Demise of the revenue rule in tax law

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In tax law, absent special enforcement treaties, sovereign countries do not enforce the revenue laws of other countries (the "revenue rule").

This common law revenue rule has been in place since 1775 when Lord Mansfield declared in *Holman v. Johnson* that "no country ever takes notice of the revenue laws of another." Or as Justice Learned Hand put it in Moore v. Mitchell: "To pass upon the provisions for the public order of another state is, or at any rate should be, beyond the powers of a court ..."

To overcome this rule, many countries negotiate bilateral treaties for information disclosure and mutual enforcement assistance to counter tax evasion. It is unusual, however, to have such arrangements with tax havens, which thrive on secrecy laws.

Of course, tax evasion and aggressive tax avoidance have always been on the radar screen of governments. John Grisham elevated tax evasion to movie star status in *The Firm* and, in the process, made the Cayman Islands infamous as a secretive tax haven and hideout for criminals.

A few years later, the Organization for Economic Cooperation and Development (OECD), which comprises the high taxed industrialized countries (including Canada), jumped on the same theme insisting that tax havens undermine the economies of the developed countries by allowing individuals, corporations and multinationals to avoid tax that they would otherwise have to pay in their home countries.

The debate over tax havens involves three principal issues. First, should any country be obliged to impose taxes on income and capital if it does not need the money for public spending?

Second, should a country that does not impose high taxes be compelled to disclose confidential financial information to the revenue authorities of the countries that do impose such taxes? How do we reconcile sovereign tax policy with global tax cooperation?

Third, should countries be allowed to "ring fence" by allowing tax breaks to foreigners but not to locals by setting up special economic zones as, for example, in China?

Perhaps the more important feature of tax haven countries is that they do not have double tax treaties, which typically require treaty partners to disclose to each other the financial activities that individuals and corporations carry on within their jurisdiction. It is quite common for tax haven countries to have confidentiality laws that prohibit the disclosure of financial information to any persons, including the revenue authorities of foreign countries.

However, the tiny Cayman Islands (262 sq km), with a population of only 45,000 and the world's fifth-largest financial centre with 600 registered banks in Grand Cayman, is a notable exception.

Unlike most other tax havens, the Caymans have an extensive array of legislative controls and treaty controls to overcome the common law revenue rule. Since 1986 the country has had a Mutual Legal Assistance Treaty with the U.S., which has been invoked on more than 225 occasions.

In addition, the Cayman Islands Monetary Authority has wide powers to obtain information and documents to assist overseas regulators to carry out investigative functions, including tax audits.

The government has a Tax Information Exchange Pact with the U.S., and the Caymans government has indicated a willingness to sign such agreements with other OECD countries where there is a level playing field and the Caymans is treated no less favourably than other countries.

The Caymans also has anti-money laundering legislation that meets the standards of the Financial Action Task Force (FATF), the OECD's anti-money laundering offshoot. Additionally, it is one of only two jurisdictions that will collect client identification retrospectively for those clients who were already established with the banks even before the new regulations came into place.

All of which makes the Caymans a clean, highly regulated financial jurisdiction – about the last place in the world where a criminal would be advised to hide anything.

Even opening a bank account is more difficult than in Canada. A customer must provide extensive personal identification documents and references from other banks. These records are maintained by the bank but may be turned over to the financial authorities if asked to do so.

In theory, the common law revenue rule reflects the principle that a country has exclusive sovereignty over its tax policy. However, Lord Mansfield's rule has limited scope in a world of increasing regulatory supervision and information exchange between countries on money laundering and terrorism financing.

The traditional rule that a country will not enforce the revenue laws of another country and that no country is under an obligation to disclose financial information to foreign governments is very much on its way to extinction.

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