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From Multilateral to Unilateral Lines of Attack: The Sustainability of Offshore Tax Havens and Financial Centres in the International Legal Order

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Abstract

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INTRODUCTION

Many micro-states have an economic model that attracts global corporations and international financial activities, because plugging into the global economy is important for states that have small domestic economies. To attract businesses, micro-states often offer low business and corporation taxes or lax regulatory regimes to compete in the fiercely competitive global market. Therefore, micro-states are criticised as offering havens, engaging in harmful tax competition and leading a race to the bottom. Although international efforts—such as those led by the Organisation for Economic Co-Operation and Development ("OECD") and Financial Action Task Force ("FATF")—have secured some co-operation from such micro-states, the micro-states' position remains an uneasy one in the international legal order, as they engage in regulatory competition with onshore jurisdictions and with each other. Following the global financial crisis from 2007 to 2009, a slew of aggressive extra-territorial legislation in the area of taxation and finance has been introduced by a number of powerful jurisdictions to bring a new onslaught onto the micro-states' economic models. This article argues that the US, EU and UK are leading such a move from the traditional multilateral approaches to governing micro-states' role in regulatory competition to unilateral approaches that are more overtly antagonistic to micro-states' economic models in offshore tax and finance. This article examines why such a move has occurred, and the confluence of driving factors for such a move. This article also examines the key unilateral measures, i.e. the rise of automatic information reporting regimes such as the US FATCA, the more modest EU equivalent, the UK's new corporate reporting and tax enforcement regimes, and the EU's reforms in financial regulation. We also see a trend in these unilateral strategies giving rise to more coordinated multilateral adoption of such strategies.

Based on a consultancy project the author led in 2015, we have gained first-hand insights into policy-making in a micro-state which is facing the challenges described above. Micro-states offering the old models of tax and financial services are at the cusp of change. However, they have little choice but to continue to try and thrive in global economic competition. We provide some reflections on micro-states' continuing role in regulatory competition in the changing international legal order.

I. THE ECONOMIC MODEL OF MICRO-STATES

Many micro-states are run on an economic model that encourages the migration of legal structures (whether or not associated with real productive activity) and financial flows in the competitive global economic landscape. Business vehicles, corporate structures and financial flows are attracted to micro-states as they are usually tax havens and/or offshore financial centres that protect bank secrecy and offer legal and regulatory regimes that are friendly for financial transactions. [1] Often, tax havens and offshore financial

1. *Reader in Laws, University College London. This article is a part of a consultancy project UCL undertook for a micro-state jurisdiction in May-November 2015. The author thanks colleagues Anna Donovan and Martin Petrin for reading an earlier draft and providing comments, all errors are mine.

Offshore financial centres ("OFCs") can be classified into three groups: functional, compound, and national. A functional OFC can be defined as being where financial activities

centres go hand-in-hand as tax benefits often drive the structuring of business vehicles and transactions. The OECD[2] defines a tax haven as a jurisdiction where:

> (a) There are no or only nominal taxes (and offering, or being perceived as offering, a place for non-residents to escape tax in their country of residence);
> There is a lack of transparency (such as the absence of beneficial ownership information and bank secrecy);
> (b) There is unwillingness to exchange information with the tax administrations of OECD member countries; and
> and there is absence of a requirement that activity be substantial (transactions may be "booked" in the country with no or little real economic activity).
> International reforms since the early 1990s have changed the phenomenon in (c) somewhat as the OECD's blacklist of uncooperative tax havens has forced a number of jurisdictions to sign a sufficient number[3] of bilateral information exchange treaties with other non-haven countries in order to be elevated from the blacklist to the grey or white lists.[4]

Micro-states may find it attractive to run an economic model based on the tax haven and/or offshore financial centre as many of them are resource-scarce and would not be competitive in global international trade.[5] Further, many of them were part of old colonial empires, such as the Channel Islands, British Virgin Islands, etc., and already benefit from institutional and legal infrastructure inherited from the former motherland that could be used to serve the needs of multinational corporations and internationally mobile capital.[6] The former British dependencies and territories have inherited a common law system that is friendly to the creation of beneficial ownership structures to protect money and assets.[7] This has allowed such jurisdictions to further

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actually take place, where full branches of banks, plus other financial services such as fund management, trust companies etc. are sited. Functional OFCs employ a significant proportion of local labour. Compound OFCs host a mixture of functional and notional activities. This category includes centres (eg. The Bahamas) that have an increasing number of shell offices that eventually become fully operational branches. Such OFCs employ a smaller proportion of the local labour force than functional OFCs (3-10 %) and contribute an estimated 10-24 % of GDP. Notional OFC are where 'shell' or brass plate offices of banks make book entries of financial transactions. However, their employment and GDP data is fragmented and incomplete. See Mark P. Hampton, Creating Spaces. The Political Economy of Island Offshore Finance Centres: The Case of Jersey, 84 Geographische Zeitschrift 103 (1996); Godfrey Baldacchino, Bursting the Bubble: The Pseudo-Development Strategies of Micro-states, 24 Development and Change 29, 29-51 (1993).

2. Org. For Econ. Co-operation and Dev., Harmful Tax Competition: An Emerging Global Issue (Feb. 19, 2016, 3:29 PM), http://www.oecd.org/tax/transparency/44430243.pdf.

3. At least 12.

4. Discussed shortly in Section B.

5. Mark P. Hampton & John Christensen, Offshore Pariahs? Small Island Economies, Tax Havens, and the Re-configuration of Global Finance, 30 WORLD DEV. 1657 (2002); Georges A. Cavalier, Redesigning Heaven: Tax Haven Reform in the Netherlands Antilles, 38 TAX NOTES INT'L 1009 (2005); Dhammika Dharmapala & James R. Hines Jr., Which Countries Become Tax Havens? 93 J. PUB. ECON. 1058 (2009).

6. Mihir A. Desai et al., The Demand for Tax Haven Operations, 90 J. PUB. ECON. 513 (2006).

7. Mark P. Hampton & Michael Levi, Fast Spinning into Oblivion? Recent Developments in Money-Laundering Policies and Offshore Finance Centres, 20 THIRD WORLD Q. 645 (1999)

innovate and develop trust and corporate structures that help multinational corporations and wealthy individuals in their tax and financial planning. Further, the relatively small populations of micro-states place less public spending demands on governments. The relatively light fiscal burdens in these micro-states therefore allow such governments to put in place low-tax fiscal policies that are outwardly attractive to foreign corporations and fund flows, and yet not compromise domestic economic needs.[8] In the post-colonial re-ordering of state sovereignty, Palan[9] observes that although micro-states have gained new found sovereignty from colonial shackles, they are placed on an unequal playing field in the global economy, and hence they have sought comparative advantage by developing economic models that plug into the growth of internationally mobile capital and finance. Looked at in those terms, there has been little choice for micro-states in developing viable economic models to survive in the global economy.[10]

Micro-states may be regarded as being engaged in international regulatory competition for international business and finance. They introduce regulatory and tax standards that attract international business and finance, creating incentives for their migration from onshore to offshore jurisdictions. They are highly responsive in introducing policy measures to attract inflows or stem outflows.[11] As micro-states usually have small populations and light fiscal needs, they enjoy advantages in being able to quickly and responsively calibrate their policies to cater to international business needs. This may be perceived by onshore jurisdictions as an "unfair" form of competition, usually towards laxity in standards.[12] On the other hand, regulatory competition can be supported as it is key to fostering regulatory innovations,[13] achieving optimal and efficient rules[14] and preventing monopolistic domination over rule-making by inefficient constituents.[15] Regulatory competition is an important paradigm

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(discussing how former colonial status has helped former British territories- the ties with the previous motherland and inheritance of a commercially friendly common law system). However, note Shaxson's damaging journalistic account of how previous colonial powers continue to use their former territories in shady financial dealings, in order for onshore institutions to appear disengaged. NICHOLAS SHAXSON, TREASURE ISLANDS: TAX HAVENS AND THE MEN WHO STOLE THE WORLD (London Vintage 2012).

8. Dharmapala & Hines, supra note 5, at 1058.

9. Ronen Palan, Tax Havens and the Commercialization of State Sovereignty, 56 INT'L ORG. 151 (2002).

10. Cavalier, supra note 5, at 1009.

11. Roberta Romano, Is Regulatory Competition a Problem or Irrelevant for Corporate Governance? 21 OXFORD REV. ECON. POL'Y 212 (2005) [hereinafter Regulatory Competition].

12. DALE D. MURPHY, THE STRUCTURE OF REGULATORY COMPETITION: CORPORATIONS AND PUBLIC POLICIES IN A GLOBAL ECONOMY (2004).

