

What will the offshore company of the future be like?

Karl Benz would probably be amazed if any one of today's fantastic cars pulled up alongside him in the street. The car industry has undergone enormous changes in only a little over a hundred years, and the last twenty years in particular have seen extraordinary developments in technology. Who would have thought twenty years ago that our safety would be protected in the case of accident by 12 airbags, or that there would be a second, electric engine, as in the new hybrid cars?

Similar changes, albeit somewhat less spectacular, have been typical of the offshore world and global market. This has been particularly evident over the last 10-15 years, which have thrown up numerous new surprises. The last 15 years have seen the arrival of new offshore company formats specifically developed to meet the requirements of the users. These include, for example, foundations for the protection of assets, which can be registered offshore not only in Liechtenstein, but also in jurisdictions such as Panama and the Bahamas. The formation of investment funds has become more regulated, but it is also true that the majority of these instruments are only available through banks and financial institutions. In numerous jurisdictions the IBC (International Business Company) company form has been developed and has flourished; this all-conquering process was started by the British Virgin Islands, but the laws were also successfully adopted by, for example, Belize, Niue and the Seychelles.

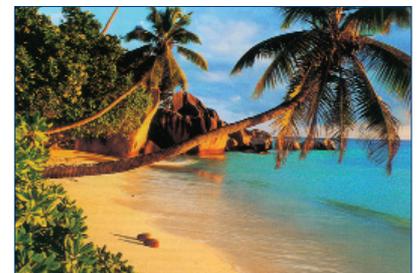
It can be seen and felt that these small - and sometimes

not so small - countries often compete against each other for clients, each hoping that they will incorporate their companies with them, and not in one of the other jurisdictions, and that they will receive the annual fees and taxes, rather than one of the competitors who offer almost exactly the same terms and conditions. International tax competition is present in our everyday lives, though sometimes even the experts don't realise it.

From the supply side, then, it would appear that everything is okay. Here too, the consumer is "king", and everything has to be done to suit the client. This, however, is not so simple. The majority of countries offering offshore services are small countries, island republics, small states or territories dependent on the constitutions of larger nations. In the international arena, their ability to enforce their rights and interests are severely limited. In this way, they are not always able to achieve everything which the interests of an open market, dominated by the laws of supply and demand, would assume. However, the legislators of these countries applied this logic, and based their corporate legislation or law reforms on market requirements. The trouble is, pure market logic can not be enforced here either, as most financial processes involve a type of play on the sum 0: what one side gains, the other side loses.

The European Union developed the concept of harmful tax competition, based on which it constantly attacks the possibilities provided by the offshore financial centres. The reason that these financial centres became a target was that, according to the EU, the beneficial taxation conditions of the offshore centres "suck" the capital and income away from the countries with high rates of taxation, who, as a result, miss out on tens of billions of euros each year in income from taxes. So it is necessary to squeeze these possibilities out of the EU, or rather adopt such tax regulations as prevent the outflow of taxes.

At the international level, however, this was not enough. The EU regulation, which takes place in the form of directives, is not capable of effectively controlling the processes,



that is, it does not allow the collection of the outflow of taxation income. It was important, therefore, to introduce into the process an international organisation which could intervene in the war against tax minimisation not only within the EU, but also globally. The Financial Action Task Force (FATF), the specialist body of the OECD, enforced numerous recommendations on the governments of the offshore centres, which led to the majority of jurisdictions embarking on a very serious programme of reforms.

Today, this programme of reforms has transformed into a type of over-regulation. While in countries such as the USA or the United Kingdom it is possible for almost anybody to run a company formation agency or office, the same activity in the British Virgin Islands, to quote one example, requires a government licence. At the same time, in the big countries mentioned above relatively little information is required from the client incorporating a company, while certain jurisdictions, or rather company registrars, require a whole list of information and details. In addition to the certified passport copy of the person concerned, they often require a recent utility bill as proof of residential address, bank references, detailed business plans, legal references, a CV, and a detailed description of the person's family situation.

LAVECO Ltd. tries to soften the effect of all this, or rather to try and understand all these seemingly negative factors which, we believe, in many cases incense our clients unnecessarily. Years ago I was amazed when, in the process of incorporating a company in Gibraltar, the local company registrar rejected the official certificate of residential address provided by the client. The client had provided a certificate from the police proving his address, which we translated into English officially and then sent off to the authorities. According to the authorities in Gibraltar, the police do not have the right to provide address certification, or rather the police do not appear on their official list of acceptable sources, while, for example, an electricity bill does. How logical! If I own 5 apartments, then I would be able to provide proof that I live in 5 places! Every language in the world has one answer to this: NO COMMENT!

