



# The Panama Papers Fallout

*“Welcome to Panama, Casablanca without heroes.”*

*- Harry Pandal, The Tailor of Panama*

The leaked disclosure of over 11 million client documents, spanning nearly 40 years, from the Panamanian law firm of Mossack Fonseca has cast a spotlight the global scope of apparent tax avoidance, evasion, money laundering, and lengths to which the world’s wealthiest citizens go to attain privacy and shield their wealth from prying eyes. The list of clients includes the famous and the infamous, naming family member and associates of several prominent world leaders. The cascade of subsequent news reports points to several facets of the story which may yet unfold. These touch on areas of interest for investors ranging from potential political fallout to the involvement of big banks. While the political toll remains to be seen, the more meaningful reverberations from this story may come in the form of reinvigorated national and global efforts to tighten regulatory schemes concerning tax avoidance and evasion.

## I. Political Fallout: The West and Rest

While naming past and present leaders of several countries including Argentina, Georgia, and Saudi Arabia, the larger political scandal lies in the revelation of close associates and family members of several leaders as clients. Within just 48 hours of the story breaking, the first political casualty was claimed as Iceland’s PM Sigmundur David Gunnlaugsson was forced to step down after the report revealed that his wife owned an offshore company holding claims against Iceland’s banks in excess of \$4 million. Despite insisting that all taxes had been paid, and no indications of wrongdoing, Gunnlaugsson had previously failed to disclose the holdings or his wife’s corporate ownership. Also caught-up in the political dragnet is British PM David Cameron. However, his is also an indirect involvement as the documents indicate that his late father, Ian Cameron, had used complex offshore schemes to avoid UK taxation for nearly 30 years. While facing harsh questions from the opposition Labour Party and internal party criticism for missteps in handling the controversy, there is no indication of any illegal activities. Both of these leaders’ predicaments reveal the role of public perception and suspicions that the very wealthy and political elite follow a different set of rules.

In Russia, several close associates of President Vladimir Putin are mentioned in the documents. Sergei Roldugin, a longtime Putin friend, was linked to nearly two billion dollars shuffled through several offshore accounts and corporate entities. While not directly tied to any of the released documents Putin has gone on Russian TV questioning their provenance and asserting the role of opposition groups, as well as the US, in trying to discredit him and his government. Given the overall lack of any meaningful political opposition plus government control over the media, it’s unclear whether the story will gain traction domestically so as to pose a real problem for Putin.

Of all the countries with citizens named as clients, China accounts for almost a third of Mossack Fonseca’s business with its Hong Kong and China offices generating nearly 40,000 companies.<sup>1</sup> Several elites within the Chinese Communist Party (CCP) were cited in the documents, including General Secretary Xi Jinping’s brother-in-law, along



with relatives of three members of the politburo standing committee, the party's top leadership body. The revelations of party-elites' financial activities have put the government and CCP on the defensive, coming at a difficult time for the Chinese leader. Economic struggles combined with growing domestic unrest are testing Jinping's leadership. The government, however, put its great internet firewall and media censors to work demanding that internet posting related to the story be taken down and also blocking access to several websites. Additionally, related stories broadcasted by CNN and the BBC were blocked by the government.<sup>2</sup>

While no allegations of wrongdoing have surfaced, the Chinese government's sensitivity on the matter appears tied to concerns over public perception given its much-publicized anti-corruption campaign waged over the last three years. As one China watcher suggests, the news "appears to confirm the belief, widely held among average Chinese, that those close to influential officials trade on their connections and live by a set of rules different from that of ordinary citizens."<sup>3</sup>

## **II. Banking Industry Fallout: Painting a regulatory bullseye on its back**

Perhaps the more interesting, yet underreported story for investors appears to be the number of big banks either directing clients to or assisting them in setting up offshore companies with Mossack Fonseca. The list of the over 500 banks that worked with the Panamanian firm includes the likes of HSBC, UBS, Credit Suisse, Societe General, and the Royal Bank of Canada. In particular, HSBC, along with its subsidiaries, was linked to the creation of more than 2,300 of the reported companies.<sup>4</sup> Its active participation may bring greater regulatory scrutiny for the bank, which has of late faced increasing questions about its business practices. This coming just a year after a raid by Swiss authorities of two HSBC offices in connection with offshore finance activities.

These institutions and the banking industry, in general, should expect to have a brighter regulatory spotlight shown on their businesses in the near term as the Panama papers drama comes on the heels of several high-profile instances of prosecutions and settlements over improper activities. Bank Leumi of Israel agreed to a \$400 million dollar fine with the US Department of Justice for assisting 1,500 US citizens evade tax obligations. In March, two Cayman Island banks plead guilty to conspiring with US clients to hide nearly \$130 million. Last November, Deutsche Bank agreed to a \$258 million fine with US authorities for its role in dealings violating US Sanctions laws. It also recently completed an internal audit citing "systemic" compliance deficiencies allowing a "suspected money-laundering pattern" to funnel as much as \$10 billion out of Russia from 2012 through 2014.<sup>5</sup>

Politicians and governments are already seeking to redirect public outrage, and big banks should prove a handy scapegoat. UK Prime Minister Cameron just put forward a new law that would hold companies liable for employees' actions in evading taxes. Both the French and German governments, along with the European Union, have announced plans to take further action on tightening rules against tax havens.<sup>6</sup> The issues of financial transparency and rules targeting tax havens will be on the agenda at the upcoming meeting of the OECD held in Washington DC later this week.