13. Roberta Romano, The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters, 23 YALE J. ON REG. 209 (2006) [hereinafter The States as a Laboratory]; ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993) [hereinafter AMERICAN CORPORATE LAW].

14. Regulatory Competition, supra note 11; The States as a Laboratory, supra note 13. But see Henri Tjiong, Breaking the Spell of Regulatory Competition: Reframing the Problem of Regulatory Exit, 66 RABEL J. COMP. & INT'L PRIVATE L. 66; Franklin A. Gevurtz, The Globalization of Corporate Law: The End of History or a Never-Ending Story? 86 WASH. L. REV. 475 (2011); Marcel Kahan & Ehud Kamar, The Myth of State Competition in Corporate Law, 55 STAN. L. REV. 679 (2002).

15. William J. Carney, The Political Economy of Competition for Corporate Charters, 26 J. LEGAL STUD. 303 (1977).

in which to study the phenomena of race to the top[16] or bottom,[17] or a race to converge.[18]

Further, it could be argued that micro-states are not engaged in regulatory competition as such because they differentiate themselves from onshore jurisdictions and other micro-states in the provision of niche services. These jurisdictions are not always responding to the same constituents,[19] and they are not pitting themselves against each other on the same terms.[20] On balance, micro-states are engaged in both competition and differentiation. Many of them do engage in economic modelling that intends to attract highly mobile international constituents such as international investment capital,[21] and multinational corporations, and such models revolve around common attributes such as tax, corporate and financial regulation and bank secrecy. But there is also a place for economic modelling to cater to other forms of businesses that may be less mobile and likely "stick" to the most suitable jurisdiction when found;[22] for example, registration jurisdictions for ships, that have concentrated in the Faroe Islands. Murphy[23] argues that much of the state-private sector relationship in the modern international economy revolves around both competition and differentiation, and different factors would affect the trajectories of such relationships. Hence, one may see competition for high standards in one area, competition for laxity in another area, convergence in yet another area and heterogeneity or differentiation as well.

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16. The States as a Laboratory, supra note 13; AMERICAN CORPORATE LAW, supra note 13; John C. Coffee, Jr., The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications, 93 N.W. U. L. REV. 641 (1998).

17. Although when certain demand pressures are strong, jurisdictions could be subject to their capture and fashion friendly rules, see Lucian A. Bebchuk & Allen Ferrell, On Takeover Law and Regulatory Competition, 57 BUS. LAW. 1047 (2001) (discussing the prevalence of anti-takeover statutes as a result of American state competition for charters); Luca Enriques & Martin Gelter, How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law, 81 TUL. L. REV. 577 (2006) (discussing bankruptcy forum shopping in the EU induced by different insolvency rules in Member States).

18. Claudio M. Radaelli, The Puzzle of Regulatory Competition, 24 J. PUB. POL'Y 1 (2004); Simon Deakin, Legal Diversity and Regulatory Competition: Which Model for Europe, 12 EUR. L. J. 440 (2006).

19. Horst Eidenmüller, The Transnational Law Market, Regulatory Competition, and Transnational Corporations, 18 IND. J. GLOBAL LEGAL STUD. 707 (2011); Gevurtz, supra note 14 (arguing that jurisdictions respond to different relevant stakeholder groups and contextual needs such as busts or scandals); Tjiong, supra note 14 (arguing that political choices underlie many jurisdictions' decisions in modeling themselves to provide services to international business).

20. This is because jurisdictions do not merely engage in 'one-issue' competition eg tax, and offer bundled services and a holistic context for doing business, differentiating themselves from each other. see Radaelli, supra note 18; Chris Brummer, Corporate Law Preemption in an Age of Global Capital Markets, 81 S. CAL. L. REV. 1067 (2007); Sebastian Mock, Review Essay, Perspectives of Regulatory Competition in European Company Law, 6 GER. L.J. 771 (2005).

21. Several commentators are of the view that jurisdictions for incorporations will become more sensitive to the needs of highly mobile investment capital that global business wishes to attract. Hence, competition in securities regulation will become more heightened. See William W. Bratton & Joseph A. McCahery, The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World, 86 GEO. L.J. 201 (1997); Ehud Kamar, Beyond Competition for Incorporations, 94 GEO L.J. 1725 (2005); Brummer, supra note 20.

22. Marco Ventoruzzo, "Cost-Based" and "Rule-Based" Regulatory Competition: Markets for Corporate Charters in the U.S. and in the E.U., 3 N.Y.U. J.L. & BUS. 91 (2006); J. Samuel Barkin, Racing All Over the Place: A Dispersion Model of International Regulatory Competition, 2 EUR. J. INT'L REL. 171 (2014) (arguing that jurisdictions will then fashion their regulatory standards for retention of such business).

23. MURPHY, supra note 12.

Many micro-states have focused on regulatory competition in tax in order to attract international financial flows and corporations. The low tax strategy has caused ire in the international community as critics regard the tax haven economic model as providing harmful tax arbitrage and competition.[24] A catalogue of behaviour by multinational corporations that use tax havens could adversely affect the level of tax revenues that home countries of such corporations can collect. For example, multinational corporations use tax havens to keep foreign income so that tax paid to the home country will be minimized.[25] Governments of mobile multinational corporations are forced to keep taxes sub-optimally low so that the wholesale migration of such corporations would be prevented.[26] In either case, the home country suffers a reduction in tax revenues and hence is able to spend less on public welfare, decreasing welfare levels overall in the home country. This view would place tax haven jurisdictions in the negative light of being parasitic economies and 'stealing' from non-haven jurisdictions.[27] However such behaviour is usually structured in a way that is nevertheless legal, and Sharman is of the view that micro-states therefore peddle a form of "calculated ambiguity"[28] to further arbitrage behaviour by multinational corporations. Such calculated ambiguity is made possible as it is backed by the sovereignty of the micro-state and its legal independence, However, the micro-state commercializes its sovereignty and legal independence in order serve the needs of international finance and multinational corporations. This could also result in a race to the bottom in terms of governance standards, a competition in laxity.[29]

Further, micro-states often institute bank secrecy laws that complement the tax haven/offshore financial centre economic models. Bank secrecy is highly desirable to users of tax havens or offshore financial centres as privacy in individual financial affairs or in corporate structuring is often valued even if legality is not in question. Bank secrecy regimes, however, may be perceived as reinforcing the economic injustice to non-haven jurisdictions, as these regimes limit information transparency,[30] even under bilateral exchange treaties,[31] and could create obstacles to regulatory investigations and enforcement. Tax authorities in home country jurisdictions face an uphill task and significant enforcement cost if they desire to recoup revenues lost to tax havens through tax evasion. Bank secrecy provides a pocket of localization and

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24. Harmful Tax Competition, supra note 2.

25. David W. Conklin & Darroch A. Robertson, Tax Havens: Investment Distortions and Policy Options, 25 CAN. PUB. POL'Y 333 (1999).

26. Joel Slemrod & John D. Wilson, Tax Competition With Parasitic Tax Havens, 93 J. PUB. ECON. 1261 (2009).

27. Id. at 1262.

28. Jason Sharman, Offshore and the New International Political Economy, 17 REV. OF INT'L POL. ECON. 1, 2-12 (2010).

29. Murphy, supra note 12 (opining that indeed in some areas, offshore regulatory competition has resulted in a race to the bottom, such as in offshore finance. However some would disagree). See, e.g., Rose-Marie Belle Antoine, The Legitimacy of the Offshore Financial Sector: A Legal Perspective, in OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION 31-32 (Andrew P. Morriss ed., 2010).

30. Clemens Fuest, Tax Havens: Shady Deals, WORLD TODAY, July 2011, at 17; Timothy V. Addison, Shooting Blanks: The War on Tax Havens, 16 IND. J. GLOBAL LEGAL STUD. 703, 710-11, 718 (2009); Guttorm Schjelderup, Secrecy Jurisdictions, 23 INT'L TAX & PUB. FIN. 168, 169-172 (2016).

31. John Christensen, The Hidden Trillions: Secrecy, Corruption, and the Offshore Interface, 57 CRIME, L. & SOC. CHANGE 325, 327-28 (2012); Addison, supra note 30, at 717-19.

shelter in an internationally connected global economy,[32] keeping key information opaque from enforcement authorities. Moreover it may assist in more nefarious behaviour that may involve illegality on the part of corporations and individuals, corruption involving politicians, especially of emerging economies, and increasingly terrorist financing for rogue organizations. Commentators have pointed out the complementarity of bank secrecy regimes[33] for money-laundering activities, and for the sheltering of ill-gotten gains such as bribes accumulated by corrupt politicians and government officials in emerging economies. To a certain extent, the existence of bank secrecy regimes that harbour corrupt politicians' and officials' ill-gotten gains also facilitate revenue drain from the development needs of emerging economies,[34] entrenching them in an abject state of institutional underdevelopment[35] and social poverty, even if they are resource rich.

