INTERNATIONAL FINANCIAL CENTRES - OFFSHORE BANKING - THE WHITLAM AND MARTIN REPORTS

In New South Wales, a report of the Offshore Banking Committee was released in February 1984. The committee was chaired by Mr N. Whitlam and consequently the report has become known as the "Whitlam Report".

The committee chose to interpret "Offshore Banking Activities" in a fairly broad sense of international banking and other related financial activities. The aim of establishing an offshore market or offshore banking centre in Australia was, according to the report, essentially to ensue that the activities were carried out in Australia, they were booked to Australia and the benefits accrued to Australia.

The committee proposed the creation of Offshore Banking Units ("O.B.U's") which would be either a separate accounting unit within an existing financial intermediary (bank or non bank) or a new "offshore bank". Foreign banks would need to apply for a licence to establish an offshore bank which in turn would operate an OBU and perhaps at some later stage also a "domestic banking unit",a "DBU". The OBU would be distinguished by the fact that all transactions were in foreign currencies.

The committee proposed that perhaps 50 licences could be granted to existing Australian Financial institutions and 20 or 30 new offshore banks might be licenced.

The committee believes that the licensing of new offshore banks should be as branches rather than as subsidiaries. This, it said, would be crucial to the ultimate viability, scope and efficiency of the offshore banking centre. Limits and rates for a branch would then assessed as part of a global banking group. The committee felt that the "well established procedures for prudential supervision of international banking through branch operations under international agreements.....(such as) the Bank of International Settlements Concordat..." would be adequate. (cf. [1984] Australian IL News 44,66].

Each applicant to operate an OBU would need to satisfy the Reserve Bank that it could meet its obligations - in the case of foreign owned institutions demonstrating their ability to supply convertable currencies to cover any deficiency or illiquidity. Further they would need to meet prudential standards established by the Reserve Bank. An annual licence fee of US$50,000 was suggested and there would be a need for initial capital of say A$3,000,000. Offshore banks would need to provide "letters of comfort" from parent and home central banks or regulatory authorities acknowledging the standing of the applicant and the provision of prudential supervisory responsibilities.

The committee noted that as Australian Banks are not taxed on their global profits and therefore enjoyed the benefit of concessional profit tax incentives (eg. in Singapore), they would not readily book foreign currency loans to Australian residents through an Australian OBU. The committee, after some hesitation, recommended the imposition of an effective penalty on those who do not borrow through the OBU by charging a different rate of interest withholding tax,or an exemption, in respect of interest payments on "pure" offshore transactions, ie, between non residents and in foreign currencies. The cost of this, in the view of the committee, would be zero as there was no evidence that such transactions were presently booked in Australia

The tax on "offshore income" should be 10 per cent to match the Singapore tax, not the normal rate of corporate tax, presently 46 per cent. As none of the offshore transactions were in fact conducted in Australia no revenue would be foregone

Amendments and exemptions from various legislation and policy in the field of banking, exchange controls taxation would be necessary. Further, there shuld be exemptions form certain aspcts of state taxation - stamp duty on cheques share investments transfers of marketable securities, guarantees, and loan securities. Further, credit to OBU accounts should not be subject to New South Wales Financial Institutions Duty.

The committee felt that supervision should be a matter of federal responsibility and state corporate affairs commission did not have a role to play.

It saw the permission to offshore banks to operate a OBU as one way of introducing foreign bank participation in domestic banking.

The report is a carefully considered and detailed proposal for the development of offshore banking in Sydney. In summary, it recommends:-

1. The creation of offshore Banking Unis, OBU's generally exempt from state taxation and subject only to an income tax rate of 10 per cent;

2. The exemption from Australian interest witholding tax on transactions booked through an OBU between non residents and in a foreign currency, and

3. The impositions of a penal witholding tax of say 20 to 30 per cent on foreign currency loans to Australian residents which are not booked through an OBU.

