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The Pandora Papers: A Legal Perspective

By James Bowden | 8 October 2021

The evocatively named "Pandora Papers" have broken, and perhaps unsurprisingly the media coverage reads like a collective condemnation of all things "offshore". This legal analysis aims to offer modest counterpoint through a professional, law abiding lens, to help put the media frenzy into a slightly more rational perspective. The offshore world is being unfairly maligned.

The proper use of companies and trusts that are established in offshore jurisdictions is not illegal or immoral, and their use for money laundering or tax evasion is extremely rare these days. Despite this, loaded terminology is being used to create a sense of widespread scandal: "hidden assets", "financial wizardry", "shell companies", "paper shuffling", "in the shadows…". While some responsible reporting does include passing reference to the fact that offshore does not mean illegal, that message is lost in the blanket condemnation of all offshore structures. Adding further fuel to the fire, in an opportunistic display of virtue signaling, many politicians have stated publicly that offshore jurisdictions are where all the "missing tax dollars" are to be found. I would suggest that the current sensationalist terminology used to describe all lawful offshore planning is unfair and that the generalized assertion of missing tax claims is wildly inaccurate.

To begin, the idea that assets held by a company or trust or any other entity are "hidden" simply because the company, trust, etc., is established in an offshore jurisdiction is incorrect. This may have been true decades ago, but it is not true any longer. The financial services industry is very important to offshore jurisdictions for their livelihood, and in order to retain any credibility, these offshore jurisdictions willingly adopted and implemented two key regimes: US Foreign Account Tax Compliance Act (FATCA) and the OECD-driven Common Reporting Standard (CRS). These regimes require, among other things, that a

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great deal of information about the assets and the owners of those assets be collected by offshore service providers and reported to the owners' home countries. Offshore service providers, including (and especially trustees take these obligations seriously and will not engage unless these requirements are met. The Canada Revenue Agency (CRA), and other tax authorities around the world, has the ability to obtain this information either through automatic disclosure protocols or upon request. Anyone who has attempted to establish a trust or bank account in any offshore jurisdiction these days will know that nothing is left "hidden". Assets held offshore are no more hidden than assets held in domestic banks. Consider that domestic bank account balances are not public information either. It is likely safe to assume that if a "leak" resulted in your own financial information being made public against your will, it would not be viewed as a social justice movement but as the intrusive privacy breach that it is. Canada purports to take information privacy laws seriously, as does every country that has entered the information age. When information is described as "hidden", this means hidden from us, the public, not from the CRA or from financial regulators.

It is also worth looking at some of the other common terms being used in recent coverage in order to separate their actual meaning from the current innuendos. "Shell company", for example is simply a holding company, one that begins with no other assets other than what it is meant to hold, and they are common and necessary both domestically and offshore. "Paper shuffling and financial wizardry": does anyone know what this means? Not likely, but such labelling suggests there is something inappropriate going on. Presumably this is a reference to careful tax planning or the design of an estate plan, all of which is entirely legal but which do indeed involve paperwork and financial planning. The term "in the shadows" clearly does mean information secrecy; but as noted earlier, this may have existed to some degree but that was before international reporting and information sharing was so ubiquitous and so aggressively enforced. There are no "shadows" in the modern-day offshore world. Such terminology is effective in selling a story – and certainly advances the public interest in exposing the bad actors, but demonstrates a failure to understand the compliance requirements of the offshore world.

It bears repeating that the CRA (and equivalent bodies worldwide) has access to detailed information about the assets and the beneficiaries of the offshore vehicles in question, and all reputable trust services providers, investment brokers and banks are subject to detailed know-your-client requirements, anti-money laundering compliance obligations, and tax-driven reporting obligations under FATCA and CRS. Anyone who would have you believe otherwise does not understand how modern offshore structures work and the onerous compliance requirements to which they are subject.

