GAP

Netherlands, Switzerland and Ireland. We consulted financial advisers, former revenue experts and academics, as well as whistleblowers from inside the secretive world of tax. Our team was:

David Leigh
Felicity Lawrence
Nick Davies
Richard Brooks
Rob Evans
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Isles of plenty

The Caymans: a Caribbean paradise ... operated in secret. A top Swiss banker turned whistleblower says he has the evidence

A hoard of banking files from the Caymans - one of the most secretive British tax havens - are being supplied to the US authorities by a whistleblower who claims they detail worldwide tax avoidance.

The Cayman Islands - Caribbean territories under ultimate UK control - are currently the target of reformers. Alastair Darling was yesterday challenged in the Commons over allegations that UK banks have been using the Caymans for massive tax avoidance schemes. Barack Obama, before he reached the White House, was one of the senators who singled out the islands as a blot on the US fiscal landscape which ought to be investigated.

The whistleblower's documents have been seen by the Guardian. They record the names and transactions of hundreds of companies, trusts, funds and wealthy individuals - information protected by local and Swiss secrecy laws.

Some of the paperwork concerns legal tax avoidance structures. Other files are alleged to point to potential illegal tax evasion by individuals around the globe.

The thousands of pages come from Rudolf Elmer, chief operating officer for the Julius Baer Swiss bank office in Grand Cayman until he was sacked in December 2002. Elmer, 53, and the bank have been involved in a long dispute. The bank accused him of forging documents and making violent threats. Elmer has accused the bank of hiring private investigators to harass him.

Elmer says his documents include all the back-up data held on Julius Baer's computer server in the Caymans at the time he was sacked, including accounts, correspondence, memos and resolutions dealing with 114 trusts, 80 companies, 60 funds and 1,330 individuals.

The bank says Elmer inappropriately obtained some documents as part of "a misguided campaign" against them. They reject his allegations as baseless and say their activities complied with all applicable laws and regulations.

In September 2005 the Swiss authorities held Elmer in custody for 30 days. They have indicated that they intend to charge him with breaking Swiss bank secrecy laws and with sending threatening messages to two Julius Baer officials.

Last year Elmer posted some documents on the Wikileaks website, which specialises in material from whistleblowers. Julius Baer got the site closed down for alleged breach of confidence, but Wikileaks had the California court order overturned on appeal.

The legal action drew the attention of the US Internal Revenue Service, who contacted Elmer. He is co-operating with the IRS, and with financial specialists in the office of Robert Morgenthau, the district attorney of New York; and with the powerful sub-committee on investigations chaired by Senator Carl Levin, which has a track record of probing offshore havens.

Elmer's disclosures follow the emergence of similar whistleblowers. One recently testified in the United States against the Swiss bank UBS, and another sold British and European authorities the contents of computer files from Liechtenstein bank LGT.

Elmer says his interest is in the network of tax havens. "People don't know how the system works. They may hear of some case, but the big picture always disappears into bank secrecy, professional secrecy with lawyers and accountants, and tax secrecy. But they need to know that this is a system which undermines our society, our democracy." He has lodged copies of files with Jack Blum, a veteran lawyer in Washington DC and an outspoken critic of the behaviour of tax havens.

Blum told the Guardian: "What Elmer is doing is extremely valuable in the process of educating people of the need for major reform. This is a system for enabling a certain class of people to avoid their societal duty, which is to pay tax."

We found and interviewed Elmer, now 53, at his new home on the Indian Ocean island of Mauritius. He used to be a part-time captain in the Swiss army, and is an accountant and auditor by training, and a lover of ballroom dancing.

He told us that originally, in 1987, he was proud to join the Zurich headquarters of Julius Baer, one of Switzerland's oldest and most respected private banks, handling some $38bn of assets, mostly for wealthy individuals.

But Julius Baer told the Guardian that Elmer had inappropriately retained documents when he was sacked by them in December 2002. They said many "were altered to create a distorted fact pattern or supplemented by forged documents".

Elmer responded to us that he had changed the titles of files to make them more easy to identify and also wrote spoof letters to tax authorities, for example purporting to be from penitent taxpayers confessing their evasion. He said he had not distorted or altered the contents of any internal document.

The bank suggested that since Elmer had forged spoof letters, they would be surprised if we placed any reliance on information from him. We invited them to identify any document referred to which they regarded as forged. They did not.

