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TERRORISTICI**

**TAX HAVENS AND MONEY LAUNDERING AS AN  
INSTRUMENT OF FINANCING TERRORIST GROUPS**

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## **RIASSUNTO**

Lo scopo di questo case study è analizzare le relazioni e le connessioni tra paradisi fiscali e riciclaggio di denaro per studiare in che modo i gruppi terroristici utilizzano questa relazione come strumento finanziario e come la comunità internazionale cerca di combatterli. Partendo dalla concettualizzazione introduttiva dei concetti di legge internazionale, paradiso fiscale, riciclaggio di denaro e finanziamento del terrorismo, il loro inserimento nella portata internazionale e il rapporto tra loro. Affronta anche il ruolo delle organizzazioni internazionali nello scenario internazionale e come stanno lavorando per combattere tali pratiche.

## **ABSTRACT**

The aim of this case study is to analyze the relations and connections between tax havens and money laundering in order to study how terrorist groups use this relationship as a financing instrument and how the international community seeks to combat them. Starting from the introductory conceptualization of the concepts of international law, tax haven, money laundering and terrorist financing, their insertion in the international scope and the relation between them. It also addresses the role of international organizations in the international scenario and how they are working to combat such practices.

## **1. INTRODUCTION**

The economic model of liberalization and profit maximization assists and promote the practice of withdrawing capital from countries with higher taxation or tax laws transferring them to places where tax regulations are lower and mild. This transfer of resources is detrimental to a large number of countries, mostly developing countries, where the effects of such withdrawals can be felt more abrupt. When it comes to tax havens, however, this is not the only concern. In fact, one of the biggest problems is the latent lack of transparency in financial data from those places, which attracts people and groups interested in money laundering, such as terrorist groups.

The usage of tax havens can be considered as a tool for money laundering. The crime of money laundering is characterized by a combination of commercial or financial operations that seeks to incorporate into the economy of each country (in a transitory or permanent way) resources, goods and values of illicit origin. In the last two decades, money laundering is associated with several other activities including drug trafficking, corruption, weapon sales, prostitution, financial fraud, kidnapping and terrorism.

Thus, these crimes ceased to be only local problems and became international crimes, whose impact can be felt in diverse parts of the globe. The money laundering from drug trafficking is responsible for the second largest flow of capital in the world, moving

around \$320 billion a year, only below the oil commercialization (AGUILERA, 2012). If this practice before was restricted to certain regions, its effects today are spread beyond the international borders, destabilizing financial systems and financing illicit activities in different countries.

The growing concern of the international community over tax havens is mainly due the increase of diverted money to these regions in recent years, as so the jurisdictions between the nations and those national securities, due the fact that much of the investment in those places comes mainly from tax evasion, drug trafficking, money laundering and international terrorism, which could finance crimes implementation within some countries. In this way, efforts to combat the lack of transparency of tax havens have been distributed worldwide, looking for innovative resolutions, capable of developing significant changes in legislation of tax havens or even the creation of a supranational legislation aimed to improve the fight against such jurisdictions (ANDRADE, 2006). The concern with tax havens has been increasing significantly since the attack of September 11 and after the crisis of 2008. Developed countries, especially the United States, and international organizations such as International Monetary Fund (IMF), the World Bank (WB) and the World Bank Economic Cooperation and Development (OECD), as well as the economic group G-20, have increased their efforts to create a regulation in international taxation. Thus, the general

objective of this case study is to discuss the international effort, through cooperation, to identify and combat tax havens and also to increase the control over offshore accounts which can finance groups that tend to propagate terrorism.

In order to achieve the general objective, the specific objectives are:

a) Conceptualize tax havens, money laundering and terrorist financing, to understand the connection between tax havens and money laundering as instrument for financing terrorist activities, seeking to highlight how these practices are related not only to economic issues, but also to social issues and safety;

b) Analyze the attempts to harmonize the standards of terrorist financing combat. For this reason, will be explored the role of organizations such as the OECD, Tax Justice Network, Financial Action Task Force (FATF), the World Bank and governmental organizations. It will also present the characteristics of the offshore centers and tax havens, as well as the role of international organizations to combat such practice. It is intended to present, in a more accurate way, how the terrorist groups use tax havens and money laundering to finance activities;

c) Finally, to infer if there is a relation between the use of tax havens and the practice of money laundering as a funding for terrorist groups.

The present research uses information such as the way and by which the capital flow is directed to these low taxing countries and also seeks the quantitative estimate of the impact of this capital in some economies.

In order to identify possible relations between tax havens and terrorist groups, it has been seen that this theme extended the role of such as OECD, World Bank, IMF and non-governmental organizations such as Tax Justice Network and FATF. In this sense, the growing concern with this issue has resulted in an increase of autonomy for international organizations to fight against money laundering, tax havens and terrorist financing and also increased public interest on the issue.

As a research source, the paper will seek to analyze the reports and financial estimation, such as the Anti-Money Laundering and Terrorism Financing of Guide (2005), Mutual Evaluation Report and Summary Executive: Prevention of Money Laundering and Combating the Financing of Terrorism (2010), Capital flight, Illicit Flows, and Macroeconomic Crises, 1960-2012 (2014), among other studies provided by different international institutions that operates in the economic sector.



## **2. MONEY LAUNDERING, TAX HAVEN, TERRORIST FINANCING AND ITS INTERFACES**

From the 1980s and 1990s, the "boom" of economic globalization occurred, leading to the consolidation of a large global financial market. This process of economic liberalization gave the investor the power to choose where the best place would be to invest their money and thus obtain higher income rates (Nye & Welch, 2012). The process of searching for the best investment sites ended up creating a network that interconnected different currencies and economies, generating competition between countries, which now are looking for ways to attract this flow of capital. In this way, the development of the global financial market occurred as an expansion of international banking transactions, liberalization of capital flows, deregulation of markets and globalization of the communication.