And so the process began, and as I mentioned earlier, a small island republic has very little ability to enforce its will. Company incorporators operating in this field are such specialist enterprises that a company employing 200 people counts as a multinational. Neither they, nor we can react effectively, even if we want to. In many cases, this desire isn't even there, hidden behind feigned or real struggles with com-

petitors. One thing is certain: offshore companies are definitely not going to disappear or cease to exist. Just as to this day cars basically continue to be driven by internal combustion engines using petroleum based fuels, so the essence of the offshore company remains unchanged: an independent structure which performs economic activities, taking advantage of the taxation benefits offered by the country of incorporation. But exactly how the rules of the game will be developed in the future is a mystery to us as well, even though we have many years of experience in this field. Therefore, clients now have to be prepared for the fact that the level of freedom which was typical with offshore companies is now a thing of the past: both the incorporation and operation of companies now involve technical difficulties of varying levels which make the administration side not only slower, but also more expensive.

Cyprus: can they cope with the onslaught?

On May 1st 2004 Cyprus, together with Malta and 8 central and eastern European countries, were part of the expansion which saw the European Union grow to 25 members. Prior to accession, Cyprus harmonised its tax laws with those of the EU, with the most important elements approved by the Brussels commission. The process was completed 18 months before accession, and on January 1st 2003 the tax laws which are primarily in place today were introduced. Even though the rate of corporate profit tax was increased from 4.25% to 10%, on the whole we can still say that Cyprus still has the most beneficial tax climate of all the 27 EU member states. There is no tax, for example, on dividends received from abroad or on the capital gains from the purchase and sale of stocks and shares. At the same time, wages and dividends paid to foreigners are also tax-free.

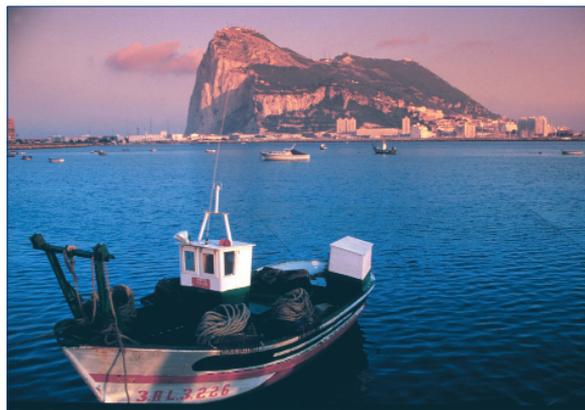
Prior to January 1st 2003, many people, including professional experts, were preparing to "bury" Cyprus, ruling out any possible future development. The reality, however, has made a farce of the pessimists' version, as demonstrated by the number of companies incorporated. 11586 companies were formed in 2004, and 14494 in 2005. The figure for 2006 is 20280 com-



panies registered in Cyprus, which, however we look at it, means a rise of 100% in two years, thanks to the increase in tax competition within the EU. From England to Romania, many EU citizens have realised the same thing: they are better off if they register a company in the country with the lowest tax rates, and carry out their business transactions through that company.

Cyprus, on the other hand, was not prepared for this onslaught. It currently takes the registrar of companies 5-6 weeks to register a new company, a process which can not be speeded up even by the payment of additional fees. Workers not only have to do overtime, but also have to go in on Saturday and Sunday to try and work off the backlog, or at least to maintain the current "tempo". Clients are becoming increasingly impatient, and some have even threatened to take their business to other jurisdictions because the administrative process is so slow. A section of lawyers and auditors from Cyprus have also taken a petition to the Cypriot government asking them to find a solution.

The only way forward is through electronic filing and judgement. For this, however, the Cypriots need to make serious developments in the fields of computer technology, experts and staffing. In all probability, international competition, the desire to maintain existing clients and the fear that the growing burden will cause the complete breakdown of the system will force the island's government to develop a fast and efficient electronic incorporation system.



Gibraltar: can it survive in its new format?

Gibraltar finds itself in exactly the position the EU wants to force upon offshore companies: on the very edge of Europe. And although geographically it is close to Spain, administratively it belongs to Great Britain, and, according to the latest referendum, the people of Gibraltar wouldn't have it any other way.