In defence, commentators on the point of tax competition argue that tax havens provide a necessary competitive force that entail beneficial effects for home countries despite the loss in tax revenues. Such beneficial effects include the generation of financial and legal innovations,[36] the development of more competitive tax regimes[37] and banking sectors,[38] and the general upgrading of regulatory standards. These arguments are contrary to the theorists who argue that regulatory competition led by tax havens results in a race to the bottom.[39] Further, the tax haven should be regarded as part of the larger context for productive activity. It is opined that foreign investment into neighbouring countries of tax havens increase because of the existence of the tax haven which provides tax planning and financial services support for the economic activities in the region.[40] Some empirical research found that foreign investment flows into non-haven jurisdictions located within geographical proximity of the tax haven increase as a result of use of the tax haven.[41] Commentators in defence of the economic model of micro-states have however found that these micro-states do not lead a race to the bottom in regulatory

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32. S. Corkill Cobb, Global Finance and the Growth of Offshore Financial Centers: The Manx Experience, 29 GEOFORUM 7 (1998).

33. Jack A. Blum, Michael Levi, R. Thomas Nayior & Phil Williams, Financial Havens, Banking Secrecy and Money Laundering, CRIME PREVENTION & CRIM. JUST. NEWSL., May 1998, as summarized in TRENDS ORGANIZED CRIME, June 1999, at 69-70; Peter Schwarz, Money Launderers and Tax Havens: Two Sides of the Same Coin?, 31 INT'L REV. L. & ECON. 37, 43 (2011).

34. Shafik Hebous & Vilen Lipatov, A Journey from a Corruption Port to a Tax Haven (CESifo, Working Paper No. 3620, 2011); Addison, supra note 30, at 707-08.

35. William Vlcek, The Global Pursuit of Tax Revenue: Would Tax Haven Reform Equal Increased Tax Revenues in Developing States?, 27 GLOBAL SOC'Y 201, 203-05 (2013).

36. Antoine, supra note 29.

37. Dhammika Dharmapala, What Problems and Opportunities are Created by Tax Havens?, 24 OXFORD REV. ECON. POL'Y 661, 671-72 (2008).

38. Andrew K. Rose & Mark M. Spiegel, Offshore Financial Centres: Parasites or Symbionts?,, 117 ECON. J. 1310, 1325-31 (2007); Hebous & Lipatov, supra note 34; Anna Manasco Dionne & Jonathan R Macey, Offshore Finance and Onshore Markets: Racing to the Bottom, or Moving Toward Efficient? in OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION 8 (Andrew P. Morriss ed., 2010).

39. Dionne & Macey, supra note 38; Craig M. Boise, Regulating Tax Competition in Offshore Financial Centers in OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION 50 (Andrew P. Morriss ed., 2010).

40. James R Hines, Jr., Do Tax Havens Flourish? (Nat'l Bureau of Econ. Research, Working Paper No. 10936, 2004); James R. Hines, Jr. & Eric M. Rice, Fiscal Paradise: Foreign Tax Havens and American Business, 109 Q.J. ECON. 149, 154-55 (1994).

41. Dharmapala, supra note 37, at 671.

standards. Micro-states need to defend the reputation of their jurisdiction as a credible jurisdiction for corporations and financial structuring, and they generally institute sound regulation and good political and administrative governance. In particular, although they support financial innovation, they are not welcoming to illegal activities such as money-laundering.[42] The emphasis placed on reputational branding by micro-state policy-makers have helped secure many of their economic models from being savaged by the international community in light of the post- 9/11 expansion in international anti-money laundering standard-setting.[43] Only the less reputable micro-states tend to be a hub for such nefarious activities.[44] Moreover a commentator[45] points out that money laundering is a systemic underground operation that spans the globe, and both onshore and offshore jurisdictions are used by determined launderers. It is therefore not accurate to assert that micro-states are primarily connected to such operations. Many micro-states indeed institute anti-money laundering regulations consistent with international standards.[46]

Although micro-states institute bank secrecy regimes, such regimes should not be condemned as necessarily hiding nefarious activities. Bank secrecy can be regarded as a means to protect individual rights and privacy where those may be under threat. For example, bank secrecy can be used to protect the assets of entrepreneurs of oppressive regimes whose assets may otherwise be expropriated by corrupt and powerful politicians and bureaucrats.[47] In sum, although micro-states compete with onshore jurisdictions and have the potential to undermine their fiscal policies, they provide regional economic benefits, are not necessarily in a race to the bottom in terms of regulatory standards and do not necessarily shelter nefarious activities such as money laundering and terrorist financing.

II. FROM MULTILATERAL APPROACHES TO UNILATERAL APPROACHES AGAINST THE ECONOMIC MODELS OF MICRO-STATES

It may be argued that many micro-states operate economic models that sit uneasily at the borderline of regulatory competition and simply regulatory

42. Dharmapala & Hines, supra note 5, at 1061; Andrew. P Morriss & Clifford C. Henson, Regulatory Effectiveness in Onshore & Offshore Financial Centers, 4-8, 14, 32 (The Univ. of Ala. Sch. of Law, Working Paper, 2012) http://ssrn.com/abstract=2016310).

43. J. C. SHARMAN, HAVENS IN A STORM: THE STRUGGLE FOR GLOBAL TAX REGULATION 107 (2006).

44. Schwarz, supra note 33, at 39.

45. JACK A. BLUM ET. AL., U.N. OFFICE FOR DRUG CONTROL AND CRIME PREVENTION, FINANCIAL HAVENS, BANKING SECRECY, AND MONEY LAUNDERING (1998), reprinted in TRENDS IN THE GLOBAL DRUG TRADE Dec. 1998, at 121.

46. For example, the Channel Islands, former UK Commonwealth countries all have in place anti-money laundering laws, derived from the international standards forged by the Financial Action Task Force since 1990. See FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING: REPORT (1990), http://www.fatf-gafi.org/media/fatf/documents/reports/1990%20ENG.pdf. The US remains able to enforce anti-money laundering laws against US Commonwealth jurisdictions such as some of the Pacific Islands, e.g. fine against a North Mariana Islands casino operator in July 2015. See also Previous Symposia, THE CAMBRIDGE INT'L SYMPOSIUM ON ECON. CRIME, http://www.crimesymposium.org/prev.html (last visited Feb. 14, 2016)(discussing the risks of managing money laundering in onshore and offshore jurisdictions in the annual Jesus College Cambridge Financial Crime Symposium which has been instituted by Professor Barry Rider since 2000).

47. Andrew Morriss, The Role of Offshore Financial Centers in Regulatory Competition, 70 (Ill. Law & Econ. Research Paper Series, Research Paper No. LE07-032), http://papers.ssrn.com/pape.tar?abstract_id=1275390.

arbitrage in tax. This 'calculated ambiguity'[48] has been criticised at the international level. Issues of unfair tax competition have been addressed by the OECD, as the cohort of onshore jurisdictions led by the OECD has since the early 1990s developed mechanisms of multilateral engagement with micro-states.

The OECD's blacklisting approach is an early multilateral approach in attempting to extend international governance to micro-states to mitigate unfair tax competition is the OECD's blacklisting approach. The OECD has since 1998 maintained a list of Uncooperative Tax Havens. This list names and shames jurisdictions that do not have in place bilateral arrangements with other tax authorities to cooperate and assist in tax enforcement. However, even with such bilateral treaties in place, tax havens would only be obliged to supply information under well-constructed data protection regimes, if the requesting jurisdiction provides very specific identification information. However, bilateral information exchange has not worked well in practice, as it is up to onshore tax authorities to discover potential enforcement targets and then seek help from micro-state jurisdictions. Micro-states do not offer this information as they adhere to their bank secrecy regimes.[49] Nevertheless, by signing up to bilateral treaties, micro-state jurisdictions that maintain tax advantages are entitled to be removed from the blacklist. By 2009, all remaining countries on the blacklist have been removed. A number of commentators argue that the blacklist has been an ineffective means of governing unfair tax competition in the international legal order, as it provides a box-ticking means of compliance which ultimately does not challenge micro-states' economic models. [50]

It can be argued that multilateral measures such as carried out under the auspices of the OECD are ineffective as micro-states would only do what is minimal and cosmetic in order to appear diplomatic. However, there is a limit to what multilateral approaches can achieve. Multilateral approaches are negotiated, and are framed in a proportionate manner so that relatively developed and wealthy OECD countries are not seen as unfairly persecuting or bullying essentially defenceless micro-states. Sharman[51] discusses how the OECD's efforts have largely become rhetorical and restrained, leading to a tacit compromise not to severely damage micro-states' economic model as long as more cooperation can be secured. Many micro-states such as the Channel Islands, and island states that are part of the British Commonwealth nevertheless take care to adhere to international regulatory standards such as in anti-money laundering and financial regulation in order not to engage in egregious behaviour that may attract unwanted attention to themselves.