The Panama Papers offer a useful case in point by way of comparison. The same organization that is responsible for the Pandora Papers "leak" (the International Consortium of Investigative Journalists) also leaked the Panama Papers in 2016. We all surely recall the scandal at the time, the maligning of offshore structures, the resentment of prominent figures who use them, the alleged tax losses and criminal behaviour, etc. Among the Panama Papers, the CRA identified approximately 900 Canadians who were using offshore structures. It has investigated almost all of them now (yes, it took them 6 years). The number of reported cases that the CRA has prosecuted as a result: zero. It is reported that a small number of voluntary settlements have been reached due to CRA reassessments and of those, we can safely assume some of these settlements were reached simply because the taxpayer in question did not have the time and energy to formally dispute the CRA's assessment (or was not willing to do so because of the name-and-shame media environment). The net result of the Panama Papers in Canada as reported to date: no wrongdoing found, and negligible under-reporting discovered. This underwhelming outcome should have been the real story, but it has not received much fanfare. If the goal is to make legitimate dealings with offshore structures by Canadians illegal, that is a question of legislative reform – however, that does not change the fact that as it stands (at least to the extent it is reported in Canada), the Panama Papers did not uncover any illegal conduct by Canadian tax payers.

With this precedent in mind, it is reasonable to expect that a similar outcome may follow from the Pandora Papers, despite the current media frenzy. Offshore structures are, simply tools in normal, intelligent, legal estate planning or asset management.

To keep things in perspective, it is worth noting as well as there are many entirely domestic Canadian strategies to reduce, defer or eliminate taxes, which are also entirely legal. The offshore environment does not offer anywhere near the variety or magnitude of tax avoidance techniques as does the domestic environment, and both legitimate tax avoidance and illegal tax evasion are much more prevalent in the domestic context than offshore. Indeed, the CRA spends the great majority of its time and effort and personnel on domestic investigations and reassessments, for that reason.

If taxpaying Canadians are feeling indignant because they believe that Canadian users of offshore structures are obtaining access to tax dodges, they can rest easy. The Canadian government has worked hard to ensure that offshore structuring does not give Canadians any tax advantages at all. Canadians are taxed on the basis of residency. If you are Canadian resident, you pay tax on your worldwide income. If you are a Canadian resident who establishes an offshore trust, that trust is also deemed Canadian resident and is taxable in Canada. There are numerous, detailed anti-avoidance rules that prevent disingenuous attempts to circumvent the rules. A different set of rules has the same effect on income earned in an offshore company. The only way a Canadian resident will avoid Canadian tax is by outright tax fraud (failing to report to the CRA), and as we have seen from the Panama Papers this is exceedingly rare. Such conduct will also never be facilitated by legitimate and law abiding trust professionals which include lawyers, banks, trustees and accountants who are invariably involved in setting up and administering these structures. Leaving aside the very few bad apples, there are no “missing tax dollars” hiding offshore.

If Canadians cannot use offshore structures to dodge taxes or to launder money, what do they use them for? There are many reasons, but some of the more common ones are: to avoid the application of a perpetuity period (21 years in Canada) so their trusts can last longer and leave longer legacies; to protect assets from future claims (not existing claims, this will not be successful against a fraudulent transfer); political stability (many offshore jurisdictions are reassuringly stable and consistent in their laws); and to benefit from the existence of progressive trust legislation (this is the main industry in those jurisdictions and they excel at it). Non-Canadians also use these structures to avoid forced heirship laws in their home country, or to achieve anonymity when their wealth makes them a target in their volatile home country, or to achieve tax efficiency for intergenerational wealth transfers. These are all normal, legal activities. There is nothing secretive about them other than the fact that there is a general expectation of privacy just as there would be with any financial services provider.

Some bad conduct will no doubt be exposed as a result of the Pandora Papers. In any set of 11.9 million documents about human behaviour this is hardly surprising. But based on an understanding of how the common and legitimate world of offshore planning works, it will likely be an infinitesimally small proportion of users who fall into that category, even if it may not always seem that way from the headlines.

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Afridi & Angell Professional Corporation, Afridi & Angell's Toronto office which was established in 2021, takes advantage of the firm's many Canadian ties and brings to our Canadian clients, and those with Canadian interests, the highest standards of advice and client service for which Afridi & Angell is known. Our Toronto office, which operates as a separate legal entity from Afridi & Angell's UAE offices, provides legal and advisory services in the following areas: corporate and commercial; mergers and acquisitions; tax planning and advisory; asset protection; private client and estate planning; anti-money laundering and anti-bribery compliance; IT outsourcing and contracting; consulting on Canada-UAE opportunities and cross-border legal issues.

Pending the launch of Afridi & Angell's Toronto website, please visit Afridi & Angell's main page at **www.afridi-angell.com**. Meanwhile please do not hesitate to contact **James Bowden** directly at jbowden@afridi-angell.com.