The documents include details of numerous trusts in which wealthy people have placed capital. This allows them lawfully to avoid paying tax on profits, because legally it belongs to the trust. In the same way, the capital can pass to heirs free of inheritance tax.

The trust itself pays no tax, as a Caymans resident. The trustees can distribute money to the trust's beneficiaries but it is essential the trustees exercise their own control over the trust's assets. If not, the assets become once more the property of the person who sets up the trust - and may be taxed.

'All the activities of our companies which you have referred to are in compliance with applicable laws'

The paperwork now being handed to US authorities appears to include several cases where wealthy individuals sought to use trust money as though it were their own. When we put these cases to the bank, they told us they did not consider it appropriate to discuss the affairs of their clients through the media.

Some documents refer to a Greek

Tax rate: 0%

Lawyers and accountants make up a tenth of the 52,000 population of the Cayman Islands, which are English-speaking, politically stable, in the US time zone, and with zero taxes. This British Overseas Territory with palm trees and luxury hotels, measuring less than 100 square miles, is the fifth largest financial centre on the planet. Tax Justice Network campaigners estimate that tax havens collectively hold more than $11.5 trillion. Some comes from tax avoidance. Each year the US may lose a total of about $100bn in potential taxes, France about $50bn, Germany $30bn, the UK between $20bn and $80bn - and the developing world loses up to $800bn in stolen capital. But in the Caymans, a prison sentence awaits anyone who discloses bank information.

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the UK.
Sid Fewster *Crickhowell*

● I suppose we must be grateful to the Guardian for the outstanding series on tax avoidance in this country by some of "our" leading companies, even though each morning's revelations give me indigestion.

The nefarious practices exposed just add gross insult to the already serious injury caused by the financial sector in this much abused country.

betrayal of all their employees who paid their full taxes.
Russell Armitage *Walsall*

● The Tax Gap articles are providing some great analysis - but before we get too sympathetic towards HM Revenue & Customs, let's not forget the unhappy world of small businesses and the self-employed, where the David and Goliath roles are reversed.
Tony Roberts *Chaniers, France*

responded

shipowner who placed $26.5m into a trust. Payments appear to be being made in and out without the knowledge of the trustees. The shipowner is said to have written letters referring to the trust as though it were a personal bank account. "The trust appears to be funding the settler's [founder's] shipping business," said one memo. Another speaks of "a risk that the structure could be regarded as a sham".

The Guardian emailed a summary of the documents to the shipping owner, who made no comment.

In other cases, the documents refer to:

- A memo by one Caymans financier, who did not leave a message on the answer machine of a UK client "in case the tapes are seized by the authorities".
- A memo about the affairs of a UK stockbroker whose trust was bluntly said to contain "undeclared money".
- Fears among Julius Baer staff that "we are rubber-stamping investment instructions" in relation to trusts set up by a London-based South American financier.
- Suspicions a German businessman sold a yacht which belonged to his trust and pocketed some of the cash for himself.