The OECD has also developed a multilateral Model Tax Convention[52] since 1993 that seeks to ensure that onshore jurisdictions have the right to tax relevant income that may be made or paid by an offshore entity subject to double taxation arrangements, and that all states should assist each other in

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48. Sharman, supra note 28, at 2.

49. Niels Johannesen & Gabriel Zucman, The End of Bank Secrecy? An Evaluation of the G20 Tax Haven Crackdown, 6 AMERICAN ECON. J.: ECON. POL'Y 65, 68-69 (2014).

50. Robert Thomas Kudrle, Did Blacklisting Hurt the Tax Havens? 12 J. MONEY LAUNDERING CONTROL 33, 45 (2009); Addison, supra note 30, at 714-16.

51. See Sharman, supra note 43, at 49-100.

52. See OECD Model Tax Convention on Income and on Capital: An Overview of Available Products, ORG. FOR ECON. CO-OPERATION & DEV. http://www.oecd.org/ctp/treaties/oecd-model-tax-convention-available-products.htm (last visited Feb. 18, 2016).

exchange of information and revenue collection. The Convention has been adopted by many jurisdictions but not by many micro-states offering offshore tax and financial centres.[53]

Since the global financial crisis of 2007-9, there has been a marked change in the international legal order. In particular, we observe that there is a move away from multilateral mechanisms to engage micro-states, to unilateral mechanisms introduced in individual and powerful onshore jurisdictions. Instead of negotiating with micro-states for more transparency and cooperation at the multilateral level, onshore jurisdictions could enact and enforce national legislation with powerful extra-territorial effects. The US's Foreign Accounts Tax Compliance Act (FATCA) and the slightly more restrained European equivalent in the Savings Directive[54] introduce transparency requirements that have the potential to completely undermine micro-states' bank secrecy regimes. In the UK, the Finance Act 2016 introduces a package of measures to combat tax evasion and aggressive tax planning. The Act provides for mandatory reporting with an international reach in relation to tax planning. Such requirements, as will be discussed below, amount to a form of organisational and behavioural regulation of multinational corporations whose headquarters are in the UK. The Act also provides for robust administrative, civil and criminal sanctions to combat undesirable tax behaviour in 'large businesses'.[55] Finally, the EU has enacted new financial regulation reforms which make it less attractive for international business and finance to use offshore financial centres. These measures have far more potency than multilateral measures discussed earlier as they affect the incentives of global corporations and finance and force them to make choices that may marginalise the use of offshore tax and financial centres. Further, these measures are subject to national enforcement, which may more effectively achieve onshore jurisdictions' purposes than relying on the international order of multilateral negotiations between states.

We now turn to examine why the change from multilateral to unilateral approaches has taken place in the international legal order. We argue below that changes in the political economy of finance is the principal driving factor, and this represents a turning point in the international governance framework for micro-states' tax and financial competition models.

A. Driving Factors for Unilateral Approaches against Micro-states- Changes in the Political Economy of Finance and Post-Global Financial Crisis Reforms

The global financial crisis 2007-9 is a turning point for the continued sustainability of micro-states' economic models not because the crisis is directly attributed to their economic models, but rather, because the crisis brought about changes in international policy perspectives and the power

53. The current signatories (end 2015) to the Convention are: Albania, Argentina, Australia, Austria, Belgium, Belize, Brazil, Canada, Colombia, Costa Rica, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Ghana, Greece, Guatemala, Iceland, India, Indonesia, Ireland, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Malta, Mexico, Moldova, Morocco, Netherlands, New Zealand, Nigeria, Norway, Poland, Portugal, Romania, Russian Federation, Saudi Arabia, Singapore, Slovenia, South Africa, Spain, Sweden, Tunisia, Turkey, Ukraine, United Kingdom, and United States of America.

54. Council Directive 2011/16, 2011 O.J. (L 64)(EU).

55. HM TREASURY, DRAFT CLAUSES & EXPLANATORY NOTES FOR FINANCE BILL 2016, 2015, ¶ 65 (UK).

balance between state and private actors in the realm of finance. In particular, onshore jurisdictions with developed financial markets that used to co-exist with offshore tax and financial centres have introduced more antagonistic measures to combat old issues, and also exploring new faultlines.

We argue that the unilateral measures introduced by the US, EU and UK are driven by three broad contexts that have reshaped the political economy of finance. First, the international financial sector, a powerful lobby that supports the offshore tax and financial centre models of micro-states have been humbled to a significant extent in the wake of the global financial crisis. This change in power balance between state and private actors has opened up an opportunity for more aggressive policy measures to be introduced in many national jurisdictions, to combat old issues that have been resistant to progress. Second, the US, many EU jurisdictions and the UK have experienced severe fiscal stresses due to the unprecedented use of taxpayers' money to bail out failed financial institutions. These new fiscal demands have resulted in austerity policies in these jurisdictions, entailing issues of tax justice to be brought back into sharp focus. Finally, the rise of rogue states such as the Islamic State in the Middle East, terrorism in Western jurisdictions, and conflict financing in various regions of conflict have given rise to questions regarding international governance of financial flows, and in particular have provided strong rationale for Western jurisdictions affected by extreme Islamist terrorism to take a wide range of regulatory measures to protect themselves.

Taking the first broad context, the balance of power between the international financial sector and national (and international) policy makers has changed in the wake of the global financial crisis. This paradigmatic shift has occurred as the failure of a number of global financial institutions in the crisis has humbled the financial sector, and policy-makers' faith in the self-governance of the financial sector has waned. The power of the international financial sector is arguably important for sustaining micro-states' economic models. These models are friendly for transactional purposes in international finance,[56] and it may be conceived that these models continued to flourish in the pre-crisis era despite the discontented critique of the OECD and many non-haven jurisdictions precisely because the lobbying power of the international financial sector has prevented harsher international measures against them.[57] As the crisis has led to the re-adjustment of power balance between the international financial sector and policy-makers in national and international outfits, micro-states may be less able to count on powerful support from the international financial sector against calls for reform.

As the crisis has been analysed and discussed extensively in previous literature,[58] this article will not belabour the narrative of the crisis further except to remind of the fact that the crisis, though termed as 'global', affected most acutely the US, several European jurisdictions and the UK, where significant banks failed or teetered on the brink of failure. Government intervention was needed in the case of Bear Stearns, Merrill Lynch and

56. Hampton & Christensen, supra note 5, at 1653-57; Palan, supra note 9.

57. Although Sharman argues that corporate lobbying power was not as significant as the moral rhetoric relating to protecting havens from bullying and the economic rhetoric relating to competition which havens championed. See Sharman, supra note 43, at 64.

58. E.g., HOWARD DAVIES, THE FINANCIAL CRISIS: WHO IS TO BLAME? (2009); Adair Turner, The Turner Review: A Regulatory Response to the Global Banking Crisis, FIN. SERV. AUTH. (Mar. 2009), http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

Washington Mutual in the US, although Lehman Brothers was allowed to fail. In the EU, government intervention took place in relation to Fortis and Dexia, and in relation to the Halifax Bank of Scotland in the UK. Government bailout occurred in the US in relation to the American Insurance Group, and in the EU, for UBS, Rabobank and HypoReal Estate, while the Royal Bank of Scotland and Northern Rock were rescued in the UK.

The humbling of the financial sector in this episode paved the way for much financial regulation reforms to be introduced in the US, EU and UK, reforms that would likely have been resisted in the good times. Although the crisis has led to a general overhaul of international regulatory standards such as led by the Basel Committee,[59] the US, EU and UK have overhauled their regimes by the greatest extent, implementing internationally harmonised standards in prudential regulation[60] but also taking the opportunity to reform conduct of business regulation, corporate and tax regulation.[61]

The powerful international financial sector has played a large part in advancing self-regulatory governance, setting standards[62] and influencing government policies.[63] Pre-crisis, much of financial sector innovation was possible in a largely de-regulated and self-governing landscape, and financial innovation was intimately connected with use of offshore tax and financial centres.[64] Much financial innovation and complexity is made possible by the use of offshore business vehicle or fund structures and offshore financial services, as favourable tax treatments reduce cost for investors. The crisis has gravely damaged policy-makers' trust in the sophisticated and de-regulated

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59. BASEL COMM. ON BANKING SUPERVISION, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS (2011), http://www.bis.org/publ/bcbs189.pdf.