Thus, within this globalized market in which capital seeks always greater profitability, it can be said:

*“Since the capital is increasingly sensitive to changes and differences between systems, a process called tax competition is developed, in which different locations compete for capital. The concept embrace competition between countries and internal competition between*

*regions of a same country as we identify in China. The smaller and less bureaucratic taxation is, the greater the amount of resources to certain jurisdiction. Some authors, such as Mitchell (2009), consider the tax competition as positive, since competition between tax havens and jurisdictions with high taxes would stimulate the reduction of taxes, favoring investment and job creation” (AFFONSO & al., 2013, p. 132)*

However, although there are authors who consider the tax competition by tax havens a positive thing to the world economy, some studies such as those presented by the FATF in the years 2010 to 2014 show that tax havens are used as mechanisms for money laundering for terrorist groups. In addition, reducing the level of taxation of States, which causes a reduction of revenues and consequently a worsening of public services, especially health and education (TAX JUSTICE NETWORK, 2012). Because of this, tax havens have been under great pressure from groups such as OECD, FATF, BM and also from the international community, to create internal control systems with the purpose of combating the individuals who use these sites to commit and perpetuate illicit activities such as money laundering, tax evasion and terrorist financing.

Therefore, in this chapter will be exposed the concepts of tax havens, money laundering and terrorist financing in order to facilitate the understanding of the relationship

between the factors. In addition, will be analyzed the historical concept of the emergence of such jurisdictions and money-laundering practices, showing how international organizations and the international community has been working to create harmonization to combat such practices.

## **2.1. THE TAX HAVENS AND MONEY LAUNDERING**

Using the connection between money laundering and tax havens, low taxation is not the only factor that attracts investments to these places. The tax havens have other characteristics besides their soft fiscal policies. Many of the investments that migrate to these places is due the high degree of banking and commercial secrecy, the lack of exchange control over deposits of people non-residents, and for having a minimum degree of political and economic stability. That way, offshore centers may attract the illicit assets in order to convert them in licit, a fact that in those economies has circulated US\$21 trillion only in 2010, according to conservative estimates. In order to assess the volume of this amount, it is possible to size them as the economy of Japan and the United States together. In addition, the ten largest private banks that have assets in offshore centers, such as like UBS, Goldman Sachs and Crédit Suisse, handle more than half of all capital of the 50 largest banks operating in these locations (TAX JUSTICE NETWORK, 2012)

Regarding to tax havens, it is possible to say about the lack of harmonization system, taxation and banking transparency, that are rules and practices aimed at establishing regulations and restrictions on financial flow. Among the many efforts to combat this practice, there is the OECD blacklist policy, which compiles cooperatives and puts them on the list. The intent of this list is to undermine the reputation of tax havens and offshore centers in order to reduce investor confidence and the flow of capitals to these sites, so these systems theoretically works as a kind of an economic sanction (Kudrle apud AFFONSO, et al., 2014).

According to the book of (Barber, 2006), the following characteristics are the main reasons why offshore centers are chosen.

- I. Tax Structure;
- II. Political and Economic Stability;
- III. Exchange control practices;
- IV. Treaties;
- V. Government Attitude;
- VI. Modern laws about corporations;
- VII. Communication and transport;
- VIII. Professional, banking and support services;
- IX. Juridical system;

X. Confidentiality and secrecy;

XI. Incentives and investment opportunities;

XII. Location.

Not only bank confidentiality and financial secrecy, but also corporate secrecy is one of the most important features in tax havens. The idea of secrecy company is that the bearer share (partial ownership title of the registered capital of a company) is not registered to the authorities, so, the identity of the international investor is hidden. Therefore, this is one of the largest obstacles which tax havens are used to financial crime, since there is no way to know who is the partner of the offshore center. Even that low taxation is not the only determining factor, it fits inside this case of offshore center to Switzerland, a country known worldwide as a tax haven, which practices a 35% income tax rate on what is produced there, that does not diminish the popularity of the country among the offshore centers because the country is known worldwide for its laws that protect and guarantee the secrecy of their investors (WALCHER, 2008).

There are many advantages by using the Swiss banking system as a source of investments, which go beyond the general benefits of offshore centers. In this case, (Barber, 2006), states that the national currency (Swiss franc) is extremely strong and stable, the country has a high banking liquidity, entry and withdrawal of banking

investments are free, there is a large monetary freedom as in any other country, it is possible to withdraw its investments in case of possible failure of the US financial system and institutions, there is easy access to financial markets, good quality services, among others. Because of that, Switzerland currently is the third largest financial destination in the world, only behind New York and London.

All twelve characteristics perpetuate the usage of tax havens, so this also developed a trading of business, that are called shelf companies, they are usually opened by accounting offices, these companies are opened abroad and own 100% of their capital stock of bearer shares (ensuring the owners secrecy). In this way, companies are used by investors to be used internationally, since the tax benefits for these companies are not applied within the jurisdiction of the tax haven of origin. Besides the confidentiality, one of the biggest challenges by controlling these types of companies is that it is possible to acquire one through the internet and email, which makes the control over the issue totally impaired (BARBER, 2006 apud WALCHER, 2008).

In order to confirm the relationship between confidentiality, attraction of investments, flow of illicit capital and tax havens, the Tax Justice Network entity has created a ranking which measures the level of financial confidentiality of the States, the Financial Secrecy Index. This list differs from the blacklists promoted by the OECD and the

FATF, as it does not focus on cooperation treaties or domestic legislation against harmful tax practices and money laundry. The Financial Secrecy Index seeks to analyze the foreign investment that countries receive and the degree of secrecy that the financial system of these places offer. According to this ranking in 2013, the places that most attracted these types of investments are places where there is the occurrence of unfair tax practices and which have jurisprudence guaranteeing the anonymity of your customers.

