Comply – or move out

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Over the past few years, many high-tax countries have stepped up the pressure on their taxpayers as well as on other countries and territories that are perceived to assist tax evasion. All kinds of blacklists have been created which – quite apart from the racist implications of labeling a "bad" list as "black" and a positive list as "white" – largely aim to discriminate against independent jurisdictions with a different tax regime and possibly a different attitude to client confidentiality.

High taxes mean high tax evasion

Many scientific studies have shown that the higher the direct taxation, the more tax evasion takes place. The problem starts somewhere at or about a 33% income tax rate, and a watershed is certainly reached at 50%. That is one reason why many EU countries already have indirect taxes (VAT) to the tune of 20% or even more. In large OECD countries, effective marginal income tax rates are often higher than 50%. In addition, public monies tend to be used inefficiently, and the people who earn and pay taxes in these larger countries often feel they do not get adequate value for their money.

British members of parliament and members of the government, for example, who misuse public funds for their private expenses, cannot possibly expect a British taxpayer to warm to the idea of increasing the already high tax burden in the United Kingdom, even though the sums involved in the expenses scandal relative to other misuses of public funds are relatively small. But this kind of irresponsible behavior in public office acts as justification for the ordinary taxpayer to become dishonest and evade taxes. It is rather like bringing up children: You cannot expect them to be kind to each other and not swear when their parents fight and shout at each other; if you smoke, you cannot expect your child not to smoke.

Tax evasion is a crime in most countries, and clearly crimes should be pursued and punished in any rule-based society. However, above a certain threshold of taxation, the frustration of tax-paying citizens increases to a point where the threshold for committing a tax offence is lowered so that such offences increase.

However, many studies also show that increasing the severity of prosecution and punishment is not an effective way of preventing such crime. Rather, you need to get to the root of the problem, which, in this case is the high tax burden and the inefficient use – or even abuse – of public money.

A further, altogether different issue is that large countries and governments cannot be trusted. In all of Europe, for example, historically only the United Kingdom, the Scandinavian countries, the Netherlands and Switzerland have avoided a complete devaluation of their currencies or public default. This is a topic that has gained attention again in the wake of the most recent global financial crisis. We can be sure that there will be more to come.

It is therefore not a surprise that citizens of most countries do not trust their governments and are unhappy about their (excessively) high tax burden and the comparatively poor public services they receive in return. Quite understandably, they seek to put aside at least some money as a nest egg in case of future need. They also do that because there is in many cases a lack of financial privacy in their home country.

Privacy is a human need

Indeed, to keep private matters private is a human need and an important element of any society which has reached a certain level of development and sophistication. Privacy in financial affairs, such as client confidentiality in banking and investments, is important for most people who have money – also and in some ways even more so for Americans, who otherwise live in a fairly transparent culture. It seems to be a natural desire to keep at least certain parts of your private finances to yourself.

This is why in Switzerland, whose society I regard as having reached quite a sophisticated level, the protection of privacy has been cultivated over time and is protected in many ways. Firstly, there is a particular cultural bias: The Swiss are notoriously private and have developed a sense of understatement. Secondly, written and unwritten rules and laws have emerged over a long period of time that protect privacy in this country. Switzerland has one of the best data protection laws in the world, in many cantons tax and other records are not publicly available, most interaction between citizen and state is protected by various confidentiality rules, and we protect banking and insurance relationships with strict secrecy provisions. Provided that trust in public office is not abused and public funds are not misused, I believe citizens who live in such an environment and are taxed reasonably are generally happy to make this contribution. In this case there is inherent trust between citizens and state, and citizens are left with the level of privacy they need to prosper and feel secure. This is essential for a developed, rule-based society. But which "developed" countries can actually offer such an environment?

Money laundering, terrorism and tax enforcement

During the last ten years, things have changed quite dramatically. It seems as if, in line with deteriorating public finances in large industrialized nations, an unprecedented attack has been launched on financial centers, first under the label of anti-money-laundering, and then, particularly after 9/11, even under the label of combatting terrorism.

There is no doubt that the laundering of criminal money and the financing of terrorism is a bad thing. However, the question is whether the financial centers who have come so much under attack are really as bad as they are portrayed to be.

The most recent FATF review, concerning Germany, shows that country's blatant failure to comply with many of the most important FATF recommendations. While jurisdictions like Jersey or the Bahamas have meticulously followed or even exceeded the FATF anti-money-laundering standards, Germany does not seem to bother too much about them. If you are a money launderer or terrorist financier, where would you rather go about your business, in Frankfurt or in Jersey?

In the latest French "blacklist", many of the well-known smaller islands that are struggling to develop a financial center of their own are labeled as "uncooperative" and will be punished by the French state, including and in particular by an additional special withholding tax on practically all payments made to such jurisdictions. However, countries like Malaysia and Singapore or Hong Kong, who are more important trading partners for France, have somehow escaped its "blacklist", even though they are generally less cooperative than many of the smaller jurisdictions.

Clearly, almost all the national and international initiatives, lists and attacks are arbitrary, discriminatory and have a whiff of a new kind of colonialism about them.

The age of compliance

Having said all that, of course each country has a right to enact laws and impose taxes as they deem appropriate. It has also been said that people have the governments they deserve. Indeed, the sovereignty of nations is a cornerstone of the modern world order and the United Nations system.

The main exception to this is the United States, which notoriously tries to enforce some of its national laws outside its borders. But here too we need to realize that in the end, if you are a U.S. citizen or want to do business with or in the USA – which is still a great country offering enormous business, investment and lifestyle opportunities – you should play by the rules of that country, or else better leave. You cannot have your cake and eat it.

In the past, when countries had less sophisticated laws and regulations, international cooperation was limited or non-existent and enforcement was therefore more difficult; many people relied simply on hiding their money. In countries like Switzerland, Luxembourg, the Bahamas and others, and in particular also the United States, an entire industry was built on this concept.

Now, however, from banks to investment managers, from insurance companies to lawyers, from stockbrokers to financial advisors, everyone dealing with other people's money is acutely aware of the need to conform to a morass of compliance laws and regulations: anti-money-laundering, anti-terrorism financing and, becoming more and more fashionable, all-encompassing all-crimes legislation that basically requires financial intermediaries to think of anything that their clients could have done wrong and include it in their due diligence process. Compliance has become a science and an art, a culture in modern financial services that, in some jurisdictions, has even become an obsession – to the point that there are places where you would simply no longer want to open a bank account because of the nuisance of answering endless questionnaires, providing numerous declarations and documentation about yourself and the origin of your money. We very obviously live in an age of compliance.

This means that non-compliance is no longer an option. At our firm, we already took this position many years before the dawn of the new millennium, when the Luxembourg and Swiss *as well as German and particularly American* banks were still happily accepting large amounts of foreign funds without asking too many questions.

It also means that you either comply with your home country's legislation and regulations, or you simply move out.

Indeed, the same internationalization and increased communication opportunities that lead to the age of compliance mean that persons of talent and means need not limit their personal life and business to only one country. Today, more than ever, you can make an active choice with regard to your residence and place of business.

This is an enormous opportunity for internationally flexible people who can and want to move in order to (re-)gain the freedom they require to prosper. It also offers an opportunity for any country wise and flexible enough to attract these new mobile entrepreneurs and their families and poses an increasing challenge to large, inflexible countries that are badly run and are losing their best brains and smartest capital. But obviously and clearly, in the age of compliance, as an individual and as a business, you have a choice to comply with local laws and regulations or to move to a jurisdiction offering greater freedom to develop your skills and invest your capital more freely. Or, as Benjamin Franklin once said: "Where liberty dwells, there is my country".

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