60. Microprudential regulation was strengthened by the Basel Committee and in the EU and remains an ongoing process, see MADS ANDENAS & IRIS H-Y CHIU, THE FOUNDATIONS AND FUTURE OF FINANCIAL REGULATION: GOVERNANCE FOR RESPONSIBILITY 332-56 (2014) and citations therein for Basel Committee documents, EU policy papers and legislation, including the Capital Requirements Directive and Regulation 2014. Reforms are also brought in in terms of crisis management and resolution, see Council Directive 2014/59, 2014 O.J. (L 173) (EU). The book above generally deals with different aspects of financial regulation reforms that have been introduced in the wake of the crisis to strengthen prudential, conduct and risk regulation.

61. Key aspects of which that affect offshore tax and financial centres will be discussed in Section C.

62. Geoffrey R.D. Underhill, Markets beyond Politics? The State and the Internationalisation of Financial Markets, 19 EUR. J. POL. RES. 197, 215-21 (1991); Geoffery R.D. Underhill, Theorizing Governance in a Global Financial System, in THE POLITICAL ECONOMY OF FINANCIAL MARKET REGULATION: THE DYNAMICS OF INCLUSION AND EXCLUSION 3-33 (Peter Mooslechner, Helene Schuberth & Beat Weber eds., 2006; Geoffrey R.D. Underhill & Xiaoke Zhang, Norms, Legitimacy, and Global Financial Governance, 32-34 (World Econ. & Fin. Research Programme, WEF 0013, 2006), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=941389; Sol Picciotto & Jason Haines, Regulating Global Financial Markets, 26 J.L. & SOC'Y 351, 365-67 (1999); Caroline Bradley, Private International Law-Making for the Financial Markets, 29 FORDHAM INT'L L.J. 127, 133-54 (2005).

63. Simon Deakin, The Rise Of Finance: What Is It, What Is Driving It, What Might Stop It? A Comment on "Finance and Labor: Perspectives on Risk, Inequality, and Democracy" by Sanford Jacoby, 30 COMP. LAB. L. & POL'Y J. 67 (2008) (for example the abolition of the US Glass-Steagall Act which then allowed the growth of financial conglomerates in the US and beyond); SUZANNE MCGEE, CHASING GOLDMAN SACHS: HOW THE MASTERS OF THE UNIVERSE MELTED WALL STREET DOWN…AND WHY THEY'LL TAKE US TO THE BRINK AGAIN (2010).

64. Ronen Palan & Anastasia Nesvetailova, The Governance of the Black Holes of the World Economy: Shadow Banking and Offshore Finance (City Political Econ. Research Ctr., CITYPERC Working Paper No. 2013/03), http://ssrn.com/abstract=2216795.

international financial sector.[65] Financial innovations and complexity introduced by the lightly regulated financial sector have not achieved optimal distribution of risk[66] but have in fact lulled all into a false sense of security which could not be sustained. [67] The post-crisis scepticism of the utility of much financial innovation[68] and complexity[69] would cast micro-states that facilitate such structuring in less positive light. Further, financial scandals that have involved the use of tax haven or offshore financial structures also cause reputational backlashes for certain micro-states. For example, the ponzi scheme run by Allen Stanford that involved using Antiguan offshore financial vehicles has resulted in a reputational backlash against Antigua.[70] The use of offshore vehicles to hide losses by Enron in order to mislead investors through deceptive financial reporting was also an episode that cast micro-states' economic models in negative light.[71] Financial regulation reforms are now introduced to affect choices that are made in respect of the use of offshore jurisdictions in financial structuring, which we will shortly discuss in greater detail.

Second, bank bailouts have put enormous fiscal pressures on the above mentioned national governments[72] and have now caused them to turn to the potential of recouping tax revenues lost to tax havens.[73] Hence, the US, EU and UK have introduced unilateral regimes that form different lines of attack against the offshore tax haven model. The biggest major step taken by the US is the controversial American regime, the Foreign Account Tax Compliance Act (FATCA) which came into force in 2014. This regime threatens to undermine the bank secrecy regimes maintained by offshore tax and financial centres. The EU has a more limited regime under the EU Savings Directive amended as of 2014.[74] These initiatives could make secrecy regimes redundant

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65. Turner, supra note 58, at 39-42; MARKUS BRUNNERMEIER ET AL., THE FUNDAMENTAL PRINCIPLES OF FINANCIAL REGULATION (2009).

66. Sugato Bhattacharyya & Amiyatosh Purnanandam, Risk-Taking by Banks: What Did We Know and When Did We Know It? (Nov. 18, 2011) (unpublished manuscript) available at http://ssrn.com/abstract=1619472; Emilios Avgouleas, Regulating Financial Innovation: A Multifaceted Challenge to Financial Stability, Consumer Protection, and Growth, in OXFORD HANDBOOK OF FINANCIAL REGULATION (Niamh Moloney et al. eds., 2015).

67. Richard E. Mendales, Collateralized Explosive Devices: Why Securities Regulation Failed to Prevent the CDO Meltdown, and How to Fix It, 2009 U. ILL. L. REV. 1359, 1361-63 (2009).

68. Avgouleas, supra note 66.

69. Dan Awrey, Complexity, Innovation and the Regulation of Modern Financial Markets, 2 Harv. Bus. L. Rev. 235, 279 (2012).

70. Nick Davis, Allen Stanford: Antigua Feels the Fallout of Ponzi Case, BBC NEWS (Mar 8, 2012), http://www.bbc.com/news/business17298267.

71. See David Cay Johnston, Enron's Collapse: The Havens; Enron Avoided Income Taxes In 4 of 5 Years, N.Y. TIMES (Jan. 17, 2002), http://www.nytimes.com/2002/01/17/business/enronscollapsethehavensenronavoidedincometaxesin4of5years.html (Enron used over 900 offshore vehicles to hide liabilities and losses, 692 in the Cayman Islands, 119 in the Turks and Caicos, 43 in Mauritius and 8 in Bermuda).

72. See, e.g., Emma Rowley, Bank Bail-out Adds £1.5 Trillion to Debt, TELEGRAPH (Jan. 16, 2011, 8:45 AM GMT), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8262037/Bankbailoutadds1.5trilliontodebt.html.

73. Britain to Clamp Down on Corporate Tax Avoidance, TELEGRAPH (June 15, 2013, 9:22 AM BST), http://www.telegraph.co.uk/news/worldnews/g8/10122298/Britaintoclampdownoncorporatetaxavoidance.html.

74. Council Directive 2014/48, Amending Directive 2003/48/EC On Taxation Of Savings Income in the Form of Interest Payments, 2014 O.J. (L 111) (EU).

and the economic model of many micro-state tax havens unsustainable. A number of offshore jurisdictions have been forced to reform their secrecy regimes and become more cooperative with onshore jurisdictions.[75] Further, the UK has also embarked on new initiatives to force disclosure of large businesses' tax strategies, discourage aggressive tax planning by large businesses[76] and to dismantle supporting infrastructures for tax avoidance.[77] The extra-territorial effect of such new legislation allows the UK to carry out unilateral measures against multinational corporations and international financial institutions. These are intended to undermine micro-states' competitive edge in tax competition and could effectively change the choices made by international business and finance.

Finally, with the rise of rogue regimes such as the Islamic State in the Middle East, extreme acts of terrorism in Western jurisdictions, and opacity surrounding the financing of internal conflict in a number of jurisdictions such as in Syria and the Democratic Republic of Congo, there is a call for greater transparency in international financial flows and strengthening of anti-financial crime regimes to attack terrorist financing. Developed jurisdictions such as the US and UK have introduced extensive financial sanctions,[78] and if effectively carried out, the disengagement of the international financial sector from rogue or conflict jurisdictions could play a significant part in choking finance to these jurisdictions, curtailing their capacities to perpetuate conflict and other nefarious activities. Bank secrecy regimes maintained by offshore tax and financial centres may be seen to be an impediment to the effective enforcement of sanctions and the international legal order against the rise of rogue states and entities. Hence geopolitical changes have placed immense pressures on micro-states to change their old models in order to participate in the international governance of rogue and terrifying behaviour, and not to become part of the rogue community.

The international legal order has greatly changed in the wake of the global financial crisis, as shifts have occurred in the political economy of finance and geopolitical landscape. These have given rise to game-changing moments for certain affected onshore jurisdictions such as the US, EU and UK, which took the opportunity to introduce rather spectacularly antagonistic regulatory reforms that affect offshore tax and financial centres. These unilateral measures

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75. See, e.g., James Shotter, Switzerland Unveils Draft Laws to Dismantle Bank Secrecy, FIN. TIMES (Jan. 14, 2015, 6:15 PM), http://www.ft.com/intl/cms/s/0/05c2d0989bed11e4b6cc00144feabdc0.html#axzz40Cp8fDYR.