- I. Switzerland;
- II. Luxembourg;
- III. Hong Kong;
- IV. Cayman Islands;
- V. Singapore;
- VI. USA;
- VII. Lebanon;
- VIII. Germany;
- IX. Jersey;
- X. Japan

If we analyze the places mentioned above, we can analyze that many of them are known as tax havens and offshore centers. It should be noted that this index does not include

only National States, but also overseas territories of countries such as the United Kingdom and the Netherlands, from the ten jurisdictions shown above, two (Cayman Islands and Jersey) are British overseas territories, which makes TJN put the Great Britain as the world's first tax haven. A stretch of the report, *The Price of Offshore Revisited* (TAX JUSTICE NETWORK, 2012) states: "The UK is the world's first tax haven and is currently a major player in banking secrecy. " Separated, the United Kingdom ranks 21st, Jersey to ninth, British Virgin Islands in the twentieth position and Guernsey appears in the fifteenth.

The ranking classification is made through the analysis of 15 different factors, which can be grouped into four different subject groups:

- a) Efficiency of financial and tax regulations;
- b) International standards and cooperation;
- c) Corporate transparency;
- d) Ownership and investments usage (TAX JUSTICE NETWORK, 2013).

In order to have a sense of the dimension of how companies use this practice, according to *The Hidden Cost of Offshore Tax Havens* (SCHNEIDER, 2013) report, among 500 companies in the ranking, 290 of them transferred US\$1.6 trillion to offshore centers. According to the secretary of Treasury of the United States, Larry Summers, the



supranational companies, which are around 60 thousand in the country, together with big audit firms and investment banks, are responsible for a tax evasion that costs the US about 10 billion dollars a year (AGUILERA, 2012)

If we compare this data with the following table of the year 2011 (Table 1), it is evident that not only the amount of income sent to these economies is increasing, but it is also possible to recognize names of large companies known worldwide such as Citibank, J.P Morgan Chase & Co., McDonalds, Motorola, PepsiCo, Apple, Chevron, Walt Disney, The Procter & Gamble Company, General Motors, Coca Cola, among others; and they also have different subsidiaries installed in several tax havens, to facilitate the remittance of capital to such sites (SCHNEIDER, et al., 2013).

*Table 1 - Multinational companies with headquarters in tax heavens countries*

Organization	Location in the US	Subsidiaries in Tax Heavens	Amount of money sent in 2011
Alcoa; American Express; American International Group; Bank of America Corp; Citigroup; Goldman Sachs Group; Hess Corporation; International Business Machine Corporation; J.P. Morgan Chase & Co; Lehman Brothers Holdingst; Merrill Linch; Metlife; Morgan Stanley; News Corporation; PepsiCo, Inc; Pfizer; Time Warner	New York	1373	US\$ 1.213.989
ConoscoPhillips; Dell, Inc; ExxonMobile Corporation; Marathon Oil; SYSCO Corporation;	Texas	193	US\$ 804.359

Valero Energy Corporation			
Abbott Laboratories; Allstate; Archer-Daniels-Midland Company; Caterpillar Inc; Deere; Kraft Foods, Inc; McDonald's; Motorola, Inc; Sears Holding; The Boeing Company; Walgreen Co.	Illinois	178	US\$ 443.687
Apple; Chevron; Cisco Systems; Countrywide Financial; Hewlett-Packard Company; Ingram Micro; Intel; Mckesson Corporation; Safeway; Walt Disney; Wells Fargo.	California	148	US\$696.155
Honeywell International, Inc; Johnson & Johnson; Merc & Co, Inc; Prudential Financial.	New Jersey	116	US\$154.283
Cardinal Health, Inc; Kroger; The Procter & Gamble Company	Ohio	107	US\$235.075
Wachovia Corporation	North Carolina	59	US\$55.528
Delphi; Dow Chemical; Ford Motor Company; General Motors Corporation	Michigan	57	US\$434.488
3M; Best Buy; SuperValu; Target; UnitedHealth Group;	Minnesota	46	US\$236.600
Aetna; General Electric Company; Hartford Financial Services; Travelers Company; United Technologies Corporation	Connecticut	43	US\$310.948
Altria Group; General Dynamics Corporation.	Virginia	43	US\$65.345
FedEx	Tennessee	21	US\$35.214
Costco Wholesale; Microsoft; Washington Mutual	Washington	12	US\$141.053
Comcast; GMAC; Sunoco	Pennsylvania	10	US\$104.486

DuPont	Delaware	9	US\$30.653
Coca-Cola	Georgia	8	US\$28.857
Sprint Nextel Corporation	Kansas	7	US\$40.146
Tech Data	Florida	7	US\$23.423
Tyson Food, Inc.	Arkansas	6	US\$26.900
Berkshire Hathaway, Inc	Nebraska	1	US\$118.245
WellPoint	Indiana	1	US\$61.134

*Source: Schneider, et al; 2013*

This table shows only investments taken from the USA which were sent to tax havens. According to the report, the US government fails to raise an estimated \$150 billion in taxes by companies and individuals who withdraw their investments from there and send it to tax havens. Therefore, a research done by Ernst & Young LLP realized that, from the 210 multinational companies studied and which have offices in eight different countries (Germany, Australia, Canada, USA, France, the Netherlands, Japan and UK), 82% of them considered transfer pricing as the most important theme regarding international taxation, with 69% of them suffered investigations regarding the use of this practice by indirect remittance of profits abroad. (TANG apud MOREIRA, 2002).

One of the most used practices to withdraw investments that have as destination the offshore centers is the under-billing of exports. This is done to reduce the profit

declared in the country of origin, so, the importer deposits the difference in an account opened in any tax haven controlled by the holder or someone connected to the company.

The current system of combating tax havens works basically with the idea of international sanction and constraint, so, it is supposed to control, which works to a certain point, but it does not focus on modifying the incentives that such jurisdictions offers to attract investors, so the advantages for capital transfers continues, and thus do not affect the incentives that make corporations and individuals to invest in such places.