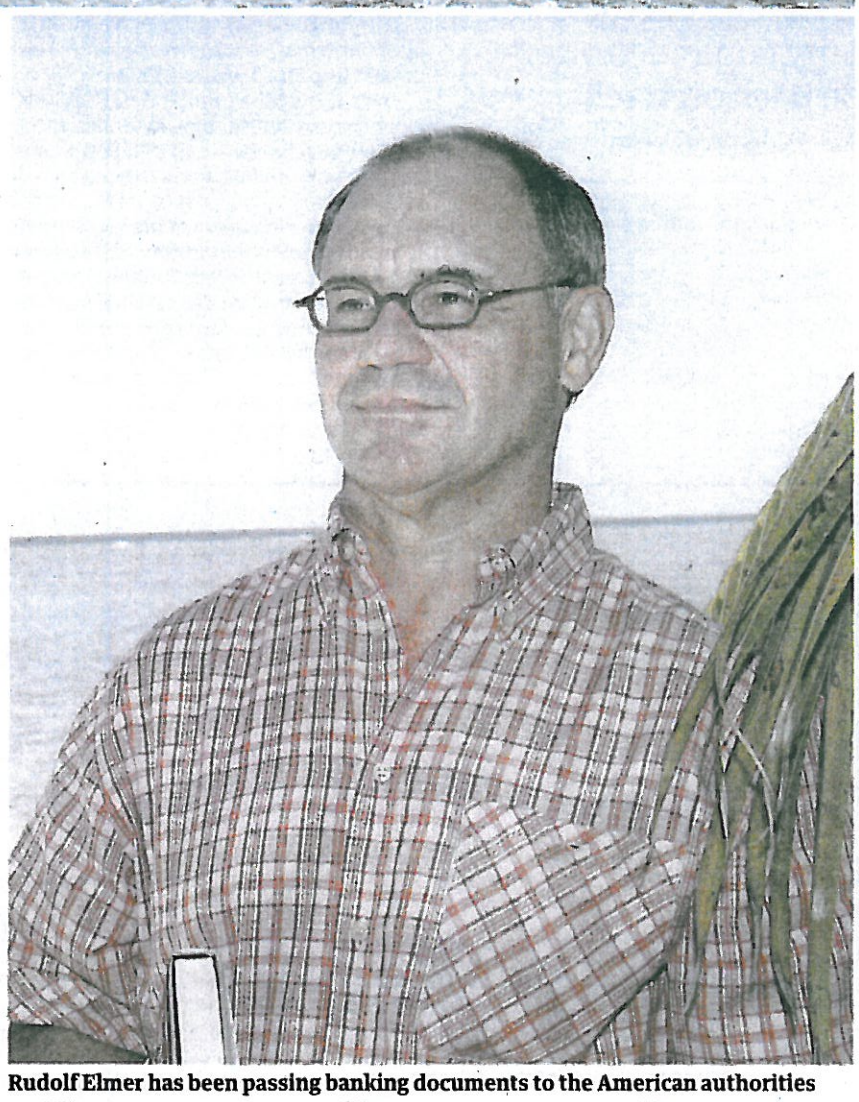
One file supplied to US authorities records concerns over a trust called Moontone, opened on the instructions of the law firm of Dr Thomas Baer, former president of the Julius Baer bank, in the name of a man named Schuler. Caymans staff did not have a passport for Schuler and no way of knowing who he was. Nor were they able to verify where the money had come from. Dr Baer told us he could not discuss a case where documents might have been supplied by a criminal source and that he was bound by lawyer's confidentiality.

He added that Swiss banks were not allowed to open accounts without complying with "know your customer" rules; and that the leaked documents did not reveal what information was available to the bank in Switzerland, nor whether the required information was finally supplied to the Julius Baer Trust Company in the Caymans.

Other Elmer files refer to an alleged trust opened by a Mexican police chief accused of colluding with drug dealers; a Brazilian politician accused of corruption; and a trust allegedly established by Canadian businessman David Radler, now better known as the partner in fraud of former Daily Telegraph proprietor Conrad Black.

'People don't know how the system works. But it is a system that undermines our democracy'

In respect of all of the contents of the files, Julius Baer told the Guardian: "All of the activities of our group companies and of the investment vehicles which you have referred to, including associated fee flows and interdependencies, are in full compliance with applicable laws and regulations. These activities are transparent to the regulatory and other governmental agencies in the jurisdictions in which they operate, to their respective external auditors and, with respect to investment vehicles, to investors in such vehicles."



Rudolf Elmer has been passing banking documents to the American authorities

Rare glimpse into offshore world of big money and low taxes

One of the more fascinating sets of records disclosed by Elmer is, he says, the confidential investor list of an offshore fund run by the Carlyle Group.

This prominent private equity operation in Washington DC counts presidents and prime ministers among its advisers, and Elmer's list opens the door to a rarely seen offshore world of big money and low taxes.

Carlyle sources did not challenge the authenticity of the list when we showed it them. They emphasised instead that all their activities in the Caymans were perfectly legal and normal.

The fund bought and sold shares in US start-up firms from its offices in Washington DC. But an offshore paper entity in the Caymans, TCG Ventures Ltd, was nominally running the show.

TCG's correspondence was administered by Swiss bank officials actually living on the islands, in return for a fee. This helped the foreign investors to minimise their tax bills and protected them from the American courts.

US tax authorities accepted this legal fiction, although the set of rules which allowed it has since been changed.