Gibraltar is one of the very few places within the European Union where offshore companies, in the classic sense of the term, can still be incorporated. Up until

2006, the so-called "exempt company" was the most popular corporate format among clients. The possibility existed since 1967 for companies registered in Gibraltar, but owned by foreigners and with no activities in Gibraltar to receive tax exemption from the otherwise 35% tax on profits. On February 18th 2005, the United Kingdom came to an agreement with the European Commission over the gradual phasing out by December 31st 2010, in several steps, of the companies incorporated earlier and operating under the tax "exempt" status.

Even in the past, the granting of "exempt" status was not automatic. In order to achieve this status and thus be subject to a fixed 400 GBP tax per year, companies had to go through an approval process. The agent who incorporated the company had to initiate the process with the Financial Services Commission, the local financial authority, and see it through to the end. As part of the process, it was necessary to provide detailed information and certification regarding

the owners and beneficiaries of the Gibraltar company.

In future, it will no longer be possible to form companies with this status, or rather it will only be possible to form companies with partial exempt status, and even those will only enjoy the beneficial taxation until the end of 2010. There is, however, another type of company, the so-called "non-

resident" company, and the agreement with the EU did not restrict the formation of this company type. The main point of these companies is that they are incorporated in Gibraltar, but are managed from abroad, so the managers are not resident for tax purposes in Gibraltar. In this case, as the companies do not qualify as local (resident) companies, they are not subject to the 400 GBP fixed tax payable by the "exempt" companies. Of course, in today's ever-changing climate, it is difficult to say exactly how long it will be possible to incorporate and maintain this type of company.

Whatever happens, it is important to emphasise that Gibraltar offers a totally unique type of company within the EU, in that it is possible to incorporate and operate a tax-free company within the EU. It can also be stated that the annual accounting requirement is relatively simple, requiring the filing of a financial report which is much less complicated than in other EU member states.

So it is not necessary to spend serious amounts of money for monthly accounts. And as the "exempt" companies were also unable to take advantage of the benefits offered by double taxation treaties, the "non-resident" company form is by no means a weaker possibility for those wishing to incorporate in Gibraltar.

From the point of view of taxation, as in other partnerships, the LLP employs the flow-through principle, which means that the company itself does not pay tax on its profits, and, provided that there is no income from UK sources, the LLP can transfer its profits to its members, without having to pay profit tax. In the model outlined above, the owners of the income would be the two companies from the Bahamas, which pay a fixed rate of tax of 350 USD per year in the Bahamas, irrespective of turnover. Obviously, the situation would be different if the owners were private individuals resident for tax purposes in any EU country, as in this case, they would have to pay tax on the income in accordance with the laws on personal income tax of the country in question. If the company wishes to trade with or offer services to partners within the EU, then the operation of such LLPs is further complicated by the EU VAT system.

UK LLP: the discreet British offshore format?

We can justifiably say that the British were the creators and pioneers behind the modern offshore world. And this is still very much apparent in British legal practices, not only from the clients' point of view, but also in the "suitably flexible" approach of the authorities towards the various offshore solutions. This is particularly the case if the tax interests of the British are not affected. Within the framework of the EU, however, the possibilities for the open support of solutions which are "harmful to tax competition" are very restricted, and the British have the utmost respect for this.

At the same time, in 2002 the English passed the LLP Act, according to which a company format which had been in existence for some 100 years or so received a fresh boost which totally modernised the conditions, with extremely beneficial tax opportunities for non-resident owners. So, what is it all about?

The LLP - Limited Liability Partnership - is a company format which is in itself a legal entity, and whose partners, that is owners, can be either private individuals or companies. There must always be a minimum of 2 "Members", and these can either be local or foreign, with no restriction. Consequently, offshore companies from other jurisdictions, say, for example, 2 companies incorporated in the Bahamas, can form an LLP in London in the heart of the City.



If, on the other hand, an LLP whose members are offshore companies paying fixed rates of annual taxation, acts as an intermediary in trading transactions between two non-EU partners, any profits "flow through" to the members completely free of tax. LLPs registered in England benefit from the huge prestige of the place of registration. This applies not only in the case of trading transactions, but also in certain investment projects, company purchases, stock exchange activities etc., where a conspicuous offshore company may be off-putting to future potential investors, or the local laws may impose sanctions on funds arriving from countries with low rates of taxation. The fact that it is necessary to form three companies and that the fees involved with the accounting requirement attached to the LLP must be taken into account make the establishment of this company structure somewhat more complicated, but at the same time the high level of prestige and the completely legal tax-free solution mean that in certain situations the additional expense is more than justified.

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