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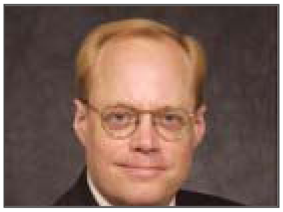

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Cayman Islands Is The New Switzerland, But Not The Way You Think

Are the Cayman Islands the next offshore target? The U.S. has cast its tax net far and wide, more a shotgun than a rifle shot. Mixing fishing and shooting metaphors seems appropriate to show just how no-holds barred American tax officials and prosecutors can be. Yes, boxing too.

The Cayman Islands have had a curious history. They have a big banking industry featuring hundreds of banks doing offshore business. There are vast numbers of branches of foreign banks, too. Financial services is a major employer, and the industry generates billions of dollars. It comprises a large portion of the total economy.

(Photo credit: rcbodden)

The Caymans may once have been infamous for drug money. Today, they are known as a primary home of the captive insurance industry. Even more, they host an enormous cadre of hedge funds. And that means oodles of money and oodles of offshore compliance issues for IRS and FinCEN to relish.

Yet some people consider institutions in the Caymans to be less rigorous in observing tax and banking laws than European nations. That creates a perfect storm. And with Swiss bank closures, deferred prosecution agreements, and many Swiss banks still under investigation, everything is different now.

It's different in the Cayman Islands too. The U.S. has pushed hard on Caribbean and Central American nations, including a pivotal John Doe summons here: IRS Issues John Doe Summonses To Citibank, Chase, BoA, Mellon, HSBC—Tax Prosecutions Coming. One by one, foreign banks and governments are taking their medicine from the U.S. And that's a fat dose.

FATCA is the centerpiece of U.S. efforts to curb tax evasion everywhere. FATCA collects information on accounts held by U.S. taxpayers. It requires U.S. financial institutions to withhold a portion of payments made to foreign financial institutions (FFIs) that do not agree to identify and report information on U.S. account holders. Almost no FFI wants to be in that position.

The U.S. keeps adding to its list of FATCA countries. It has already signed an Intergovernmental Agreement (IGA) with the Cayman Islands. But there is more afoot with the U.S. pursuit of financial advisers in the Caymans. That ties in nicely to the FATCA agreement.

Some foreign banks report to the IRS voluntarily, some via agreements. An Intergovernmental Agreement allows foreign banks to report to their own government on Americans. The foreign government can then report to the IRS. Foreign banks can use this avenue to avoid reporting directly to the IRS. But like it or not, report they must.

The Cayman Islands IGA here is a Model 1B agreement. It means FFIs in the Caymans must report tax information about U.S. account holders to the Cayman Islands Tax Information Authority. It acts as the sole channel in the Caymans for the provision of tax-related information to other governments.

In turn, the Cayman Islands Tax Information Authority relays the information to the IRS. But the win for the U.S. didn't end there. The two countries also signed a new Tax Information Exchange Agreement (TIEA).

The U.S. has an impressive collection of signed FATCA agreements here and a long list of deals in principle. Plus, it is engaged in dialogues with more jurisdictions. For U.S. account holders, coming clean is the best bet.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.