76. HM REVENUE & CUSTOMS, IMPROVING LARGE BUSINESS TAX COMPLIANCE: CONSULTATION DOCUMENT, 2015 (UK).

77. HM REVENUE & CUSTOMS, TACKLING OFFSHORE TAX EVASION: A NEW CRIMINAL OFFENCE FOR OFFSHORE EVADERS: SUMMARY OF RESPONSES, 2015 (UK); HM REVENUE & CUSTOMS, TACKLING OFFSHORE TAX EVASION: A NEW CORPORATE CRIMINAL OFFENCE OF FAILURE TO PREVENT THE FACILITATION OF TAX EVASION, 2015 (UK); HM REVENUE & CUSTOMS, TACKLING OFFSHORE TAX EVASION: STRENGTHENING CIVIL DETERRENTS FOR OFFSHORE EVADERS, 2015 (UK); HM REVENUE & CUSTOMS, TACKLING OFFSHORE TAX EVASION: CIVIL SANCTIONS FOR ENABLERS OF OFFSHORE EVASION, 2015 (UK).

78. See Financial Sanctions: Regime-Specific Lists and Releases, Gov.UK (last updated Feb. 8, 2016), https://www.gov.uk/government/collections/financial-sanctions-regime-specific-consolidated-lists-and-releases#documents; Sanctions Programs and Country Information, U.S. DEP'T OF THE TREASURY (last updated Feb. 16, 2016), https://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx.

are largely unresisted to date and may give rise to gradual international convergence.[79] We now turn to discuss key aspects of these unilateral measures that are game-changing for the offshore tax and financial centres.

III. Key Aspects of Tax and Financial Regulation Reforms in the US, EU and UK

A. The Rise of Automatic Information Reporting Regimes

In 2011, the US passed the HIRE Act in which the FATCA was introduced to come into force in 2014. The FATCA achieves an astonishing level of extra-territoriality. It requires all United States citizens, including individuals who live outside the United States, to report their financial accounts held outside of the United States. It also requires all global non-US financial institutions to search their records for accounts associated with suspected US citizens, in order to report their assets and identities to the US Treasury. The FATCA introduces comprehensive and costly compliance for foreign financial institutions in order to make reports to the US Treasury, on the pain of suffering a withholding tax of 30% on all US-sourced income if the foreign financial institution fails to comply.[80] This has given rise to an 'automatic information reporting' regime whereby the onus is reversed onto financial institutions to supply tax intelligence to national authorities. National authorities need not go through the inconvenient processes of trying to uncover opaque tax information in order to initiate exchange of information with tax haven jurisdictions.

By requiring global financial institutions to report on US citizens' accounts and assets abroad, FATCA effectively rides roughshod over tax havens' secrecy regimes and renders the opacity services provided by tax havens and offshore financial centres redundant for US citizens. Some commentators[81] are of the view that FATCA has finally brought about an effective regime to end tax avoidance by US citizens. Grinberg[82] is of the view that the global financial sector is well-placed to serve as information intermediaries for national revenues and should be put to work to end the artificially sheltered opacity[83] sustained by tax havens. Further, commentators[84] also think that FATCA would spawn international convergence towards an automatic information reporting system that is imposed on global financial

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79. See OECD, STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL INFORMATION IN TAX MATTERS (2014) (OECD is developing international convergence in automatic information reporting regimes); see also OECD, PUBLIC DISCUSSION DRAFT BEPS ACTION 12: MANDATORY DISCLOSURE RULES (2015).

80. See Mark R. Van Heukelom, The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better To Comply than to Opt Out, 39 J. CORP. L. 155, 159-61 (2013) (discussing the FATCA provisions).

81. Susan C. Morse, Tax Compliance and Norm Formation Under High-Penalty Regimes, 44 CONN. L. REV. 675, 678-79 (2012); Joshua D. Blank & Ruth Mason, Exporting FATCA (NYU Law & Econ. Research Series, Working Paper No. 14-05, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2389500.

82. Itai Grinberg, Beyond FATCA: An Evolutionary Moment for the International Tax System (Jan. 27, 2012) (unpublished manuscript) available at http://ssrn.com/abstract=1996752.

83. Cobb, supra note 32.

84. Morse, supra note 81; Blank & Mason, supra note 81, at 1245; Grinberg, supra note 82, at 56-61; Luzius U. Cavelti, Automatic Information Exchange Versus the Withholding Tax Regime Globalization and Increasing Sovereignty Conflicts in International Taxation, 5 WORLD TAX J. 172, 209-10 (2013).

intermediaries.[85] This may become the new standardised order in fighting tax avoidance and in instituting a new tax morale. Support for the automatic information regime is also compounded by fears of the rise of rogue states and conflict financing. Micro-states would be under increased international pressure to ensure that they are in cooperation with sanctions regimes and not privy to financing internationally anti-social and dangerous behaviour.

On the downside, FATCA affects many US citizens living and legitimately earning incomes abroad, and the low reporting threshold of $50,000 means that a wide net of US expatriates will be caught. One commentator[86] laments the excessive inconvenience this may cause to US citizens living abroad if foreign institutions that serve a small number of US citizen accounts decide to withdraw services. Further, FATCA may result in diminished investment and dealings with US companies and persons, and creates new burdens for an already-burdened banking sector that has to cope with complying with many new regulations since the global financial crisis.

Other commentators are opposed to FATCA as it is intrusive and unnecessary. Karundia[87] is of the view that FATCA does not respect treaties that the US has signed with existing information exchange partners and is a form of overwhelming extra-territoriality. Bean and Wright[88] view the FATCA as intrusive as it impinges on the right of sovereign states to order their tax regimes and govern banking secrecy, and such 'egregious extra-territoriality' amounts to a form of American imperialism. Other commentators[89] are also of the view that FATCA is unnecessarily extensive and harsh as the objective of tax revenue collections could be achieved by negotiating withholding tax regimes with other states. It is not necessary to bulldoze over other jurisdictions' banking secrecy regimes in order to recover tax revenues.

The institution of FATCA has to date compelled many international financial institutions to comply for fear of being shut out of the extensive US bond, securities and currency markets. It has made a major inroad into the bank secrecy regimes of many tax havens and it is now a question whether more jurisdictions would follow in the steps of FATCA and make it increasingly impossible for tax havens to continue offering their services to international finance and business.

It may be argued that in the EU, a semblance of FATCA-mimicking has already taken place. The EU Administration Cooperation Directive[90] imposes mandatory automatic information reporting on income from employment, life insurance products, pensions as well as ownership of and income from real

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85. OECD, STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL ACCOUNT INFORMATION IN TAX MATTERS (2014).

86. Frederic Behrens, Comment, Using A Sledgehammer to Crack a Nut: Why FATCA Will Not Stand, 2013 WIS. L. REV. 205, 209 (2013).

87. CA Ashish Karundia, Is Foreign Account Tax Compliance Act (FATCA) a Permissible Treaty Override?, TAXSUTRA (Mar. 16, 2015) available at http://www.taxsutra.com/search/results?op=&search_text=ca+ashish+karundia&form_build_id=form-L4NdvoZoKY3SmbV3rzt3oXcHgPpVdwRn89ZZ92ToO30&form_id=solr_search_search.

88. Bruce W. Bean and Abbey L. Wright, The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism?, 21 ILSA J. INT'L & COMP. L. 333, 367 (2014-2015).

89. Melissa A Dizdarevic, The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before 79 FORDHAM L. REV. 2967 (2011); Frederic Behrens, Comment, Using A Sledgehammer to Crack a Nut: Why FATCA Will Not Stand, 2013 WIS. L. REV. 205 (2013).