## **III. US Banking Laws: Forget Panama, Sioux Falls is the new Switzerland**

The Panama papers controversy has made relatively little news splash in the US. Aside from the US media's hyper-focus on the presidential primary races, this story has made few headlines seemingly due to the lack of Americans mentioned in the leaked documents. While the reason for this is debatable, it has brought attention to the simple fact

that Americans don't need to go offshore to gain banking privacy and seek tax havens. A recent study testing the limits of financial transparency and Know Your Customer (KYC) requirements found that of the 54 firms approached, "firms in tax havens were much more likely to follow international Know Your Customer rules than those in the U.S. and other OECD countries."<sup>7</sup>

The complicated mosaic of banking and incorporation laws in multiple US states like Delaware, South Dakota, and Nevada offer Americans the ability to create tax havens without going offshore. Shruti Shah, vice-president at Transparency International, an anti-corruption organization, recently commented, "You don't have to go to Panama or other tax havens. They are not the only ones making it possible for corrupt officials and other criminals to launder their money. You can do it in every state in the U.S." Indeed, the Tax Justice Network's *2015 Secrecy Ranking*, ranked Panama as 13th while the US came in 3rd behind only Switzerland and Hong Kong.<sup>8</sup> As Doyle McManus writes, "the United States has emerged as an active competitor in the 'corruption services' business," prompting the movement of assets from "traditional tax havens such as Zurich and Bermuda to less elegant banking centers like Reno and Sioux Falls."<sup>9</sup>

#### **IV. Global Tax Evasion: Mind the (Tax) Gap**

Irrespective of potential political fallout, the Panama papers investigation has invigorated discussions about the international problem of tax evasion in an era of budget deficits and austerity. Governments are being much more aggressive in their efforts to reclaim these lost funds. The current debate swirling in the UK points to the seeming unofficial pastime of the country's wealthiest citizens in avoiding and evading taxes. A UK government study conservatively estimates that during 2010-2011 tax evasion and avoidance combined accounted for £9 billion of the country's £32 billion tax gap.<sup>10</sup>

Globally, it is estimated that between \$6 and \$7 trillion worth of financial assets goes unreported as a result of the use of tax havens for either illegal tax evasion or legal tax avoidance strategies.<sup>11</sup> Of this figure, the related tax evasion is between \$19 and \$38 billion a year on capital income, and between \$2 and \$2.6 trillion on personal income. A 2012 study, examining the issue as an EU-wide phenomenon, suggests that the combination of tax avoidance and tax evasion cost member states approximately €1 trillion annually (mostly as a result of illegal tax evasion). Put into context this amount is more than the total health care spending in EU countries, four times higher than the average amount spent on education, or equivalent to paying off total EU public debt in under nine years.<sup>12</sup>

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- <sup>1</sup> "China 'largest market' for Panama Papers law firm," AFP April 7, 2016. 16. <https://www.yahoo.com/news/china-largest-market-panama-papers-law-firm-icij-031453475--finance.html>.
- <sup>2</sup> China ramps up Panama Papers censorship after leaders' relatives named," The Guardian, April 7, 2016. <http://www.theguardian.com/world/2016/apr/07/china-ramps-up-panama-papers-censorship-after-leaders-relatives-named>.
- <sup>3</sup> "China in the Panama Papers: A ChinaFile Conversation," April 6, 2016. Available online at <https://www.chinafile.com/conversation/china-panama-papers>.
- <sup>4</sup> "Panama Papers: Major Global Banks Created Thousands Of Shell Corporations," April 4, 2016. Available online at <http://www.ibtimes.com/panama-papers-major-global-banks-created-thousands-shell-corporations-2347973>.
- <sup>5</sup> "Deutsche Bank Found 'Systemic' Failure in Russia Cash Flight," Bloomberg, April 14, 2016. Available online at <http://www.bloomberg.com/news/articles/2016-04-14/deutsche-bank-found-systemic-failure-behind-russia-cash-flight>
- <sup>6</sup> [http://finance.yahoo.com/news/panama-papers-show-tax-avoidance-075656564.html;\\_ylt=Awrc1THNHg1Xb28AiSnQtDMD;\\_ylu=X3oDMTByZnU4cmNpBGNvbG8DYmYxBHBvcwM5BHZ0aWQDBHNIYwNzcg--#](http://finance.yahoo.com/news/panama-papers-show-tax-avoidance-075656564.html;_ylt=Awrc1THNHg1Xb28AiSnQtDMD;_ylu=X3oDMTByZnU4cmNpBGNvbG8DYmYxBHBvcwM5BHZ0aWQDBHNIYwNzcg--#).
- <sup>7</sup> "For research, we pretended to be crooks and terrorists and tried to buy shell companies. The results were disturbing," The Washington Post April 7, 2016. Available online at <https://www.washingtonpost.com/news/monkey-cage/wp/2016/04/07/for-research-we-pretended-to-be-crooks-and-terrorists-and-tried-to-buy-shell-companies-the-results-were-disturbing/>.
- <sup>8</sup> <http://www.taxjustice.net/wp-content/uploads/2013/04/FSI-2015-Presser.pdf>.
- <sup>9</sup> <http://www.latimes.com/opinion/op-ed/la-oe-mcmanus-panama-papers-20160406-column.html>.
- <sup>10</sup> <https://www.gov.uk/government/publications/2010-to-2015-government-policy-tax-evasion-and-avoidance/2010-to-2015-government-policy-tax-evasion-and-avoidance>.
- <sup>11</sup> <http://www.voxeu.org/article/balance-payments-statistics-and-hidden-assets>.
- <sup>12</sup> <http://www.globalissues.org/article/54/tax-avoidance-and-havens-undermining-democracy#Thescaleoftaxavoidance>.