Carlyle emphasises that the American tax authorities lost nothing from this arrangement. What seems clear, however, is that such an offshore structure makes it in effect a voluntary matter for some foreign investors to disclose their profits to tax authorities in their home countries.

The fund, Carlyle Venture Partners, put together 67 wealthy companies and individuals to invest approximately $230m.

According to the documents, investors included the Saudi prince Talal bin Abdul-Aziz ($1m); two companies advised by Prinz Michael von und zu Liechtenstein ($7m); the late Akram Ojjeh, who earned a fortune brokering arms deals in the Middle East ($2m); the Kuwaiti state's sovereign wealth fund ($10m); and London-based Saudi companies linked to the Bin Laden family construction group ($2m)

There are American names on the list. Felix Smolka, a hotelier in Boca Raton, Florida, was listed as the contact point for two anonymous entities who tipped in $1m each, Durant Trading LC and Milestone Development Corporation. Smolka told the Guardian that both were offshore companies which he did not own: he was merely an "investment adviser" to one and a "contact" for the other.

The list of investors also includes anonymous companies and trusts from Panama, Liechtenstein, the British Virgin Islands and the Channel Islands, each with its own secrecy laws that conceal the real owners.

In an extreme example of offshore "layering", one person invested his Carlyle Group $1m into the Caymans through an anonymous company in Panama. The contact name given to Carlyle transpires in turn to be merely that of a firm of administrators in Liechtenstein, most notoriously secretive of all havens.

The Caymans host more than 9,000 private equity funds and about 80% of the world's hedge funds.

so I get more income?
Dr Peter West *York Health Economics Consortium*

We will never get a fair or efficient system if businesses are taxed on profits. It will always be easy for big businesses to suppress profit artificially or to transfer it to low-tax jurisdictions. Would it not be better to tax all businesses a small *ad valorem* tax on their UK turnover instead?
Richard Heller, via email

relocated and some obscure tax havens appear as major oil exporters even when they have no oil.
Prof Prem Sikka *Essex University*

It's great to see you shine your spotlight at some of the corruption of big business. It's so easy for the media to take pot shots at the government, but it's got to the stage where there is very little meat left on the carcass.
Andrew Kemp, Liverpool

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In the country where tax evasion is no crime, Swiss private banks are unrepentant about siphoning off other governments' income

Critics of Switzerland would say that the country and its banks are running an anti-social enterprise, in effect picking billions of dollars a year out of the pockets of others. It was the spectre of Switzerland that Britain's prime minister, Gordon Brown, sought to raise in parliament yesterday, as he attempted to assure critics that he was doing something positive against tax avoidance.

The Swiss openly assist not merely legal tax avoidance but also the deliberate concealment of wealth for the purpose of evading tax - something regarded as a crime all over the developed world. Swiss authorities have boycotted and even sabotaged efforts to stop this drain of taxable cash. The German finance minister last year called for Switzerland to be officially named and shamed as an unco-operative tax haven.

Swiss bankers themselves estimate that they hold at least 30% of the estimated $11.5 trillion of personal wealth hidden in the world's tax havens. Konrad Hummler, president of the Swiss private bankers' association, has said: "The large majority of foreign investors with money placed in Switzerland evade taxes."

And he remains unapologetic. He acknowledged to the Guardian that Swiss banks siphon off other governments' revenue.

"I admit it is undemocratic," he said. "But I have a feeling that the democratic system went way beyond their legitimate role against the taxpayer. What these states do may be legal, but it is not legitimate."

He singled out Germany, France and Italy as "illegitimate states", whose citizens had no protection from excessive taxes. "We are so allergic to the Germans... because the Germans have the feeling that citizens belong to the state. There is a very old, very deep worry of the Swiss people against the Germans - it goes back to history, especially the second world war."

He described the Organisation for Economic Co-operation and Development [OECD], which has fought tax havens, as a "tax cartel". He said the Swiss would not willingly compromise banking secrecy or their view that tax evasion was no crime.

However, he added: "There is always a possibility that you can blackmail Switzerland, because we are dependent on good relations with Europe. It would be very unfriendly. Anyway, if we were forced to hand over information, the money would only go away, to another country."

The Swiss do very well out of their activity. Their banks routinely charge fees of 10%, while the regional cantons earn millions by levying a little tax on foreign individuals and companies who would otherwise have to pay a lot of tax in their own countries.