90. Council Directive 2011/16, 2011 O.J. (L 64) 1, 6 (EU).

property. The EU Savings Directive of 2014[91] now provides that payments of interest income, whether directly or indirectly derived, that are made by paying agents in the EU to entities (whether onshore or offshore) with a beneficial owner resident in the EU must be reported to relevant national authorities in order to ascertain the identities of beneficial recipients. Hence automatic information reporting is the key mechanism used in the Directives as well, but with a more limited scope, as only paying agents in the EU are affected, in relation to entities associated with an EU beneficial owner. Further, EU Member States can enter into bilateral arrangements with each other so that the financial institution can report to government intermediaries which then facilitate information relay. The financial institution may then not need to report directly to the beneficial owner's home jurisdiction. Where beneficial owners do not consent to the reporting of their identities by the financial institution to their home authorities, a withholding tax of 35% applies. The withholding tax allows home authorities to collect revenues although it may be perceived to be the price to pay for not consenting to the automatic reporting regime. During the transitional period of the Directive, a number of European member states such as Austria, Luxembourg and micro-states such as Monaco and Liechtenstein, as well as UK Crown dependencies, have all opted to apply the withholding tax rather than subvert their bank secrecy regimes.[92] EU residents are however not absolved from their own reporting obligations.[93]

It may be argued that the EU regime is not as extensive and draconian as FATCA as FATCA makes major inroads into banking secrecy in addition to achieving tax revenue collection. But it is queried whether the EU regime will remain nuanced or will be pressured to move towards convergence with FATCA. It must be noted that the UK has in late 2013 concluded agreements with all of its Crown dependencies to require automatic information reporting of UK residents' income and funds held in such offshore entities regardless of where the funds are incorporated and managed or where income is generated and received.[94] With such automatic reporting obligations in place in favour of at least the US and UK, offshore jurisdictions would find it difficult to sustain the old economic model which has nevertheless created much wealth and prosperity for islanders.

B. The UK's Finance Bill 2016

In the UK, bold new initiatives are being introduced to compel transparency of tax behaviour, to strongly discourage tax evasion and aggressive tax planning, and to dismantle the structures that assist in such behaviour.

The UK Treasury published a number of consultation papers in the summer of 2015 in relation to new criminal sanctions for tax evaders[95] and

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91. Id.

92. Lukas Hakelberg, The Power Politics of International Tax Co-Operation: Luxembourg, Austria and the Automatic Exchange of Information, 22 J. EUR. PUB. POL'Y 409 (2015).

93. Luzius U. Cavelti, Automatic Information Exchange versus the Withholding Tax Regime Globalization and Increasing Sovereignty Conflicts in International Taxation, WORLD TAX J., 172 (June 2013); Dizdarevic, supra note 89.

94. Bean and Wright, supra note 88, at 363.

95. HM Revenue & Customs, Tackling Offshore Tax Evasion: A New Criminal Offence for Offshore Evaders (Summary of Responses and Further Consultation) (July 16, 2015).

severe civil penalties for them.[96] There are already in place financial penalties for tax evaders, but the new sanctions would raise the penalties to match the values of assets hidden from tax authorities so as to destroy the incentives for tax avoidance. These measures have now been introduced in legislation.[97]

Further, the Treasury is targeting large businesses for tax compliant behaviour, such large businesses including corporations, partnerships, investment funds and other business vehicles whose annual turnover exceeds £200 million or whose balance sheet assets amount to at least £2 billion.[98] Large businesses are required to publish their tax strategies and policies in relation to a number of specified tax regimes. In particular, groups of companies need to publish a group tax strategy. The contents of disclosure are not prescribed, and such publication must be made at least 9 months prior to the end of the financial year. It is envisaged that the mandatory disclosure of "tax strategies" would fit in with the wider corporate narrative reporting framework[99] introduced earlier that is intended to show how business governs itself in relation to performance and compliance. Although the scope of "tax strategies" reporting is not defined, we envisage that refinement of expectations would likely be achieved through the voluntary code of conduct in best practices that the Treasury will establish for tax planning behaviour. Large businesses are to comply with the voluntary Code of best practices, and failure to do so may result in these businesses being regarded as "uncooperative" and "high risk",[100] therefore allowing the Treasury to order them to enter into a 'special measures' regime. Under the regime, increased scrutiny and possible withdrawal of privileges such as the ability to tender for government procurement would entail, as well as public naming and shaming.[101] Such special measures would last at least 2 years.

Finally, enablers or assisters of tax evasion would be subject to severe civil penalties too.[102] The scope of enablers and assisters is rather wide, and the consultation paper provides examples of who may fall within its scope. A noted example of interest to micro-state tax havens is that micro-state corporate services and financial institutions that provide services to facilitate successful tax avoidance would be regarded as an enabler or assister within the scope of the proposed legislation. They can be pursued by the UK authorities on an extra-territorial basis. However, the penalties will only apply if it is established that professional services know that such assistance would likely result in tax evasion. The Treasury mooted instituting a criminal penalty for such assisters and enablers of tax evasion, but has ultimately dropped the proposal.[103]

In sum, the UK has taken bold steps to change incentives on the part of large businesses to engage in aggressive tax planning or tax evasion. The purported

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96. HM Revenue & Customs, Tackling Offshore Tax Evasion: Strengthening Civil Deterrents for Offshore Evaders (Consulation Document) (July 16, 2015).

97. HM Revenue & Customs and HM Treasury, DRAFT CLAUSES & EXPLANATORY NOTES for FINANCE BILL 2016, §§ 68-70 (Dec. 9, 2015).

98. See id. at § 65.

99. See Iris H-Y Chiu, Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK, 38 DEL. J. of. CORP. L. 983 (2014).

100. HM Revenue & Customs and HM Treasury, supra note 97, at §66.

101. HM Revenue & Customs, Improving Large Business Tax Compliance(Consultation Document) (July 22, 2015), enacted in the Finance Act 2016, § 66.

102. HM Revenue & Customs, Tackling Offshore Tax Evasion: Civil Sanctions for Enablers of Offshore Evasion (July 16, 2015), § 67 and Schedule, Finance Act 2016.

103. HM Revenue & Customs, Tackling Offshore Tax Evasion: A New Corporate Criminal Offence of Failure to Prevent the Facilitation of Evasion (July 16, 2015).

power to carry out extra-territorial enforcement against individuals in the corporate and financial services sector who undertake tax and financial planning in onshore and offshore jurisdictions could also be a fearsome disincentive for such individuals.

C. Financial Regulation Reforms and Other Measures that Dis-incentivise the Use of Tax Havens

In the realm of financial regulation, international standards and EU legislative reforms introduced post-crisis now make it more costly and/or less attractive to use offshore financial centres for financial transaction structuring, such as in securitisation and the establishment of investment funds. In the pre-crisis era, it is arguable that both onshore and offshore financial regulation regimes have been similarly de-regulatory where the wholesale sector is concerned. [104] This has achieved a form of parity and created synergies for the use of offshore financial centres to complement the structuring of global financial transactions. Wholesale finance at the international level is therefore very much a web of bilateral private obligations that was not subject to mandatory transparency.

However, such opacity has allowed risky practices to be relatively undetected or losses to be hidden for purposes of reporting fraud, such as in the case of Enron before its downfall. Post-crisis financial regulation reforms have now introduced a differentiation between onshore jurisdictions most affected by the crisis and their offshore counterparts. At the general level, financial transaction transparency[105] has been greatly increased, and the regulation of financial institutions' conduct and internal control[106] have greatly ramped up. In this general context, the use of offshore vehicles may now become more awkward, costly or unattractive for regulatory compliance purposes.

In the area of securitisation, offshore financial centres which offer tax advantages have been an indispensable part of securitisation transactions. In such transactions, financial institutions that originate the assets for securitisation, such as home mortgages, transfer the assets to an offshore special purpose vehicle in order to remove the assets from their lending books, and in order for such assets to be repackaged, tranched and then rated to be offered to investors.[107] Offshore corporate vehicles are essential in securitisation as they are cost effective for loan originators/sponsors and offer tax advantages to investors. Further, such vehicles can be structured to be bankruptcy remote and not affected by the originator's own credit ratings. As such, these vehicles can achieve high credit ratings and attract significant investor interest in the securitised assets. However, there are weaknesses in using offshore structures as the principal offeror of such assets- the quality of information transparency offered to investors may be superficial, and investors

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104. See Commission Regulation 2015/2365, 2015 O.J. (L 337)(EU); Commission Regulation 648/2012, 2012 O.J. (L 201)(EU); Commission Regulation 600/2014, 2014 O.J. (L 173) (EU) (There was no regulatory reporting required eg in wholesale sector markets such as short term funding markets based on rehypotheticated collateral, or OTC derivative contracts, both are now governed by EU legislation).

105. Commission Regulation 600/2014, supra note 104.

106. See IRIS H-Y CHIU, REGULATING (FROM) THE INSIDE: THE LEGAL FRAMEWORK FOR INTERNAL CONTROL IN BANKS AND FINANCIAL INSTITUTIONS (Oxford, 2015).

107. Erik Gerding, The Shadow Banking System and its Legal Origins (working paper, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1990816.

may not have recourse against originators for defects in due diligence that affect the ultimate profitability in the underlying assets.

