as Luxembourg and Monaco, which he quickly added “is not a tax haven” (but then went on to say Monaco should be “straightened out.”)

Congress is putting enormous pressure on the IRS to find new revenue to plug the U.S.’s ballooning deficits - U.S. Senate investigators estimate tax havens cause this country to lose \$100 billion yearly in taxes. At a Senate Finance Committee hearing last July, Sen. Kent Conrad (D-ND), a longtime IRS defender, lost his temper at a senior IRS official who he thought was giving vague testimony. “I don’t think the testimony you’ve given on offshore tax havens shows me you’re serious,” Conrad said. “People in the tax world tell me this problem is growing geometrically... My defense of you guys is over.”

ERE SCRUTINY WILL INCREASE



Washington lawyer Jack Blum, an offshore expert who represents whistleblower Kieber, said the IRS's whistleblower program, which recently hiked its rewards to informants from up to 15% of the government's recovery to up to 30%, will prompt more offshore industry employees to fill their own compact discs with their banks' secret data. "I think this will unleash an avalanche of information about hiding money offshore," he said.

And Obama is taking a hard line on the issue. His 2010 budget says new tax haven crackdowns, paired with tax hikes on companies' foreign

profits, will bring \$210 billion into the Treasury over 10 years. As a senator he co-sponsored a tough anti-tax haven bill that now is given a good shot at passage. During the presidential campaign, Obama described a Cayman Islands building housing 12,000 U.S. companies, adding, "that's either the biggest building in the world or the biggest tax scam in the world."

For years the Caymans and Switzerland have been favored for their offshore banking by the American and Middle Eastern wealthy. African officials prefer the British Virgin Islands, the Channel Islands, Monaco and

Switzerland. Russian oligarchs like Cyprus, Jersey and Switzerland.

In any case, tax haven accountants and lawyers tell clients who want their assets most deeply entombed in secrecy to “ladder” their accounts in successive tax havens. They advise the source of the funds (the “beneficial owner”) to set up a trust in the Caymans, say - under its law, the trust’s creator (or “settlor”) will not be identified publicly, because the trust’s documents are not filed publicly. These papers usually remain in the files of the “trustee,” often the accountant or lawyer. The Cayman trust might own a trust in the British Virgin Islands, controlled by a trustee-accountant there, and it owns a company in Switzerland - about which no information is available. The stupefying complexity and opacity is the whole point.

While many of the funds in offshore havens were placed there by criminals, drug dealers, terrorists and corrupt leaders, many corporations, completely legally, use offshore havens to reduce their taxes. In January the Government Accountability Office (GAO) released a report showing that 83 of the nation’s 100 biggest companies, including some that received taxpayer bailouts, have used offshore subsidiaries to reduce their taxes. Citigroup - which got \$25 billion in bailout money and \$300 billion more in guarantees - has 427 tax haven subsidiaries, including 91 in Luxembourg alone, the GAO said.



Helping add to the pressure for change is that a huge amount of the toxic mortgage-backed assets that infect the financial industry are parked in tax havens. Two Bear Stearns hedge funds that collapsed in 2007, helping spark the worldwide crash, were based in the Caymans. One reason for the failure of British bank Northern Rock was a shadowy affiliate, Granite, which was based on the island of Jersey, and held tens of billions in debt but no employees.

Suddenly humbled by the global crisis, some of the world’s most powerful governments now aim to change the longtime status quo on tax havens. French Prime Minister Francois Fillon said the G20 conference should be “an occasion to engage in a battle without mercy against tax havens, which are a hell for all the others.”

If the global rules are changing, then the world’s revenue agents, prosecutors, tax attorneys and due-diligence investigators had better prepare for a surge of new, interesting work. The information emerging from the vaults could be eye-opening.

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James Mintz Group, Inc.
32 Avenue of the Americas
21st Floor
New York, NY 10013