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## NEWSLETTER

### WHAT DOES THE FUTURE HOLD FOR YOU, OFFSHORE WORLD?



In recent years in these columns we have published the figures for the numbers of new offshore companies formed each year by each jurisdiction. For 2009, however, not even Offshore Investment, the most significant profes-

sional publication in the field, undertook the publication of exact figures, but rather just highlighted certain figures in a kind of summary from which only the main tendencies could be deduced.

Naturally, the international economic recession has not left the world of companies untouched, and the downward trend in the economy has been mirrored in the number of new companies being formed worldwide. The loss suffered by the world offshore market is somewhere in the region of 100 000 companies. That is approximately how many fewer companies were formed in 2009 than in 2008\*. The number of companies formed in each Offshore Financial Centre has fallen dramatically by some 30 – 40% everywhere except Hong Kong. The city state, returned to Chinese administration more than 10 years ago now, managed to increase the number of companies formed by almost 10% in comparison with the previous year.

In connection with the recession, the amount of capital being taken out of the various Offshore Financial Centres was also noticeable. According to some figures – which, in my opinion, are impossible to verify – the figure for 2009 came to some 500 billion dollars. That is approximately the sum that the owners of the capital took “home” from the amounts deposited in the tax havens. The reason, in the view of the experts, is twofold. On the one hand, funds were needed to help and rescue family businesses which had become weak, indebt-

ed or almost bankrupt as a result of the recession. As one of the factors which accompanies the recession was the drying up of bank loans, it is little wonder that the assets hidden away in the much maligned offshore countries took on the role of life-saver. One of the most interesting facts to emerge from the autopsy of the recession is that family businesses are much more viable than their public counterparts, which can be sucked dry by shareholders and bonus-hungry managers, and are helpless in the face of the problems of liquidity. The “I want to look after my own company and I have the means to do it because in the past I was cautious and put money aside” principle proved to be the winner, as it was not necessary to go cap in hand to the all-powerful banks.

At the same time, it is an undeniable fact that the other reason behind the repatriation of funds was pressure and threats. The resolutions passed by the G-8 nations last April had a significant effect in the fight against the tax havens. The struggle not only took on a new momentum, but also received a new ideological content. Previously, the EU could only denounce the Offshore Financial Centres on account of unfair tax competition and the resulting siphoning off of capital. The main point of attack of the OECD was the lack of transparency of corporate structures, which facilitated the possibility of both money laundering and the financing of international terrorism. For several decades they were unable to show any significant results, which led to a number of jurisdictions questioning whether it was worth taking them seriously on the international level. This was particularly the case when it turned out that the direct expenses behind the terrorist attacks on



\* The figures do not include companies formed in the USA.

the London underground were somewhere between 5000 and 10000 pounds, a figure which quite clearly does not need to be financed by the establishment of an international chain of offshore companies. The mentioning of international tax competition also becomes somewhat ironic when the EU is unable to agree on unified rates of corporate tax for its 27 members, and thus there is a difference of 25% between the highest and lowest rates applied.

However, the world's political leaders, with those responsible for the EU at the forefront, singled out the transactions carried out through the international offshore financial world as one of the reasons for the recession. It is difficult to say whether this is true or rather they were just trying to increase their own popularity while also finding a scapegoat. The essence is that the world leaders declared war once again, and gave license to the international organisations to continue their fight. Gordon Brown, the then British Prime Minister actually stated that they would be shutting down the tax havens by 2015. The declaration appears pretty categorical, but can it really be achieved?

For more than two decades now I have witnessed in my business career that the market has always produced the solutions dictated by the laws of supply and demand. One of the most fascinating moments of the recession came towards the end of 2008 when the pub-

## ECONOMIC CRISIS:



lisher unexpectedly re-printed Marx's "Das Kapital". One section of the public opinion interested in finding the reasons behind the worldwide recession turned to the classics, and it was Marx's opus which provided the answer to certain questions. The nature of capitalism from the beginning of the era of free competition to today in many ways has remained unchanged. It's a bit like studying a 19th century book on anatomy: man still hasn't developed a third kidney, while the two we have are described perfectly on those pages, together with the correct Latin names.