In addition, the incentives to a country cease being a tax haven are low: what the country earns with its tax haven status or offshore center normally is greater than the cost of not cooperating with the system, so, this way of combating tax havens, beyond being ineffective, also harm the local population by withdrawing the source that probably is the biggest income of the state. Usually the consequence of this scheme is the attempt by limiting the supply of tax havens, without the counterpart of demand reduction, that promotes and encourages even more counterproductive practices. Instead of reducing the problems associated with tax havens, many will eventually benefit countries that became outsiders that tend to resist the cooperation, creating a distorted way that incentives the predatory practices (AFFONSO, et al., 2014).

The growing concern regarding the relationship of tax havens with terrorist groups occurs mainly because criminal groups realizes the failures in the financial system and began to exploit such failures to move the money from country to country, in order to reinvest this capital in legit business in different places (HOUGH, 2008, p. 267). The method used in the financial operations of the Al-Qaeda group can be used as an example of this process: their money laundering process is called the "bank account archipelago" because the remittances are sent to different offshore accounts at different locations, like Cyprus, Switzerland and several accounts in the Caribbean. The main function of this amount of accounts and places is to launder money that will be used to finance group activities, from the Sudanese Bank, where it is believed that Osama Bin Laden paid 450 million of dollars years ago to become a business partner (BELL apud LOPEZ, 2006).

### **3. THE TAX HEAVENS WITHIN INTERNATIONAL RELATIONS**

In order to carry out their actions, terrorist groups need to find ways to finance its activities. Although the main objective of terrorist groups does not involve financial matters, financial support is essential for the performance of its activities. In this sense, the FATF (Financial Action Task Force) defined terrorist financing as any action that

could be characterized as economic assistance to terrorist elements or groups. Financing to terrorist groups is already a securitized issue even before the attacks in the United States. So, the international community, especially the UN, was already concerned about this issue, so that in 1999, the International Convention for the Suppression of the Financing of Terrorism, which stipulates that:

Article 2. [...]

1. Any person commits an offence within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and willfully, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out:

- (a) An act which constitutes an offence within the scope of and as defined in one of the treaties listed in the annex; or
- (b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act.

The security research is no longer thought only as defense or war, the international security agenda began to include not only the military sector but also political, economic, social and environmental. In this sense, the need by analyzing how criminal entities spread around the world can be financed, therefore, there is also the need to

combat this practice. In this way, this chapter will analyze the attempts to harmonize the standards of combating terrorist financing, mainly exploiting the role of organizations with global reach, such as the OECD, FATF and Tax Justice Network. For this will be discussed on how international cooperation and interdependence are involved in this process.

### **3.1. INTERDEPENDENCE AND INTERNATIONAL COOPERATION**

The debate on the legitimacy of tax havens and the consequences of its existence of such tax regime have been widely discussed in organizations and internally in the countries, through the creation of an internal legislation against this practice and also the growing of non-governmental institutions working on it. But even so, it is still a mystery measure accurately how much money is deposited in these economies. The consequences are not only economic but also social, caused by illicit transfers, such as the maintenance of organized crime, corruption and terrorist financing, that interfere the society as a whole, although we often do not realize these consequences.

This international scenario makes propitious the emergence of the cooperation between States and organizations, aimed at regulating or combating these practices, mainly

through negotiation processes, sanctions and coordination politics. In this scenario, the International Political Economy research is fundamental to understand the problem, since it is seen as the marriage between two disciplines: economics and politics area, integrating market researches and political analyze of a single field of study (COHEN, 2008).

The gradual decrease of trade barriers, increasing the competition and interdependence between countries, in particular between industrialized democracies countries, according to Cohen, was promoted by liberals of the United States and was guided by the newly created GATT and IMF. Initially, this liberalization phenomenon occurred more slowly, then gained speed, with which tariffs fell down and the convertibility of currencies was restored, thus causing world trade growth, opening markets and mutual dependence. This is how financial flows and offshore began to grow, from the late 1950s onwards. This scenario will follow until 1970, due the oil shock and the end of Bretton Woods tied to exchange rates, a new era of slower growth and stagnation began, emerging the protectionism again as an alternative to countries to avoid the consequences of the crisis (COHEN, 2008)

The international cooperation context can be seen as a process in which the political coordination makes the States adjust their behaviors to the expectations of the other



States. Even in cases where initially there was no tendency of cooperation, the actors tend to influence others through negotiation, sanctions and bargaining, so despite continuing to pursue their own goals, now they do in order to gain benefits for all, even if they are achieved at different levels and unequal (PRATES, 2016).

In this way, it cannot be denied that, the way Member States relate and connect with each other, impacts the way we perceive sovereignty. The concept of sovereignty is an inheritance of the ideals that was emerged in the French Revolution and can be considered an evolution of the sovereignty concept in the Absolutist era, of absolute power, exclusive, unquestionable and unlimited of the Monarch. However, sovereignty can be understood as the non-subordination of the State to others and that it has "unrestricted power" to exercise within its own territory, without prejudice the international law (Nye & Welch, 2012)

But in the book "Understanding Global Conflict and Cooperation" (Nye & Welch, 2012), the authors assumes that sovereignty, considering that a State has absolute control within its territory, would be in fact a control to different levels, since even popular governments rarely have absolute control under their jurisdiction. Therefore, one of the reasons is that the interdependence, especially that occurs in the economic sphere, is one of the factors that have great influence on the sovereignty of a State.

Thus, more and over the international policies of different States influence the decision-making of others. The phenomenon of interdependence does not constitute a threat to sovereignty. This apparent restriction of freedom of a State action, is what Keohane and Nye (2001) call operational sovereignty since States agree to restrict their ability to influence the policies of other states, then used as a mechanism in international politics negotiation. In this way, the actors sacrifice their control over events occurring internally, that is, at the national level, they increase influence over events that occur within other states; as an example, international policies of control against drug traffic, immigrations and organized crime, among others.

