

FINANCIAL FEATURE



The Pros and Cons of Offshore Banking

[By Akbar Ali]

Though the term “offshore banking” is commonly associated with money laundering, tax evasion, and organized crime, it is a perfectly legal banking alternative which comes with both pros and cons. Put simply, offshore banking is the system by which a depositor utilizes a bank in a location outside the account holder’s country of residence. The main draw for depositors is that offshore banks are typically located in areas designated as “tax havens” where taxes are levied at very low rates. In some instances, the tax rates at offshore banks are nonexistent.

Advantages

In addition to the lower tax rates, offshore banks offer the following benefits:

1. Enhanced bank privacy
2. Fewer and more relaxed restrictions
3. Easy access to deposits
4. Funds are protected from political or civic unrest

This last benefit is especially important because many offshore banks are located in island nations, notorious centers of political unrest and economic uncertainty. Nations suffering from extreme poverty like Belize also try to attract foreigners with the hope that they might invest some of their offshore holdings in the nation’s underdeveloped economy.

Not all offshore banks are located in economically depressed areas: Switzerland, Andorra, and Luxembourg are all wealthy, independent states with strong and well-established offshore banking industries. Of course, if the account holder lives in a nation with a stable political and/or economic environment, then it might be moot to consider investing abroad.

Offshore banks may also offer competitively higher interest rates in accordance with both lower operating costs and federal intervention.

Americans who have accounts in offshore banks are required by law to declare any and all such accounts when completing income taxes or evaluating total assets. Failure to do so is tantamount to perjury and carries stiff and severe penalties.

In the wake of the attacks on September 11, 2001, there has been an attempt to increase regulation of foreign accounts in order to curb any funds being illegally moved or allocated for what may be construed as illegal activity. Many in the offshore banking industry have resisted these calls for reform, saying that they will quickly translate into unnecessary regulations and increased fees, and open the gate for domestic banks and tax agencies to access money in offshore accounts. Moreover, they contend that offshore banking is vital to the interests of competition, which keep the markets from growing too expansive or monolithic.

Another advantage to offshore banking is that it provides an incentive for underdeveloped island nations to expand their economies and attract foreigners from industrialized countries. Places like

Bermuda and the Cayman Islands are famous not only for their tourism, but for the plethora of banking opportunities for investors from North America, Europe, and Asia.

Among the many traditional banking services, offshore banks provide the following services:

1. Deposit taking
2. Credit
3. Wire and electronic funds transfers
4. Foreign exchange
5. Letters of credit and trade finance
6. Investment management and investment custody
7. Fund management
8. Trustee services
9. Corporate administration

Disadvantages

Like most financial services, offshore banking is not without its own dubious

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history and has been connected numerous times to the funding of organized crime through illegal money laundering. It has also been connected to the Mafia and to various terrorist groups before *and* after 9/11.

Another disadvantage is the logistical difficulty encountered because of geographical differences. It is not always easy to access funds in a foreign nation when it is many hundreds (if not thousands) of miles away. With ever-expanding modern telecommunications, however, these issues are few and far between.

Offshore banking is also frequently considered the domain of the privileged and requires rather high incomes for eligibility. The cost of establishing and maintaining offshore accounts is not slight; there is no such thing as 'free checking' for foreign account holders.

Also, in order to maintain tax revenues in countries providing offshore banking

services, the burden tends to fall on middle-income groups whose taxes are raised when the tax rates on offshore accounts are held steady or even lowered. Many economists believe this to be exploitation of the native working class and are working to bring attention to their plight.

Statistics

Financial experts believe that up to half of the world's capital is held in offshore accounts, an astounding figure when one considers that tax havens like Cyprus and Hong Kong contain barely more than 1% of the world's population. Almost a full third of the profits of American multinational corporations are held in offshore accounts. You might also be surprised by the following statistics:

1. One-third of the world's wealthiest individuals are estimated to have holdings in offshore banks totaling \$6 trillion (yes, *trillion*).

2. Approximately \$3 trillion is held in deposits in tax haven banks with the remaining \$3 trillion held in securities by international business companies (IBCs) and trusts.
3. Between 2% and 5% of global economic output (approximately \$600 billion and \$1.5 trillion) is laundered illegally each year.
4. Offshore banking is the main vessel through which most of the world's drug money is believed to be laundered. Some estimates place this figure at \$500 billion annually, which exceeds the combined total income of the world's poorest 20%.

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