So, the first question is: will there still be demand for the services offered by the offshore world, even if the politicians threaten those who use them with all sorts of horrific sanctions? I will reply to this question in detail later, but for now, will just state briefly that yes. But will there be "supply" to satisfy the "demand"? As freedom of enterprise is everybody's constitutional birthright, no-one can be stopped from establishing and operating a company in a tax haven. The obligation to pay taxes is naturally another story; the bargaining and enforcement powers of the state in which the individual is resident for tax purposes are much stronger. The legislation of numerous countries states that the income distributed, and in certain cases income not even distributed, to their citizens in offshore jurisdictions is subject to tax "at home". One of the consequences of the recession is that governments quite clearly want to try and recoup their deficits and sums paid out to support the banks through additional taxation, and are prepared to use every means to achieve this.

Gordon Brown's statement should be taken seriously: the closing down of some offshore possibilities has already begun. The British Prime Minister primarily, and with a great deal of show, was targeting those small countries which attracted and accumulated significant levels of capital when



compared to their size. So who are the ones who are really in danger? In my opinion it is first and foremost the couple of dozen or so small countries or jurisdictions which deal primarily with the formation of International Business Companies (IBCs). In recent decades these have been the most marketable company types and jurisdictions. Their advantages lie in their simplicity and prices. IBCs could be formed with one director and one shareholder,

in certain jurisdictions the shares could be issued to the bearer, there was no requirement for the companies to file financial reports in the country of registration, because the tax was a fixed annual amount, meaning no control by tax authorities and the managers didn't even have to hold the annual general meeting as set down in the legislation and memorandum and articles of association. The biggest problem with these companies was that they were quite clearly formed for "offshore purposes". Generally, the law regulating their formation was a specifically designed one (the International Business Companies Act, or a variation of it). As far as the legislation was concerned, the jurisdictions simply copied the laws of other jurisdictions, and when the law was adopted simply inserted the name of the new country and reduced slightly the amount of fixed annual tax to be paid, thus making themselves more attractive than their competitors. The model corporate legislation of the British Virgin Islands was faithfully copied by Belize, then Niue and also the Seychelles; the list could be continued



with numerous small countries who produced very similar legislation without simply copying the original. These jurisdictions dug their own graves: they turned the offshore company, still the privilege of the business elite at the start of the 90s, into an item of mass-production, and at the same time drew

the spotlight of international public attention onto themselves.

The OECD made it impossible for the IBC jurisdictions to continue operating as before in two ways. On the one hand, they forced them to write and adopt laws which provided for the same type of transparency as on-shore companies. For example, bearer shares can no longer be issued, only registered ones. Every document, or a copy, must be kept in the registered office. Although it is not yet the case, plans are in the pipeline to make these companies keep up to date accounts and file annual financial reports with the local authorities, or at least to have them sent to and kept in the office of the registered agent or secretary.

The second important change concerns the exchange of information. If you go onto the website of the OECD ([www.oecd.gov](http://www.oecd.gov)), you can find a list of all the countries who have signed such international agreements. There are currently more than 250 such agreements worldwide. The list is very interesting, and I suggest that everybody should study it. But why is the exchange of information so important? Obviously because it means that the data can legally be accessed even if there is no agreement for the avoidance of double taxation.

One of the last points of the model agreement for the avoidance of double taxation actually deals with the legal exchange of information between tax authorities. If there is such an agreement in place, in theory it is relatively straightforward to acquire data on each other's tax subjects, though how well this works in practice is another question. The main aim of the exchange of information agreements is to provide this possibility in cases where there is no agreement for the avoidance of double taxation. As the signing of an information exchange agreement





is significantly easier than in the case of a complicated double taxation agreement, it is quite obvious that the aim of quickly arranging such agreements is to provide the legal basis for the acquisition of data.

Just think about it: if there are accounts, contracts, bank statements, owners' details, then it is worth requesting these from the given

jurisdiction. And although the OECD agreements do not provide the possibility for the automatic exchange of information, if significant grounds for suspicion and the right reasons can be proved, the partner to the agreement is obliged to hand over the details held on that territory.

The whole thing seems quite alarming. Will Gordon Brown be right after all? Who knows? Let's look at the worst possible scenario. Even though he has since been forced to say goodbye to Downing Street, his decisions still live on. If these jurisdictions are forced to introduce accounting, tax and information exchange, will it still be worth considering such solutions? In my opinion, the answer is yes. Among the offshore jurisdictions and company types currently available, there are a number which, though not as easy to administer as an IBC from the Seychelles, still offer excellent possibilities for tax-planning. The following list is just a sample of those on offer: the US LLC, LLPs and LPs registered in England or Scotland, companies formed in Hong Kong, Cyprus and certain types of company from the United Arab Emirates.

So why do I think that these companies are more capable of surviving than, say, a company incorporated in the British Virgin Islands? The offshore principles are just as accessible in these jurisdictions: only companies owned by foreigners and income from sources outside the given country are free from taxes, and even then, this is only true of corporate tax. There are, however, two significant elements which distinguish these countries from the IBC jurisdictions.

