In last month’s issue, Stephen Platt, Chairman of the BakerPlatt Group, penned a thorough article on the proposed “Stop Tax Havens Abuse Act.” Mr. Platt was correct to draw attention to the bill. If enacted, it would wreak havoc on an offshore finance industry that is already reeling from the global credit crisis that started in 2007.

For both individual taxpayers and the respective offshore banks, the bill introduces unprecedented reporting and disclosure requirements and effectively assumes that the motivation for any offshore transaction is an illegal evasion of taxes.

Proponents of the bill, including prominent senators from both parties and President Obama himself, wrap their words in a tone of moral indignation towards those who do not pay their “fair share.” Normally, much of this rhetoric can be disregarded as populist campaign speech. After all, Senator John Kerry ruffled quite a few feathers with his castigation of “Benedict Arnold” companies who made use of overseas tax havens to lighten their corporate income taxes. Once the 2004 election had passed, the issue quietly died.

President Obama himself was not above the occasional descent into populism before taking office. During the 2008 election, he caused a diplomatic row with Canada and Mexico by threatening to “renegotiate” the NAFTA free trade agreement. Interestingly, he distanced himself from that rhetoric when campaigning in the border states that had benefitted from the trade agreement. As president, Mr. Obama has shown no desire for revisiting the issue.

The dynamics of the American political system encourage extreme proposals before elections, as they draw attention to the candidates in question. But that same system tends to soften the proposals before they become law. Rivalries between branches of the government, between the two houses of Congress, and even between various geographic blocks within each house tend to prevent excesses.

There are exceptions, the most obvious recent examples being the rather draconian Patriot Act and Sarbanes-Oxley Act. Both were passed under extraordinary circumstances and would have likely never even been proposed in more normal times. Only crises as significant as the September 11, 2001 terror attacks and the Enron scandal made them possible.

Of course, the current credit crisis qualifies as an extraordinary circumstance. Public sentiment towards banks in general is perhaps at an all-time low. The assorted federal bailouts to the banking sector have come with calls for the government to take a more active role in regulating the banks. Thus far, public rage and governmental attention has been directed mostly at American banks, but offshore banks have not been completely immune.

UBS, the Swiss giant, is the centre of a major scandal involving allegations that the bank intentionally solicited and encouraged Americans to evade taxes. The CEO of UBS’s Global Wealth Management, Raoul Weil, has been indicted in what has proved to be a major embarrassment for the bank. UBS also came under fire for insider trading violations.
The financially impaired position of offshore giants such as UBS due to losses on credit derivatives combined with the embarrassing scandals have weakened the ability of these banks to defend their businesses. Furthermore, what congressman would want to be seen defending offshore finance – even completely legitimate offshore finance – in this political climate?

Offshore financial centres have always had a precarious existence that is subject to political winds in far away capitals. In the end, the offshore centres have survived the periodic onslaughts and have continued to grow and thrive. We believe that this will again prove to be the case for a number of significant reasons.

Firstly, the Obama Administration has had some rather embarrassing tax issues of its own. No fewer than three high-level appointments, including the Treasury Secretary himself, have had income tax issues come to light. The Treasury Secretary’s own tax issues make it difficult for him to attack offshore financial centres in the name of stamping out tax evasion.

Secondly, the Obama Administration simply has too much on its plate right now to make the Stop Tax Havens Abuse Act a priority.

President Obama has made cutting the taxes of the middle class a priority in his stimulus program, and he has indicated that he may postpone his plans to increase taxes on high-income earners. For all of his campaign rhetoric, Mr. Obama’s tax policies in practice are looking not too unlike those of Ronald Reagan or George W. Bush. In this more permissive, supply-side environment, a more laissez faire attitude towards the offshore financial sector is likely to prevail.

Finally, as a candidate, Barack Obama make “repairing America’s image abroad” a major priority. One of the first tests of this conviction came with the international uproar over the “Buy American” provision of the stimulus bill. The European Union went so far as to threaten formal complaints to the WTO in response.

President Obama’s reaction to this is key: “I think we need to make sure that any provisions that are in there are not going to trigger a trade war.” He was quite sensitive to how the legislation was received abroad.

The Stop Tax Havens Abuse bill singles out several sovereign nations, among them Singapore, Switzerland, and Costa Rica. It also targets Hong Kong, now a Special Administrative Region of China. If Mr. Obama is serious about mending fences with the outside world, it is difficult to see how this would be done while demonising these countries, particularly China. Of course, in politics, domestic issues usually trump foreign policy concerns.

Our reading of the situation is that offshore financial regulation will likely to be off the table for at least the next year. It is most likely to be resurrected during the run-up to the 2010 congressional elections. So, for the time being, the offshore financial sector should have a little breathing room.