In this context, transnational relations have increased the sensitivity of societies in relation to each other, changing the relationship between governments. According to Keohane and Nye (2001) there are five effects of increasing these international system, they are: the change of attitude of the actors; international pluralism; increasing restrictions on state action through interdependence; the expansion of the ability of certain governments to influence others; and the emergence of autonomous actors with private external policies that may influence the State policies. All of these five effects depend on the presence of transnational organizations. Thus, transnational relations make states a little more depended that they cannot fully control, so they need new instruments of influence, such as international organizations.

Although, according to liberal theorists, interdependence can be defined as a mean to achieve peace and cooperation, however, (Nye & Welch, 2012) states that the interdependence is not so simple, since, for him, interdependence refers to the mutual dependence between the actors, which may bring benefits or costs and that sometimes accompanied by friction and conflict. In the current context of world politics, interdependence can be seen as "Situations characterized by reciprocal effects between countries arising from international exchanges, such as cash flow, goods, people and information across borders " (KEOHANE & NYE, 2001, p. 88)

International relations are currently characterized by an increasing exchange of information between individuals, companies and institutions, thus making changes in internal and external political relations. Therefore, it can be said that the interdependence can be originated from materials (naturals) or social phenomenon's (economic, political or perceptible). As the focus of this case study is on economic factors, it can be said that economic interdependence is very similar to military interdependence, as can be seen in the author's words:

In general, economic interdependence is similar to military interdependence which is the basis of traditional international politics and has a high degree of social origin, especially perceptible. Economic interdependence involves choices on values and costs. (Nye & Welch, 2012, p. 251)

It is important to analyze the costs and benefits of interdependence. (Nye & Welch, 2012) states that the gains of a policy can be quantified by the zero-sum, which happens when the loss of one actor represents the gain of the other, the opposite is also valid. In cases where the result is non-zero, we can have a negative result or a positive result. In this sense, when a positive result is obtained, this means that both actors had gains; in return, when the result is negative means that both have lost with this policy. Regarding the costs caused by interdependence, there are two issues to be analyzed: the sensitivity that refers to the quantity and rhythm of dependence effects; and vulnerability related to relative cost of changing the structure of the interdependent system, so that a country less vulnerable is not necessarily the least sensitive.

Many actors that adepts the liberal theory of international relations believe that globalization, as a subset of interdependence, causes greater interdependence, cooperation will replace competition in the international cooperation, as it will generate more mutual benefits, thus encouraging the international cooperation. Despite this, (Nye & Welch, 2012) makes an observation that interdependence affects policies in different ways, since there is a distinction between what would be a domestic or external matter of a country may become nebulous.

That is because, according to the authors (Nye & Welch, 2012), even though the

interdependence joint benefits that would encourage cooperation, this phenomenon can also be as a weapon, since, in some cases, States are more interested in the relative gains of their rivals than with the absolute gains of themselves, this can be seen mainly in economic policy. Therefore, this process has an impact on all sectors of society in general, mainly in the transformation of politics, economy, culture and society. (Nye & Welch, 2012) further states that:

Even though globalization has been going on for centuries, its contemporary modality is faster and more intense, which makes more unpredictable the relationships between different networks and their effects (Nye & Welch, 2012, p. 247)

Globalization is defined as a worldwide network of interdependence, but this does not mean that it represents a universality, because as (Nye & Welch, 2012) affirms, a globalized world market means a free flow of goods, people and capital, where you have similar interest rates. Although globalization has more flexible national borders, this does not diminish their importance in the International role.

The globalization process has several dimensions. In economic terms, globalization represents a new phase of the capitalist system which influences changes by opening new markets, which has been happening with more intensity since the 1970s, which had as a consequence the permeability of economic barriers and, consequently, the

globalization of the tax bases and decreasing the State role as an economic regulator. Thus, the State began to have less control over the economic choices of its citizens, so that with the globalization, the States end up competing to each other to attract contributors (MASON, 2017).

It can be said that the process of globalization acts in a way that the role of the State undergoes into transformations. As a result of this transformation, there was tax competition, which may have the effect of decreasing unnecessary government spending, because it limits the governments to increase taxes, since, in order to attract more investment, the government should lower taxes (MASON, 2017).

All this integration makes international networks increasingly complex and fast, so that their effects also become unpredictable. Therefore, globalization is followed by a constant uncertainty, because there will always be a competition, where, on one hand, there will be increasing complexity and uncertainty, and on the other hand, we will find the efforts of governments and corporations to manipulate these interconnected systems. (Nye & Welch, 2012).

Considering the high level of interdependence in which we currently live, it makes necessary for us to have jurisdictions rules that promotes the tax harmonization and bank transparency. Moreover, considering that the origin of funding for terrorist

activities, the FATF sets standards policies to combat the terrorism financing (THE FINANCIAL ACTION TASK FORCE, 2012). Therefore, it becomes important to study how international regimes in this context work and whether are effective in what they propose and how it combats illicit and harmful tax evasion and money laundering.

### **3.2. INTERNATIONAL REGIMES**

Regimes are the result of negotiation among actors in sectors which they have a common interest in cooperation. According to (KEOHANE, 1982), this cooperation is a voluntary participation and beneficial to the participants, since, if it were not, the actors would opt to do not participate. According to the authors, the regimes role is to create a set of rules and practices with the purpose of coordinating the actor's behavior when there is no authority to enforce those rules.

Regimes created a solid environment, which would reduce the transaction costs and uncertainty generated by agreements, increasing its benefits. Thus, the regimes would assist in the realization of mutually beneficial treaties, increasing the degree of cooperation in international politics. However, just as regimes can benefit their participants, they can also impose costs on actors who do not adopts, called outsiders, creating an environment of coercion to adhesion (KEOHANE, 1982). That coercion occurs through the imposition of standards on those who choose to join the regime,

through prohibition or sanctions on trading with outsiders. These regimes, according to (KEOHANE, 1982) definition, are oriented towards control (control-oriented), so that this regime is usually used to combat predatory practices. It is in this system that much of the international regimes are based, against tax havens, whose objective is to reduce the number of such places by imposing constraints and costs to the actors.