At the legitimate corporate end of the tax spectrum, about 6,000 global companies have now chosen to place activities in Switzerland, according to the official agency, Location Switzerland. There are so many mining companies, particularly from Russia and China, that the canton of Zug has become a trading centre for minerals.

Dun & Bradstreet in Zurich identifies more than 180 UK businesses with holding companies in Swiss cantons. Such entities generally will pay no tax at all on capital gains and very low tax on income. Some will also negotiate individual "tax rulings" in which the canton allows them to cut corners on their tax returns or makes favourable assumptions about their financing.

Local cantons also often offer tax breaks to wealthy foreign individuals and company executives, who are allowed to live there without paying any income tax if they pay the canton a fee, usually five times the rental value of their Swiss home. There are so many of them in villas along the eastern shore of Lake Zurich that it is known as the "Gold Coast".

Konrad Hummler: calls Germany, France and Italy 'illegitimate states' because their citizens have to pay excessive taxes

Christoph Meili: fled to the US after being accused of breaking secrecy law by the biggest commercial bank in Switzerland

Switzerland's lucrative tax haven industry is constructed from two laws out of step with other developed governments.

First, whereas most countries will merely sack bank employees who leak information, the Swiss charge them under article 47 of their criminal code and jail them. Second, whereas most countries regard tax evasion as a crime, Switzerland insists that it is no crime at all unless it involves active fraud, such as the forgery of paperwork.

The result is that other countries are constantly trying to breach the walls of the Swiss fortress. Indeed, Switzerland's bank secrecy law was introduced, in 1934, to stop bank staff helping the French tax authorities - and certainly not, as the Swiss sometimes claim, to help Jewish refugees hide their assets from the Nazis.

The Swiss use their law to clamp down on leaks. In January 1997 Christoph Meili, a 28-year-old security man at the biggest commercial bank in Switzerland - Union Banque Suisse (UBS) in Zurich - discovered that the bank was burning the records of Jewish clients who had died in the Holocaust. When he reported this to press and police, he was himself accused of breaching the law and ended up fleeing to the US, where he was granted political asylum.

Swiss authorities have been fighting a running battle with Rudolf Elmer, 53, a former senior employee of the Julius Baer bank who posted internal paperwork on internet sites which, he claims, reveals tax evasion and money laundering by individuals. Elmer was held in prison for 30 days and told he will be charged for breaking the secrecy laws.

Last year a UBS employee was arrested in the US, pleaded guilty to organising tax fraud and agreed to tell all. Bradley Birkenfeld alleged UBS staff routinely broke laws forbidding foreign bankers to tout for business among wealthy Americans. They travelled to US golf, tennis and yachting events sponsored by UBS, lying on their visa forms about the purpose of their visit, armed with laptops with heavily encrypted files and deploying counter-surveillance techniques for which they were specially trained.

UBS had signed a "qualified intermediary" agreement, undertaking to report any US individual with an account. But Birkenfeld said the bank helped thousands of clients to dodge this by shifting their money into offshore companies. UBS advised clients to destroy evidence of their accounts and - for an extra fee of 500 francs - offered to store their banking correspondence for them in Zurich.

Birkenfeld said UBS had helped 19,000 US taxpayers to shelter $18bn, and encouraged them to buy jewellery or art that they could bring back into the US. He also said he had smuggled diamonds in a tube of toothpaste for a client. A US Senate committee concluded: "The top management of UBS in Switzerland was well aware of the bank's practice of maintaining undeclared accounts for US clients."

The Swiss have fought off every attempt to make them change. They belong to the OECD but refuse to sign any tax information exchange agreement of the kind that the OECD now supports. They trade with the European Union but they have refused to sign up to the EU savings directive, which asks for the account details of all European residents to be passed to their respective tax authorities. Following their refusal, other nations, particularly Austria and Luxemburg, have also boycotted the OECD and EU initiatives.

As a compromise with the EU, these "boycott nations" have agreed to collect tax on EU residents' accounts, deduct a fee for their hard work and pass on the balance to the correct tax authorities. However, since the directive applies only to individuals, there is anxiety in Brussels that, behind the scenes, banks have been repeating the manoeuvre that UBS used to defeat the Americans, simply converting individuals into offshore companies.