The Whitlam Report is not the first examination of offshore banking undertaken at the official level in Australia. The Campbell Inquiry commissioned a study this issue by Professor J.R. Hewson, Offshore Banking in Australia AFSI, Commissioned studies and selected papers The Campbell Report (Australian Financial System, Final Report ACPS, 1981) did not make a recommendation on the question, but stated that if there were a place for offshore banking in its recommended transitional period of exchange deregulation, then a programme of staged development of a market could be devised: paragraph 8.93

The question was also considered in a report prepared for the Government of Victoria; B.L. Hamley, Currency Market Inquiry, 1982. That report concluded the development of such a market was both feasible and desirable. Is recommendations included:-

- The abolition of witholding tax;
- exemption from state taxes;
- concessional taxation of income earned from offshore banking;
- exemption from exchange control;
- a prudential framework without reserve or liquidity restrictions ; and
- changes concerning the management of the exchange rate and the forward market

The Whitlam Report was also preceded in New South Wales by a market intelligence report by Peat Marwick Mitchell Services, Sydney Financial Growth Centre for the Pacific, August 1983. The Report was commissioned by the NSW government, and contains useful background information.

The Martin Report (Australian Financial System Report of the Review Group, AGPS 1984) also examined the question. This was established to review the Campbell Report for the need federal Labour Government It examined the potential benefits, costs, scope and concessions required for offshore banking; and its conclusion, on the whole, were unfavourable. It concluded in para 11.24:-

> The Government's decision on 9 December 1983 to float the Australian dollar and to dismantle the major part of exchange controls has significantly reduced the impediments to establish of an offshore banking centre. The floating of the currency substantially reduces concerns from the macroeconomic management viewpoint about the development of offshore banking. Exchange conrols no longer represent a barrier to offshore banking activities involving residents as well as non-residents. This is not to suggest that the conditions have been established for such activities to flourish. The lateness of Australia's claim and the strength of competition could both be important inhibiting factors in the development of an offshore banking centre. The Group judges that, while there are likely to be benefits from the development of an offshore centre, the direct impact on employment and economic activity and on invisibles earnings would be of limited magnitude. The broader benefits from internationalisation of the Australian financial sector are difficult to assess. The Group notes that such internationalisation should in any event be furthered by the substantial dismantling that has occurred in exchange controls. The development of an active Australian offshore banking sector would be facilitated by - indeed, it would almost certainly require - the granting of considerable concessions, financial and policy-oriented. The Group recognises that scope now exists for initiatives by private interests in the conduct of offshore banking business. It questions, however, the justification for tax concessions which would result in tax treatment of international banking activities that was more favourable than that accorded to other types of business activity.

The Final decision of offshore banking will obviously be a political one. If offshore banking is approved, there will be of course be considerable implications for the legal profession. Some of the objections currently being raised include:-

- issues of tax avoidance, and avoidance of reserve requirements.
- issues in relation to the adequacy of supervision even if Australia joins the Basle Concordat, which some argue is still inadequate.
- issues involving the claim by other powers to extraterritorial jurisdiction This would be exacerbated if the OBU's were to take the form of branches, as the Whitlam Report recommends, for this would ensure that the foreign OBU remained a national of another country;

- inequity resulting from the proposed concessional rate of tax of 10 per cent on the profits of offshore banking, and the resultant distortion on the allocation of resources in Australia;
- The effect of the proposed penalty witholding tax (perhaps 20-30 percent) on interest on borrowing in foreign currencies by Australian residents where these are not booked through an Australian based OBU. This would probably encourage most such loans to be booked through an OBU, and it is said the cost would rise to cover Australian income tax of 46 percent and witholding tax of 10 percent. It is said the cost would be passed on the borrower.
- The legal context of foreign banking, including questions concerning the right of foreign legal firms to practice in Australia (see separat note), sovereign immunity for state borrowing and arbitration law (see separate note) The question of sovereign immunity will be the subject of a forthcoming report by the Australian Law Reform Commission.

Other critics have suggested reasons why an offshore centre might not develope, for example the five year exemption from then 10 per cent tax on offshore banking profits from syndicated loans in Singapore, the proximity of Singapore to other Asian capitals the possibility of labour stoppages affecting our communictions infrastructure, the possible development of Tokyo as an offshore centre, and the possible US repeal of witholding tax which might weaken all offshore markets.

The benefits argued in terms of employment and business seem, however, attractive. The final decision will therefore involve a delicate exercise of judgement. Whether or not one approves its recommendations, the Whitlam Report has undoubtedly performed a distinctive service in highlighting the issues involved, and in presenting in clear and impressive terms, a detailed proposal for the adoption of such a centre.

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