International Tax – best approached with a spirit of adventure!

There's something about International Tax Planning that makes you feel like you're travelling, notwithstanding the fact that you may not have even left your desk, let alone your office and country! A sort of virtual experience then, that can be quite fulfilling and engaging, with ever-changing landscapes and people. As I said, just like travelling!

I got the "bug" for this back in the mid-1980's when I did an overseas 'career enhancing tour' for 3 years with Coopers & Lybrand (now PwC) to Papua New Guinea. I spent the majority of those 3 years helping European's, Australian's and Hong-Kong Chinese to maximise the 'fruits of their labours', by trying to ensure they paid the minimum amount of tax as possible via the use of tax havens – then known as tax avoidance, but these days that's become a blurred terminology with tax evasion (always illegal). Tax avoidance as a terminology is now deemed to be "*the practice of not seeking topay tax contrary to the spirit of the law*". So global governments (G20), it seems, are now looking to sculpt one's moral tax compass (personal and corporate) as an alternative to actually addressing the need for joined up international tax legislation.

From the research I've undertaken, it's become apparent to me that the OECD/G20 will quite probably spectacularly fail to address the global "Tax Gap" (the difference between the money that governments should collect from the taxes owed in their respective countries if everyone complied with the law and the amount of money that governments does actually collect in tax); this is estimated to be anywhere between £35bn to £120bn in the UK alone, so globally who knows what it may amount to! This latter figure of £120bn equates very closely to the governments expected 2011/12 deficit of £126bn. Food for thought – should this be tugging at our professional moral compasses?

Oddly, HMRC it appears, do not have sufficient resources to employ people to collect it, nor it would seem, the OECD/G20 to legislate to tackle the problem head-on globally.

So given the unlikely absence of any joined up global legislative agreement, as above, governments are leaning on tax payers, businesses and professionals alike to conform by way of suggesting what is an acceptable moralistic stance. Witness the recent treatment and "outing" of Amazon and Starbucks to name but a few. It runs deeper, I can assure you, from recent practical experience (see below).

There is some proposed OECD/G20 tinkering with tax legislation around Controlled Foreign Companies (CFC) and interest deductions and non-trading finance profits, but something I have recently come across, is more robust global approach to the 'substance' of entities in tax havens, or any other economic zone for that matter, which may prove to be a more lucrative and pragmatic approach to tackling the global tax gap(s).

Obviously tax havens play the major part in this tax gap – or as they are now starting to be termed - 'Secrecy Jurisdictions'

The Tax Justice Network suggested in 2008 that:

Tax havens are places that create legislation designed to assist persons – real or legal – to avoid the regulatory obligations imposed upon them in the place where they undertake the substance of their economic transactions.

They added with regard to tax havens:
There is a second characteristic that most tax havens share in common. They create an environment of secrecy that allows the user of the structures created using its law to do so either wholly anonymously, or largely so.

They went on to define offshore finance centres as something quite different. They said:

Offshore financial centres are not the same as tax havens. OFCs are the commercial communities hosted by tax havens that exploit the structures that can be created using that tax haven's legislation for the benefit of those resident elsewhere. In other words, the offshore financial centre is made up of the accountants, lawyers, bankers and their associated trust companies that sell services to those who wish to exploit the mechanisms the tax haven has created.

This differentiation of tax havens from offshore financial centres is important. It makes clear that any process of change would require action not just against the territories that are secrecy jurisdictions, but also against the bankers, lawyers and accountants who populate the offshore financial centres. Interesting indeed!

So what does all this mean contextually from some recent practical experience?

Two years ago I was involved in the set up of a global tax efficient structure for a UK based insurance business, who wished to start trading into the USA, but had significant concerns that might arise from commercial litigation. It was determined that the best way to mitigate this was to establish an offshore 'buffer' entity in Bermuda. So far so good. Out of this then arose the opportunity to shelter potential future profits from the "punitive" tax rates prevailing in most European territories. A structure involving Malta (an EU territory based very much based on UK corporate legislation and favourable tax rates under the right circumstances) and a holding entity in Guernsey owned by a QNUPS. Job done, client happy, off we go. Various subsequent tax haven disclosure precedents have left my client asking "Is it still all OK?" Thankfully the QNUPS is sufficiently robust to withstand these changes as there is no ownership (beneficial or otherwise) anywhere in the overriding structure.

Move forward to 2013 – a different client of mine based in Australia moves personally to Hong-Kong (HK).