After last year's scandal, the Americans applied intense pressure to UBS to hand over the details of the 19,000 undeclared US accounts.

Rather than possibly lose its licence to do business in the US, the bank was willing to surrender - but the Swiss finance ministry intervened to ensure that if files were handed over, it would be on the fictional basis that it was evidence of fraud, thus preserving the officlal Swiss stance that they will not co-operate with other nations on mere tax evasion. Gordon Brown claimed yesterday that the Swiss might reform in the wake of the latest UBS scandal. But it hasn't happened yet.

How Switzerland sells itself

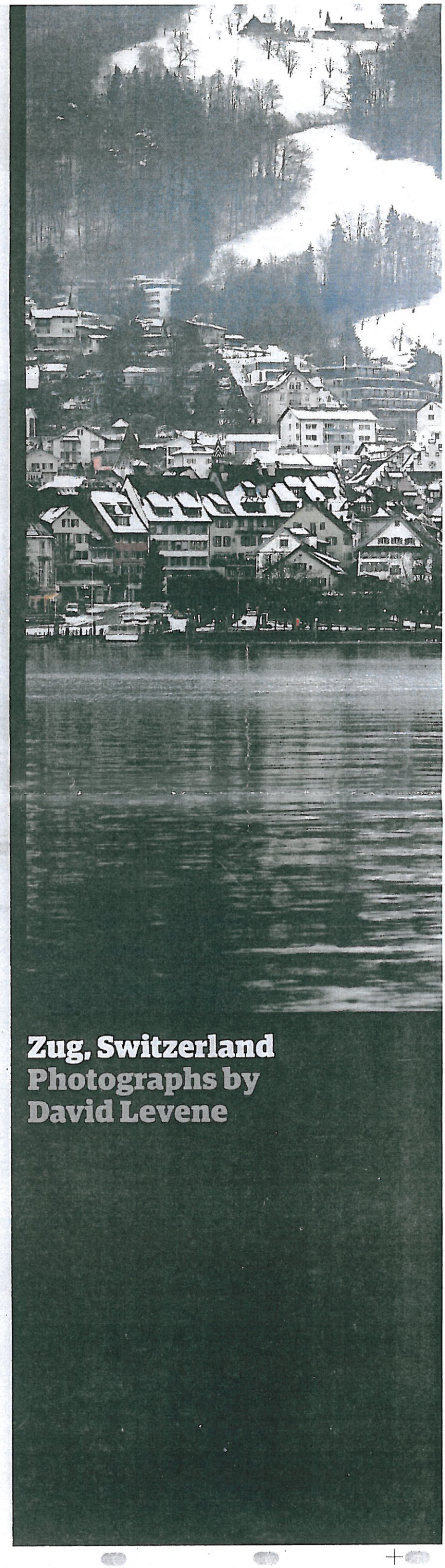
"Location Switzerland" is the Swiss **government agency** that markets the advantages of "restructuring".

"Taxes: Why pay more?" is how its **handbook** for foreign companies puts it. The Swiss **corporate tax rate** for foreign trading companies is about 7-8% compared with 28-30% in the UK.

Location Switzerland point to the commercial reasons for "restructuring" too - economies and efficiencies from centralised buying, ordering and selling.

But the reason to do it in Switzerland is to save tax, as the big **accountancy firms** who market the concept are quick to point out. They call it TESCM - "tax-efficient supply chain management". Ernst&Young were among the first, advertising that centralisation could "result in a 40% increase in earnings, but 40% of this [increase in earnings] would go to the tax man ... But when the two were integrated, net profit improvement soared ..."

One **consultant**, Bill Bronsky, explained in a trade paper in 2006: "This is the **multimillion pound** opportunity. Using the TESCM model companies have been able to move from effective tax rates of 35% to a rate of less than 15% after **restructuring**. There are well over 100 companies (many in the FTSE 100) that have significantly restructured their business operations to optimise their tax position."



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The difference between the corporation tax companies pay and the theoretical amount they would pay if debatable exemptions and allowances, plus artificial avoidance schemes, were abolished.

The transfer of Walkers crisps to a foreign subsidiary has cost UK millions

How to save a packet

A curious thing happened to the UK profits of Walkers Snack Foods in 1999. They fell off a cliff, as did the UK tax bill that went with them.

