Not all bank accounts in tax havens amount to criminal conduct

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Abstract
More than 500 Australians are apparently on a list of tax haven users obtained by the Washington-based International Consortium of Investigative Journalists, as part of its investigation into the use of offshore companies.

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The general perception of a tax haven as mostly illegal and illegitimate isn’t borne out. Image sourced from www.shutterstock.com

More than 500 Australians are apparently on a list of tax haven users obtained by the Washington-based International Consortium of Investigative Journalists, as part of its investigation into the use of offshore companies.

But anyone relying on this list should not cast aspersions about illegal activity without first acknowledging that there are many legitimate uses for tax havens.

The two misconceptions about the use of tax havens is that the activity is both illegal and illegitimate. But having a bank account with a bank in a tax haven is not illegal under Australian law and there are many legitimate reasons why Australian taxpayers - either individuals or corporations - conduct business in tax havens.

What does amount to illegal conduct is failing to declare a bank account in a foreign country or the ownership of assets in another country. Secondly, it is illegal not to include income generated from money or assets owned in a foreign country as part of an Australian taxpayer’s assessable income.

Through Operation Wickenby, the Australian Taxation Office (ATO) has been very successful in detecting and deterring Australian taxpayers from hiding income in tax havens. AUSTRAC, the Australian government agency responsible for monitoring the flow of funds in and out of Australia, in conjunction with the ATO have been successful in detecting Australian taxpayers using tax havens. Therefore, only complete idiots would try to hide money in tax havens today.
However, there are legitimate uses for tax havens by Australian taxpayers. This may amount to simply the ownership of property in a known tax haven as a legitimate investment, especially if it is in a resort on a tropical island.

One media report referred to figures from the ATO showing that A$16 billion flowed to tax havens between 2007-2008. But A$29 billion flowed back to Australia from tax havens. If tax havens cease to exist, then Australia would probably not attract a similar level of foreign investment from mobile capital looking for a safe haven to invest in. One prominent example is the A$85 billion Future Fund, which is invested through asset managers located in the Cayman Islands.

In 2009, then-Minister for Finance and Deregulation, Lindsay Tanner, justified this practice on the basis that the Cayman Islands was becoming more transparent and negotiating a Tax Information Exchange Agreement with Australia. He also conceded that "given the structure of the industry and complexity of international law, this is common practice".

However, the most extensive lawful use of tax havens comes through the global insurance and reinsurance industry.

Havens such as the Cayman Islands are a popular location for what are known as “captive” insurance companies. Captive insurance companies are wholly-owned by a large corporation to insure risks associated with the business. The captive insurance company then obtains reinsurance from a large insurer for large losses but maintains the risk itself for small losses.

Far from being illegal, many large Australian corporations and banks have their own captive insurance companies located in tax havens such as the Caribbean or Singapore. Since 1996, the Australian Taxation Office has recognised insurance premiums paid to captive insurance companies as tax deductions, when the case of WD & HO Wills (Australia) v Federal Commissioner of Taxation established a precedent.

Many insurance and reinsurance companies are also located in tax havens such as Bermuda, a dominant player that hosts 35% of the insurance industry worldwide and 65% of the global reinsurance industry.

The main justification is that insurance and reinsurance companies are able to invest their premium income without the cost of paying income tax on the earnings - meaning there is more money to be used to pay out claims for major global catastrophes.

Without this tax benefit, many businesses would not be able to operate because they would not be in a position to acquire the required insurance cover for their particular business activity. This was the situation in the US in the mid-1980s when US businesses were unable to obtain liability insurance cover, according to the research by Yelena Tsvaygenbaum from the University of Connecticut.

Tsvaygenbaum's research shows half of all risks insured through Bermuda are of US origin and one third, European. About 60% of all policies sold in Bermuda are for property insurance and reinsurance.

Reinsurers take some of the risk from the original insurers and, by doing this, insurance companies can take on more risk, or less desirable risk, thus helping more customers.

So if premium income was not given favourable tax treatment by tax havens, then many risks facing businesses throughout the world would not be insured. The continued existence of tax havens in the insurance and reinsurance industry is firmly acknowledged as being of global importance.