1. The offshore status is not declared openly. In these countries, the tax-free possibility for certain types of company is not based on specially-penned laws which have obviously been written to provide tax exemption for income from abroad.

2. The stability of the legal systems of these jurisdictions is based on traditions dating back several decades, or even centuries, and as such the international organisations find it very difficult to attack them. The majority of IBC jurisdictions, on the other hand, only have a history dating back one or two decades, and in this time they have not managed to fully integrate the offshore system into their economies, even though they are very much afraid of losing the income generated by the operation of offshore companies.

I would now like to examine the foundations of these statements for each of the above jurisdictions.

**US LLCs.** In 1978 Wyoming became the first state to introduce legislation on the registration of LLCs (Limited Liability Act of Wyoming). The legislation was based on the European models of limited liability, and in particular the German GMBH, but, as the Americans were unable to accept the fact that the company could not issue share certificates showing ownership, they allowed, in contrast to the European principles but in line with those of the American corporation, for the issue of the so-called Certificate of Interest. From 1978 onwards, each US state adopted the LLC model with the passing of its own LLC Act. LLCs follow the principle of flow-through taxation, whereby in most cases the income of the company flows through for taxation to its owners or members, where they

are resident for tax purposes. From 1998 onwards, the regulations on federal taxation in the USA took on a check the box format, which considerably simplified the situation and in numerous cases provided com-



plete exemption from tax for income earned abroad by foreigners from the point of view of US federal taxation as well. The essence of the exemption is a type of "exemption on income from outside the territory", based on an analysis of the conditions and requirements of several complicated regulations. In this way, US governments continued to vigorously deny the existence of "offshore" within their shores, and so were always able to deflect all international attacks. At the same time, it is also worth noting that Delaware is the only state within the US where even the yearly filing of an annual report, in which at least the details of the managers are revealed, is not required.

**English LLPs.** The establishment of LLPs was brought about by the Limited Partnership Act of 1907, which was modernised by the Limited Liability Partnership Act of 2000. LLPs established under the new laws are legal entities, whose assets are totally separated from the assets of their members, and all of whose members' liability is limited to the membership capital paid in. LLPs follow the American principle of flow-through taxation, which means that income is taxed at the membership level, not the LLP itself. Although the various English tax specialists have a penchant for debating the details of the tax-free status of the company, almost all agree that income obtained by LLPs with foreign owners outside the UK and the EU is exempt from tax in England, at least at the corporate level. The requirement to keep accounts and file annual financial reports make the LLP slightly less convenient than the US LLC (in the case of Scottish Limited Partnerships, there is no such requirement).

**Hong Kong.** As a result of the territorial principle of taxation, companies are not subject to tax on income from sources outside of Hong Kong, while locally acquired income is taxed at the rate of 16.5% (profit tax). This territorial approach is not new to Hong Kong, and dates back many decades to the times of British rule. And although the city state

was returned to communist China more than a decade ago, there have hardly been any changes at all in the tax system and corporate legislation. The Chinese have taken meticulous care to make sure that it doesn't appear in any way as though they are trying to dictate the rules of the game. It is also true that they don't allow anyone else to dictate either, and they have only allowed those rules of the EU and other international bodies to be integrated which are of an undeniable benefit to the economy. It is not by chance that the number of companies formed in the last year grew by 10%.

**United Arab Emirates.** One of the most important characteristics of the tax law of the 7 emirates is that, with the exception of a 5% import duty, there basically aren't any taxes. This applies to local companies, companies registered in free trade zones and companies established as offshore companies alike. The whole territory of the emirates is a tax-free zone, based on historical traditions dating back many years. Here, it is not parliament which passes the laws, but the emirs, each of whom, quite naturally, is interested in enriching their own emirate (*The LAVECO Newsletter*



*2010.3 will deal in detail with the possibilities offered by the United Arab Emirates in the fields of both company formation and banking transactions)*

**Cyprus.** In truth, Cyprus is not a tax exempt jurisdiction, as companies registered in Cyprus are subject to 10% tax on profits on their worldwide income. However, the legislation is administered extremely liberally, which allows for numerous types of income to be exempted from tax. In this way, in most cases, among others, dividends received from abroad, and dividends paid to foreigners by companies from Cyprus are exempt from tax; profit from the sale of foreign real estate is not subject to tax, and neither is the capital gain on the sale of shares; in many cases, only 50% of income gained from interest is taxable. The whole tax climate of Cyprus is the most favourable in the whole EU. The tax laws passed in 2002 were hardly even noticed, and the "offshore traditions" which Cyprus has enjoyed

since 1974 have been almost perfectly passed on, even with the adoption of the EU directives.