Walkers still manufactures its crisps in Leicester at the world's largest crisp factory, as befits the top brand in a country whose potato snack habit is one of the largest in the world.

Its sales, boosted by that footballing symbol of middle England, Gary Lineker, have remained by and large as healthy as his image, despite nutritionists' best efforts.

And yet Walkers' UK profits took a dive from which they have not recovered.

The explanation, the Guardian has discovered, was quite simple.

Walkers had been "restructured" by its owners, the US transnational giant, Pepsico.

This shifted much of its profits to a tax haven in Switzerland.

In June 1999, Pepsico transferred ownership of its Walkers brands, built up in the UK over the decades since it first began frying in 1948, out of England and into a Swiss subsidiary, Frito-Lay Trading GMBH.

Moreover, up to the most recent accounts, the Swiss company had still not actually paid Walkers for them.

Walkers carried on making the crisps that millions of Britons eat daily at its sites in England.

It also carried on employing roughly the same number of production workers, about 3,000, and its marketing still boasts that "we're proud our crisps are made from 100% British potatoes, and we love our home".

But for all Walker's Britishness, its "intellectual property" and "business functions and risks" had quietly migrated to the low-tax canton of Bern.

The British factories were reduced from a major profit centre to mere contract manufacturers, paid a margin over their costs by Pepsico's Swiss trading company.

Walkers on paper no longer owns at any point the raw materials or products it makes; it does not own the potatoes that go into the factory nor the crisps that come

Gary Lineker is the advertising face of Walkers. The firm has shifted a large portion of its profits to a tax haven in Switzerland

out. Its sales and marketing company does not own what it sells to the supermarkets and pub chains. It just collects commission like the Avon Lady. Pepsico's Swiss-registered entity owns the goods remotely instead.

What has this surreal arrangement meant for the UK exchequer?

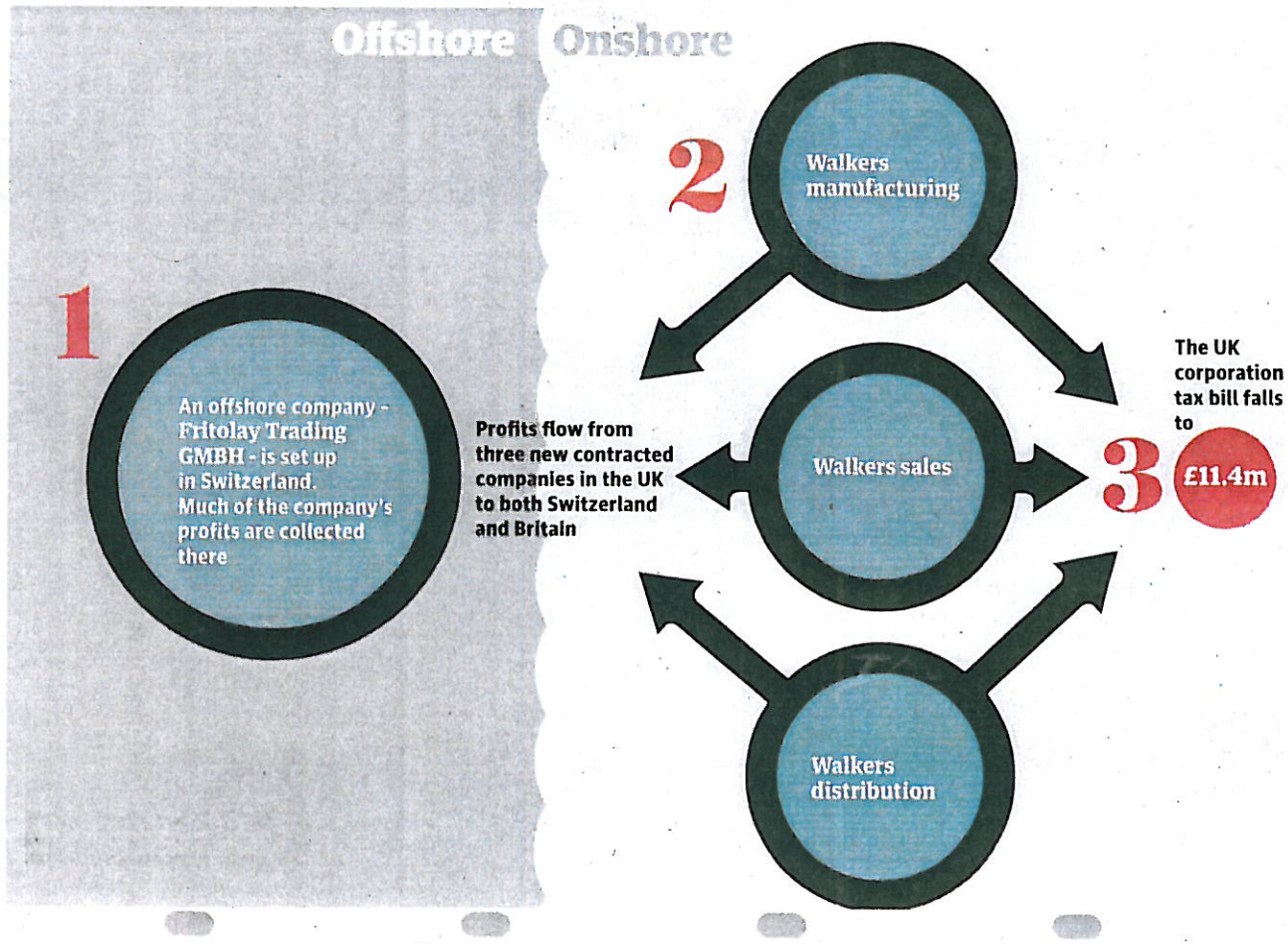
The year before it happened, Walkers Snack Foods was turning over £469m. This generated profits in the UK of £91m and a tax bill of £28m to hand over to the British Revenue.