He personally owns, having developed the product, the IP/Brand of a new alcoholic drink product. He has a procurement entity in Australia for the production and a trading company in HK to globally market the product. HK is a good place to be from both a personal tax (no CGT) and corporate basis – low CT rate 16% and no benefit in kind issues.

Can I help him park the IP/Brand somewhere tax efficient? Ideally, IP should be covered by something called the Madrid Agreement (MA) – there may be no point parking your IP in a territory that is not MA recognised, as withholding taxes, due to a lack of double-taxation treaty, are likely to apply to any royalties/fees paid from another jurisdiction to a non-MA recognised territory e.g. BVI., so it's not tax free! A commercial aspect that also came out of this planning was to ensure that trademarks and patents were all registered where commerciality dictates, before transferring them to the potential tax haven. The reason being that, if subsequently disputed, the cost of setting up the tax efficient structure could be wasted.

So Luxembourg became a prime focus for the IP/Patents destination (if it's good enough for Starbucks.....!).

The need for a European trading Group then also became part of the brief to tap European markets, with the owner planning to live (temporarily) in Spain – a country with significant economic issues and a likely hike in personal and corporate tax rates, so no point putting a corporate entity there for the time being. Ditto France, for which I recall being told by a French accountant (IAPA) at a recent UK200Group conference is essentially "closed for business, do not come here"!

So we sculpted a Global structure that included the existing HK and Australian entities, on to which it was planned to bolt the previously mentioned Malta/Guernsey structure. All looking good.

Then out of the blue, the client get a serious offer of investment and future acquisition from a major global drinks company. An initial investment for 20% of the equity, with significant follow on investment and a pre-formulated buy-out subject to trading volumes being achieved. Great I thought, the proposed structure will work perfectly to mitigate any CGT on the future gains.

Not so, it appears that the corporate moral compass has kicked in, the major drinks company possibly having recently achieved a favourable settlement with HMRC, indicated that they could not be involved in a structure that included Malta, Luxembourg or Guernsey. Guernsey I can sort of understand, and to degree Luxembourg, but Malta seemed a bit unfair. A reasonably new destination with no obvious contentious issues, but I was not in the driving seat!

We were told to look only at Netherlands or Eire as our European trading entities and given 10 days to revise the structure pending their buy-in, all just before Christmas. Splendid!
So where did I go for such immediate help?

I'd previously tapped up my old firm PwC, for some tax advice in Australia – the concept of "substance" and what that needs to look like, was being flagged as vitally important.

I turned to UK200Group International Associates and IAPA to see what could be done, as I was looking not just for tax, but pragmatic operational advice as well. I can honestly say that the two firms I spoke to in Netherlands and Eire could not have been more helpful. They acted expeditiously and with clarity. I also used an UK200Group International Associate and IAPA contact in Spain to check out the personal tax issues.

However, what came across loud and clear from these conversations was the concept of "substance"; it is no longer enough just to have a company with a registered office and a few key meetings a year and someone knocking out the accounts, to ensure you are actually there. You need to have a more established presence, perhaps an employee and certainly a commercial function, if you want to ensure your company is treated as resident in that territory and benefiting from whatever corporate tax and other opportunities that may exist.

A conclusion was reached, but heavily caveated due to the limited amount of time to fully explore all of the issues - operational, commercial and tax that such DD must include. Pro tem the Netherlands looks to be the better option, due to a number of factors – central European hub, favourable tax treatment on IP amortisation (even if acquired from a connected party), loans to directors (to mitigate Spanish income tax issues) are allowed with no corporate tax issues as long as interest is charged e.g. no equivalent s.455 charge on the company; language is not an issue, to name but a few.

Thankfully common-sense prevailed; the potential investor accepted that there had not been sufficient time to adequately carry out sufficient and appropriate DD on these destinations and has agreed to invest via the HK company, even though Malta was deemed to be too "risky"!

What I have learned though is that perhaps the moral compass stance by governments is having an impact – a major global player has decided not to participate in a structure that includes well known tax havens; a top-4 accounting firm is playing a very straight bat on "substance" (and transfer pricing); and us lesser mortals are waking up to the need to ensure that substance is a key factor in "being there"!

Perhaps though, it's not such a gloomy future for tax havens, with news this week about established tax havens now seeing most of their new business emanating from China and wealthy Chinese individuals. Now where's their moral compass?

Finally, don't underestimate the power, depth and usefulness of the UK200Group International Panel, International Associates and IAPA resources.

Good articles and reference sources:
What's the Tax Gap? www.taxresearch.org.uk/Documents/FAQ1TaxGap.pdf
PCs Tax Havens Report www.taxresearch.org.uk/Blog/briefing-sheets

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