Post crisis, securitisation has become a more costly process as originating institutions must retain risk of at least 5%,[108] and improve due diligence and transparency of underlying assets. Otherwise, such assets could become very unattractive, as the holding of such assets attracts severe regulatory capital treatment- a high risk weighting of 1250% for the assets concerned and consequently high levels of regulatory capital against such holdings.[109] Further, credit rating agencies have come under fire[110] for readily giving top ratings to such structured products in the pre-crisis era, and are now subject to regulation in the EU that requires such assets to be rated with more care.[111] As such, offshore jurisdictions need to reform their securities regulatory disclosure regimes and regulation of internal governance and control generally in financial regulation, so that securitised assets offered by offshore special purpose vehicles can remain well-rated, attractive to investors and compliant with regulatory requirements. These would likely impose more cost on such structured finance transactions. Price Waterhouse Coopers[112] is of the view that these are challenges for the continued viability of the offshore securitisation industry, and it remains uncertain if this business model will continue to flourish or may become too costly in view of the new regulatory demands.

Further, reforms in financial regulation have now tightened up the scope for mutual recognition of offshore financial structures for the purpose of marketing and distribution in the EU. Such mutual recognition is now based on more stringent criteria based on the quality of the micro-state's tax and regulatory governance. For example, the EU Alternative Investment Fund Managers Directive 2011[113] (that provides for a pan-European passport for onshore hedge and private equity fund managers provided they comply with the Directive) provide only for limited rights to market funds incorporated outside the EU. Such funds would have limited marketing prospects if they are not incorporated in a jurisdiction compliant with the Model OECD Tax convention.[114] As many alternative funds are incorporated in micro-states in order to protect investor income from home country capital gains taxation, the EU Directive is arguably challenging that practice by making it more difficult for those funds to access the European investor markets. In fact, the European Securities Markets Authority has only granted European-wide marketing rights to hedge funds domiciled in Guernsey, Jersey and Switzerland, at the moment

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108. Commission Regulation 575/2013, art. 405, 2013 O.J. (L 176) 1, 238 (EU).

109. BASEL COMMITTEE, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS, ¶ 90 (2010); BASEL COMMITTEE, BASEL III DOCUMENT: REVISIONS TO THE SECURITISATION FRAMEWORK (2014).

110. Claire A. Hill, Why Did Rating Agencies Do Such a Bad Job Rating Subprime Securities?, 71 U. PITT. L. REV. 585, 585 (2010).

111. Commission Regulation 462/2013, art. 8b, 8c, 2013 O.J. (L 146) 1, 17 (EU).

112. Price Waterhouse Coopers LLP, The Next Chapter: Creating and Understanding of Special Purpose Vehicles (Dec. 2011), https://www.pwc.com/gx/en/banking-capital-markets/publications/assets/pdf/next-chapter-creating-understanding-of-spvs.pdf.

113. Council Derivative 2011/61/EU, art. 34-6, O.J. (L 174) 1, 42-44 (EU).

114. See Model Convention with Respect to Taxes on Income and on Capital, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, http://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf (which determines tax liabilities in such a way that by and large abolishes the role tax havens would play in tax avoidance).

leaving out the Cayman Islands, which is a large hedge fund domicile jurisdiction, the US, Hong Kong and Singapore.[115]

The unilateral measures discussed in this Section are aimed at dis-incentivising the use of offshore tax and financial centres by multinational corporations and international financial institutions. EU financial regulation and the UK's Finance Act 2016 attempt to undermine the use of such offshore tax and financial centres. The US FATCA and European Savings Directive attack the bank secrecy regime that complements offshore tax and financial centre models. Would these unilateral measures so disarm any comparative advantage micro-states enjoy in regulatory competition that the death knell for such competition is sounded? The abovementioned measures could have the effect of permanently altering the international legal order if offshore tax and financial centres are eventually 'driven out of business'.

IV. Future Trajectory in Micro-states' Reforms and Conclusion

Commentators have wondered aloud how these new challenges may endanger micro-states' sovereignty as well as economic survival.[116] Further, it is observed that the unilateral measures discussed above are paving the way for international standards based on these unilateral measures. The OECD has in 2014, in tandem with the coming into force of the US FATCA, issued a Standard for Automatic Information Reporting, as a measure of international convergence.[117] Further, work is in progress under one of the action groups of the OECD to bring about convergence in mandatory tax reporting for businesses.[118]

Micro-states have arguably reached a turning point for their economic models. Their reliance on tax arbitrage is arguably unsustainable in the long term, and in general, they need to move away from the model of simply capitalising on regulatory arbitrage or avoidance, as the unilateral measures discussed above signal a new resolve on the part of powerful onshore jurisdictions to close in on areas of arbitrage. It is not sustainable to construct an economic model that merely exploits existing arbitrage gaps for international businesses.

Regulatory competition at the 'low end'[119] is unstable and unsustainable. The negative reputation associated with exploitative arbitrage tends to adversely affect the assets associated with the low end of regulatory arbitrage. These assets could then be subject to restrictions in non-haven jurisdictions and suffer from less global mobility. In an age of increased regulatory demands and higher standards, the use of offshore jurisdictions for low-end compliance will become counterproductive for international business and finance. Some micro-

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115. Chris Flood, Fortress Europe Freezes Cayman Islands Hedge Funds Out, FIN. TIMES, (Aug. 2 2015 2:05 am) http://www.ft.com/cms/s/0/89fe442a-36d7-11e5-b05b-b01debd57852.html#axzz460K6Tfua.

116. George A. Cavalier, Redesigning Heaven: Tax Haven Reform in the Netherlands Antilles, 13 TAX NOTES INT'L 1009 (2005).

117. See Standard for Automatic Exchange of Financial Information in Tax Matters, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm.

118. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, BEPS ACTION 12: MANDATORY DISCLOSURE RULES (2015).

119. Barkin, supra note 22.

states have started winding down their tax and offshore financial centre models, for example, the Netherlands Antilles has marginalised its tax haven economic model to become more internationally convergent has therefore reduced the scope of its role in tax competition.[120]

However, micro-states may adapt to their new challenges by reforming their economic models to engage in new forms of international regulatory competition.[121] Based on a consultancy project the author has carried out for a micro-state jurisdiction, we have engaged with policy-makers and obtained early first-hand insights into what visions micro-states may develop for the future.[122]

Micro-states have little choice but to engage with international regulatory competition. Many micro-states have small domestic economies, hence there is a limit to the extent they can develop their real economies in goods and services to compete in international trade. Their comparative advantage may lie in the provision of specialised services for international business and finance and in continuing to commercialise certain aspects of its regulatory sovereignty to cater for such needs.[123] In other words, micro-states are unlikely able to move away from the mixture of regulatory competition and differentiation that has sustained their economic models, but the bases for such competition and differentiation may need to change.

Many micro-states have become affluent[124] over the last decades. Although this makes it difficult for policy makers to choose to move away from hitherto successful economic models, micro-states are also strongly incentivised to preserve their affluence. Further, with their experience in facilitating financial innovation and their well-established ties with the sophisticated financial sector, micro-states continue to be motivated to generate policy innovation in the same spirit. In this age of globalisation of business especially through the internet and rapid breakthroughs in digital technology, micro-states are exploring innovation and diversification that would allow them to remain competitive in new ways in the global economy.

Micro-states need to cater for international business needs, but as international business is facing higher regulatory standards in many onshore jurisdictions, and investors are concerned that such standards be maintained, micro-states should develop incorporation jurisdictions that are modern, user-friendly, supported by sound standards for governance, transparency and regulatory monitoring, and are attractive to international investors. Micro-states would also need to engage in administrative and bureaucratic innovation to make their incorporation and financial regulatory services viable yet cost-effective. Further, micro-states should also look into niche markets that they can develop, in order to meaningfully differentiate themselves in the competition for international business and finance.

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120. Barkin, supra note 22.

121. See generally, OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION (Andrew P. Morriss ed., 2010).

122. The project is confidential at the moment but law reform proposals may be afoot in due course.

123. Andrew Morriss, The Role of Offshore Financial Centers in Regulatory Competition, (Sept. 2008) http://papers.ssrn.com/pape.tar?abstract_id=1275390.

124. Andrew Massey, Modernizing Government in the Channel Islands: The Context and Problematic of Reform in A Differentiated but Feudal European Polity, 82 PUB. ADMIN. 421 (2004).

The future of regulatory competition based chiefly on tax arbitrage looks unsustainable, as post-crisis unilateral measures adopted by the US, EU and UK are likely to undermine micro-states' tax and offshore financial centres in a manner more than ever imagined under previous multilateral arrangements. However, micro-states can take the opportunity to reframe the terms of regulatory competition, and play a part in shaping the international legal order even in such challenging times.