In this growing scenario of interdependence after World War II, trade agreements and the establishment of international organizations to facilitate cooperation become inevitable. Institutions such as the International Monetary Fund (IMF), World Bank and the OECD were set up to strengthen government policies, but also private institutions, since they work as institutes that assist governments, with information, decision-making process and in the cooperation process; however, they do not have the power to take these decisions on their own or to require States to follow their suggestions.

Although international organizations and private institutions cannot impose cooperation or agreements acceptance, the level of economic interdependence in which we currently live do not allow States to completely isolate themselves from the international system, because the cost of this isolation would be very high. Thus, the globalization, which in the second half of the 20th century had great expansion, built



cooperation between governments so that States needs to accept that some nations will have the power to influence their national domestic policies.

In the fiscal sphere, governmental and non-governmental organizations act in a very expressive way in the search for a fair and non-detrimental tax system, combating tax havens and money laundering not only for terrorist financing, but also for tax crimes. As stated in the Reference Guide to Anti-money Laundering and Combating the Financing of Terrorism (2005) of the World Bank, the UN has played a very important role, mainly at the beginning of the discussions on terrorist financing and money laundering. Concerned with the intensification of drug trafficking and the growing amount of capital related to this activity that were joining the banking system, the UN created The United Nations Drug Control Program (UNDCP), which would result in the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances or the Vienna Convention (1988). Although it does not use terms such as money laundering, the Convention defines the concept and advises countries to criminalize this activity.

In 1999, the UN approved the International Convention for the Suppression of the Financing of Terrorism, which imposes to the ratified States the criminalization of terrorism, terrorist organizations and terrorist acts. According to the Convention, is

considered as a crime any person providing or collecting funds that are used for the execution of any act of terrorism (WORDBANK, 2006).

Tending to increase international efforts against the money laundering, the UN has adapted the International Convention against Transnational Organized Crime (2000) or, as it is also known, the Palermo Convention. Thus, the Convention criminalizes the money laundering, establishes regulatory regimes to detect all ways of money laundering (including customer identification, preservation of documents and communication of suspicious transactions), encourages international cooperation and the exchange of authorities at national and international level, and considers the establishment of a unit to collect, analyze and disseminate this information. The Palermo Convention is considered to be very important as its provisions adopt the strategy previously defined by the FATF and its of money laundering standards (WORDBANK, 2006).

With a growing concern in the international scenario with transnational cases of money laundering and terrorist financing, the Egmont Group emerged in 1995. This group is formed by the Financial Information Units (FIUs) and aims to be a forum in which FIUs can increase the exchange of financial information, increase their expertise and the capacity of their employees, promote improvements in communication between

FIUs and help build UIFs worldwide. In addition, since 2004, the Egmont Group also aims to analyze financial information regarding terrorist financing. Currently the group is composed by 94 jurisdictions. It is worth mentioning that the Egmont Group is not an organization but an informal and independent body that works directly in cooperation with the FATF (EGMONT GROUP, 2015)

The important framework of cooperation in tax matters came mainly from the perception of the impact that tax havens had on the global financial system, so the OECD was created in 1948 (PALAN, 1998 apud AFFONSO, et al., 2014). In addition, the growing wave of market liberalization and economic globalization have led to stipulation of international rules for tax competition, transparency, exchange of information to find alternatives to unfair trade practices, terrorist financing, money laundering and the increasing usage of tax havens began to be debated.

The OECD is an international organization currently composed of 34 member countries. It stems from the creation of the Organization for European Economic Cooperation (OEEC), set up in 1948 to assist in the implementation of the Marshall Plan, but the OEEC changed the name to Organization Economic and Cooperation Development in 1960 when Canada and the USA signed the new OECD Convention; so the OECD was officially born on September 30, 1961. The OECD role is based on

monitoring economic developments in the world, so that the main objectives of the organization are: support economic growth, develop employment rates, raise the level of income, contribute to the economic maintenance, assist the economic development of other countries and assist the international market growth (OECD, 2015)

In this sense, the organization is responsible for researches such as the Working Group on Bribery, which monitors the implementation by the signatory countries of the Convention on Combating Bribery of Foreign Officials in International Business Transactions; in addition, there is also work in the area of international cooperation through agreements, standards and recommendations, such as the capital movements, bilateral tax treaties application, and also to create guidelines, such as corporate governance or environmental practices (OECD, 2015)

According to the (OECD, 2015), jurisdictions with low tax rates are a threat to the current economic-financial system. In the area of taxation, the organization operates on several fronts, such as the exchange of information, public and fiscal policies, taxation and crime, treaties on taxation, transfer pricing, among others. Thus, the organization uses three models to classify international tax competition:

1. "low tax system", when the effective rates are objectively lower than those of other states, but without characterizing something that is strongly

detrimental;

2. "preferential tax system", when the current tax regime uses very low or zero rates;
3. And the model that includes the countries that actually have favored taxation, which are tax havens.

Into his OECD system, the last two models are considered typical of harmful tax competition (TORRES apud MASON, 2008). The first time the OECD issued a report on harmful tax competition was in 1998, Harmful Tax Competition: An Emerging Global Issue, which is considered a pioneering analysis of predatory tax practices. According to him, harmful tax competition has some characteristics that must be identified in order to recognize such jurisdiction. Such as:

- no or only nominal taxation (usually this rate is very low or zero) on income, it is the starting point for classifying a jurisdiction as a tax haven;
- if there is a delimitation of schemes, i.e., if the preferential tax regime is totally or partially isolated in the domestic economy, in this case the scheme may exclude resident tax payers or companies that use that scheme may be prohibited from operating in the domestic market; it is necessary to identify whether such benefits are normally granted only to non-residents or are applied

to transactions involving in some way non-residents;

- lack of information exchange, tax havens usually have to enact laws or administrative practices so that companies and individuals can benefit from rules of secrecy;
- whether there are concessions that do not affect national fiscal policy;
- if the profit determination of a multinational group does not conform to international principles, particularly in the methods suggested by the OECD.