But in 1999, the year the brands were sold, Walkers Snack Foods turnover almost halved, as did its profits, and the UK tax bill went down to £14.7m.

The original Walkers operation in Britain had by now been split into three separate components - the original manufacturing arm, Walkers Snack Foods; Walkers Distribution; and Walkers Snacks, a sales and marketing entity.

Before restructuring

After restructuring



Adding all their tax charges together, the Walkers total came to just £18.3m - nearly £10m less than the previous year's £28m.

By 2000, the first full year after restructuring, the total UK tax contribution from the new group had plummeted further to just £11.4m.

Profits were piling up in low-tax Switzerland, in what was presented as now essentially a Swiss-managed operation.

The Walkers companies were said to be merely making and distributing the crisps, and collecting the money from UK supermarkets, on behalf of the real managers abroad.

There were some strange features to the newly devised "sales and marketing" entity, Walkers Snacks. A large chunk of the old Walkers' turnover was allocated to it.

The average pay of the 170 employees also allocated to it in 1999 was exceptionally high, suggesting some expensive people might work there.

£40m The amount given back to Britain by Pepsico after a deal with the tax authorities. The move followed a long dispute

But there turned out to be much room for argument with HMRC about just how "Swiss" the Walkers crisps operation had really become.

In shifting a substantial chunk of the profits from its operations out of the UK to Switzerland in this way, Pepsico became one of the earliest adopters of the sort of business restructuring that Revenue sources now describe as the biggest threat to the UK tax base.

Dozens of large companies have followed the Pepsico route. Tax authorities around the world struggle to keep up with them.

It took two more years for the Revenue to blow the referee's whistle on Pepsico. By that time the UK tax bill from the restructured companies had shrunk to around £8m.

Corporations, just like individuals, submit their returns in arrears.

Walkers' auditors, KPMG, recorded the Revenue's challenge to its tax returns. "The tax authorities have queried a number of historical transactions," they said.

However, the auditors added that "management are confident that the treatment which has been adopted is correct."

Nevertheless, the company started making a provision in the next few years for a bigger tax bill but without disclosing it in its statutory accounts. It did this "on the grounds that it might be prejudicial to the company's interests in its dealings with the tax authorities".

Eventually, Pepsico did a deal, and gave around £40m back to Britain.

But the dispute moved at glacially slow speed.

It took until last October for a final settlement with HMRC to be agreed and revealed in the small print of the Walkers accounts.

The UK had managed to claw back less than a third of what it might have received had an unchanged structure continued producing the same sort of level of UK profits and tax as Walkers Snack Foods had in 1998.

Invited to comment, New York-based Pepsico told us: "Pepsico manages its tax affairs in a prudent and lawful manner."