But will there be any demand for all this? The question is hypothetical, and I have already given the answer: yes there will. Why am I so confident in my answer? If you take a copy of the work of Marx mentioned earlier and flick through just a few



chapters, the answer will become clear straightaway. The whole essence of capitalism is competition. When market conditions apply, competitors have no

choice but to pit themselves against one another. And although it is difficult to eliminate the effects of corruption and monopolies from the markets completely, efficiency and competitiveness are difficult to beat in any market: if someone is able to produce goods at a lower cost, they will enjoy a favourable position in comparison with their competitors. In terms of competition, tax is an expense, just like the cost of raw materials, and if someone pays less tax, then more will remain in the pot, which in turn can then be used for further development or distributed as a dividend. Tax competition, therefore, is genetically encoded in the capitalist system. All the while differences exist between the taxation of two countries (and here I mean the whole tax climate), then capital will always be drawn towards the country with the more attractive tax system. One of our clients once jokingly stated that offshore companies are like performance-enhancing drugs in the economic world. This only sounds amusing, however, the first time you hear it. If we look at the fortunes and business empires which have been built up in central and eastern Europe over the past 20 years, then we will be hard pushed to find any where offshore companies are not behind the ownership and financing.

And now we have reached what is possibly the most interesting point of the whole topic: if income and corporate taxes were reduced to 0, would these mean the end of demand for offshore companies and that LAVECO would have to shut up

shop? Temporarily, for a few months, maybe. But then sooner or later the telephone would ring, and from the other end of the line someone would ask what will happen to his heirs when he dies. Will his children really have to pay 40% inheritance tax on the assets they inherit? Not long ago there was a case where unfortunately one of our dear Russian clients passed away at a far too early age, leaving behind him several successful companies. If his family had to wait for the official inheritance procedures and their written rulings, this could take as long as 6 months. In an operational company this would make life impossible. With offshore solutions, this procedure can be reduced to 3-4 days, and only the official death certificate and a translation need to be provided. This is exactly the reason why clients who are really well-prepared select and establish company structures in which this solution is already built in.

So will Gordon Brown be right? One day for sure. But when will that be?

Probably when the last surviving Cypriot who offers advantageous tax solutions dies. And then the last entrepreneur who is looking for such solutions dies...

Váradí László  
Managing Director  
LAVECO Ltd.

## NEW SERVICE

I would like to draw your attention to a new service being offered by one of our partners. The essence of this is that clients will be able to order landline telephone numbers and all the related services (such as answering machines, message forwarding) in numerous countries in Europe, the United States, Australia and the eastern Asian region. If you would like to receive more information on this, please contact us and we will give you the contact details of our partner, who you will then be able to contact directly.





## LAVECO AT MIPIM



This year we took part for the second time at MIPIM, the world's largest real estate exhibition. In the 3rd week of March each year, in

the Cannes exhibition centre on the French Riviera, they organise this gigantic show where the leading lights in the real estate industry can present their wares. Although there were fewer participants this year as a result of the recession, the number of companies on show was still incredible. Numerous visitors came to the LAVECO stand with enquiries, and they all received detailed information on the formation of various types of company, to help them weigh up the pros and cons.

## MEETING WITH MARFIN LAIKI BANK

The relationship between LAVECO Ltd. and Marfin Laiki Bank dates back more than ten years now. At the time, Popular Bank Plc was our main banking partner in Cyprus, and the fruitful cooperation has continued over the years, with LAIKI still playing a very important role in the everyday financial lives of many of our clients. At the beginning of May the manager of the bank's International Business Unit



in Larnaca came to Budapest. In the course of the meeting our colleagues received information on the latest services offered by the bank and on the situation regarding the recession in Greece. Eleftherios Loizou informed us



that the bank is not involved in any way in the financing of the Greek debts and has not invested in government securities or bonds; furthermore the bank's position is stable and their liquidity is good.

## LAVECO AT THE MOSCOW FOREX EXPO

Our colleagues also participated for the second time in the Moscow FOREX Expo. Over two days several thousand investors and people interested in the FOREX markets attended the event which was held in the exhibition rooms of the Radisson Slavyanskaya hotel in the centre of the Russian capital. The LAVECO stand was visited by those interested in opening investment accounts and making transactions not as private individuals, but as corporate entities.



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