The report also contains recommendations aimed at encouraging international cooperation between Member States and others. These recommendations are divided into three different groups. The first makes recommendations concerning legislation and practices:

1. Recommendation for countries to control foreign corporations (CFCs);
2. For countries to adopt control measures on foreign investment funds;
3. Recommendation on the limitation of exemption from participation and other foreign income tax exemption systems in the context of harmful tax competition, for countries to eliminate double taxation of income from foreign

sources and to restrict such income;

4. Recommend countries to exchange more information on international transactions and foreign operations;
5. Publication of administrative decisions regarding the specific position of a taxpayer;
6. Recommend that countries follow principles established in 1995 by the OECD on Transfer Pricing;
7. Access to banking information in order to eliminate impediments to access to this information by tax authorities; (OECD, 2015)

The second group of recommendations is on international conventions and includes issues such as:

8. More intensive and effective use of information exchange;
9. Recommendation for countries to consider including tax conventions with a view to restricting the entitlement to non-resident benefits that may lead to harmful tax practices and to have the Model Tax Convention amended to include such provisions;

10. Recommendation to modify domestic anti-dumping rules in order to remove any ambiguity and uncertainty they may have international tax treaties;
11. List specific tax benefit exclusions found in international treaties to use in future treaties;
12. Report existing treaties and non-negotiation with tax havens;
13. Recommendation for coordinated oversight programs (joint audits, coordinated training programs) by the tax authorities;
14. Mutual assistance to the recovery of tax amounts that are abroad; (OECD, 2015)

Finally, the last group of recommendations emphasizes the expansion of international cooperation, and these are the last five recommendations in the report:

15. Member countries adoption of guidelines on established preferential tax regimes and establishment of a forum to implement the guidelines and other recommendations;
16. Creation of a list of tax havens by the Forum;
17. Creation of measures to ensure that countries with links to tax havens do not



contribute to increasing harmful tax competition and that countries dependent on tax havens can also ensure that such relationships do not contribute to augmenting or promoting harmful tax competition;

18. Recommendation to develop and promote the principles of good tax administration;

19. Recommendation for non-OECD states to engage in a dialogue with a view by promoting the recommendations contained in this report; (OECD, 2015)

The OECD also often lists tax havens, the most known is the blacklist, which lists countries that do not cooperate with the exchange of information and does not follow the recommendations of that organization to control tax havens. The lists are used to discredit some jurisdictions in the international system. There is also the gray list, for example, which is made up of countries that have committed themselves to adopting international fiscal policy standards, but which in fact do not do so in full (AGUILERA, 2012). Currently, no country is listed as a non-cooperative jurisdiction, meaning no country is blacklisted. However, the last countries to leave the list after agreeing to adopt measures aimed at international cooperation were: Andorra, Liechtenstein, Liberia, Monaco, Marshall Islands, Nauru and Vanuatu in 2001 (OECD, 2019).

This strategy of trying to create international embarrassment through the publication of blacklists is criticized as some member countries of the organization fit the parameters used by it to recognize jurisdictions with favored taxation, but these have never been included in the lists released. For example, these lists do not include banks located in some American states that carry out similar practices, such as Delaware, or Austria, Belgium, Holland, Switzerland, Luxembourg, Hong Kong, Ireland, Singapore, which may also be considered as tax havens because there is banking secrecy in these places, but the OECD does not include them (MASON, 2008). In addition to the blacklist, the OECD also created the Global Forum for Transparency in Tax Information Exchange, which aims to establish a global pattern of cooperation and information sharing, shifting its international stance and strategy to a more cooperative; in addition, the focus of the organization has also changed, focusing on issues of fiscal secrecy rather than necessarily focusing on fiscal policies and taxation (Kudrle apud AFFONSO, et al., 2014).

In the chart below it is possible to compare the objectives and ways of action of the main world institutions that fight for the control of abusive tax practices and tax havens.

*Table 2 - International Institutions*

Organization	Type	Mission	Role
OECD	International Organization	Acts in Global level to support economic growth, develop employment rates, raise the level of income, contribute to the maintenance of economic and financial stability, assist economic development to other countries and help in the international market growth	Makes recommendations on: 1. International conventions, 2. Legislation and internal practices, 3. International Cooperation extension
FATF	Intergovernmental Organization	Acts at global level to establish standards and promote the effective implementation of legal, regulatory and operational measures to combat money laundering, terrorist financing and other threats related to the integrity of the international financial system.	Makes recommendations on: Policies against money laundering and terrorist financing; Confiscation policies; Terrorist and chemical weapons financing; Transparency regarding ownership and control of legal entities and other structures; The power and responsibilities of the competent authorities; International cooperation.
TJN	International Private non-profit Organization	Its mission is to modify the current global design on issues related to taxes, tax havens and financial globalization.	It operates through projects such as: "Country by Country reporting", Global Alliance for Tax Justice; Fair Tax Mark; The Offshore Game; Competitiveness; Human rights.

Source: Elaborated by the author

In the same chain of action against harmful tax practice, we also have the FATF, an intergovernmental body created in 1989 by member countries of the G-7, the current G-8, at a convention held in Paris. Currently, this organization is made up of 34 member countries, as well as an observer state, which is Malaysia. (FATF, 2019)

In addition, the FATF is also supported by regional organizations such as the Caribbean Financial Action Task Force (CFAT) and the Latin American Financial Action Task Force (GAFILAT), as well as other regional organizations acting as associate members and represent the world's major financial centers. The first version of the "40 recommendations" was published in 1990 and generated a significant positive impact in some countries, as this led to the criminalization of money laundering and the creation of the Council for Financial Activities Control (COAF). The list of recommendations continued to be updated so that the latest one occurred in 2015 and provides a guide for countries to adopt standards and promote legal action against the crimes that the organization is fighting.

The organization has reiterated the importance of its recommendations, mainly those related to issues such as transparency requirements, which means having more information about the beneficiary properties and control of companies, trusts and other legal entities and structures, in addition to stringent requirements on electronic resource

transfer information. There is also concern about the increasing globalization of the threats of money laundering and the financing of terrorism. Therefore, the FATF is increasing the scope of international cooperation between government agencies and between financial groups in order to bring more efficiency to information exchange, tracking, blocking, confiscation and repatriation of illegal goods. In addition to the reiteration, there is also the inclusion of a number of other topics, such as proliferation of weapons of mass destruction, expansion of the list of crimes other than money laundering, which includes other tax crimes and also under the corruption (THE FINANCIAL ACTION TASK FORCE, 2012).

In addition to the recommendations, the FATF also works with the OECD blacklist policy. In this case, currently on the list of non-cooperative and high-risk countries are: Iran and the Democratic Republic of Korea; although Algeria, Ecuador and Myanmar are included in the blacklist, they are considered to be less non-cooperative than Iran and North Korea, since they have already adopted some measures recommended by the FATF, even in a very discreet way. In the list of countries making progress are 11 countries, mostly from the Middle East, as: Afghanistan, Angola, Guyana, Indonesia, Iraq, Laos, Panama, Papua New Guinea, Sudan, Syria, and Yemen (THE FINANCIAL ACTION TASK FORCE, 2012).

It can be seen that the FATF does not act directly in the fight against tax havens, but makes several recommendations on cooperation issues, exchange of information, increased supervision of financial transactions, as well as emphasizing the crimes of money laundering and terrorist financing and combating them through government institutions, although it does not refer directly to tax havens, this organization looks at the procedures and situations in which those jurisdictions are normally involved.

In addition to the operation of different types of international and intergovernmental organizations, the fight against tax havens and the practices that involves them, there are also international private networks, such as the Tax Justice Network. Founded in 2003, located in the United Kingdom, this organization is basically a non-profit organization with the support of a small core of staff composed of academics, practitioners and experts in the phenomenon of tax evasion and tax havens.

The progress of the TJN has gained more evidence as the subject has been more widely disseminated. Another important factor is that, because it is an independent organization, their work does not focus on state policy, since most of the reports and analyzes are not focused on the actions of the states but on the private sector, which adds a different vision to that expressed by the OECD and FATF, because rather than creating a blacklist of countries, TJN seeks to publish companies that use these

practices to increase their profits.

As a conclusion we can see that international regimes of bank transparency and tax harmonization have been inefficient in the fight against tax havens. Such policies, while successful in some aspects, such as coercion for tax havens to restrict secrecy laws and ensure the signing of international cooperation treaties, especially with regard to the exchange of information, still have little impact on those who use these financial services, and they are not able to prevent success in offering such financial services from non-cooperative states (HINES apud AFFONSO, et al., 2014). In addition, many of the FATF and OECD recommendations to combat money laundering still do not work fully internally in several countries, thus creating legal gaps in the fight against tax evasion crimes.

Therefore, we see that international cooperation on a reformulation of the world tax system still needs to evolve, especially the way tax havens are sued to abandon such damaging tax practices. It is also clear that it is essential that international organizations work together in pursuit of this objective, and the first step to be taken would be to standardize the definition of tax havens, in addition to an impartial action, specially within its members.

#### **4. CONCLUSION**

Throughout this case study, it realizes that the existence and use of tax havens are not a recent phenomenon, but it shows a growing tendency within the current financial system, added to a turnover of around US\$21 trillion in 2010 (TAX JUSTICE NETWORK, 2012). In this way, it was tried to ascertain the legal and illicit practices of usage of the tax havens and how works the regulation of these jurisdictions, through the international and intergovernmental organizations and also of private institutions.

It was possible to observe through the analysis of the theoretical reference that a large amount of capital flow sent and handled in these low taxation jurisdictions comes from business or money laundering practices that occur in international level, mainly as a result of bank secrecy policies and societies that these economies practices. In addition, the use of tax havens by multinational corporations stimulates unfair tax competition worldwide, which generates large losses for national economies, money that could have been invested in national policies, which causes damage to the population (KAR & SPANJERS, 2014).

Therefore, while States are sovereign in their territories to establish any necessary tax policies, when dealing with illicit capital flows, there are no effective control mechanisms, which have proved to be strictly necessary to control and ascertain such



financial transactions. Thus, much of the work of international institutions and also of national bodies are focused on transparency and information exchange in order to identify the source of money circulating there. Therefore, the role of those organizations, such as the OECD and the FATF, is to find the alternatives to control the international capital flow and the identification of illicit flows, always focusing on international cooperation. However, nowadays it is still necessary for such institutions to employ policies of pressures and retaliations, such as the blacklist, trying to promote international cooperation and to unify legislations.

Nevertheless, the practice of capital remittance to tax havens is also used for terrorist financing purpose, the easiness of hiding capital origin and to whom capital belongs is attractive to such groups, since they need to move capital between themselves. Most of the international treaties ratified by several States are related to financial control, by preventing possible money laundering transactions and to increase the performance of domestic agencies. Although those countries have shown themselves being very cooperative with international policies, some of them still has a lack of legislation to consolidate and criminalize terrorism and its financing.

Finally, it is necessary that the States recognize that they share the responsibility of modifying the current world banking system, which often creates an enabling

environment for financing illegal activities. Throughout this case study, it was sought to emphasize the importance of international cooperation to combat problems such as money laundering and terrorist financing without imposing excessive costs to the States, International and Transnational Organizations and Private Institutions.

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