# ONSHORE: THE NEW OFFSHORE

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In this article, my thesis is essentially this, that offshore vehicles are wonderful things, but nowadays – at any rate as far as the private client is concerned – we should always ask ourselves, "Can we not manage perfectly well with an onshore vehicle?" I say, "nowadays", but has that not always been wise? To some extent I think it has. The taxman looking at the taxpayer's file comes across a reference to a company incorporated in the Bahamas. His instinct is to make further enquiries. But if he comes across a company incorporated in England, he may well turn over the page. Some countries discriminate against offshore vehicles – blacklisting certain jurisdictions and imposing withholding taxes on outgoing payments or denying deductions for them. What I think is new about "nowadays" is that the offshore jurisdictions have been, if I may use the expression, *rumbled*: they allowed themselves to be used for a lot of business which depended simply on never being found out. But it was. Of course, as we all know, a lot of respectable business has been done – and is being done – through the offshore jurisdictions. But their image has taken a battering. The press and the public do not understand the difference between 'evasion' and 'avoidance'. (Some judges, unfortunately, do not seem to understand it either.) We complain about that, but I see no prospect of it changing, and I think that nowadays, in advising the individual client about any new matter – especially if the client is in any way a public figure, we need to take into account the public perception of the steps we are advising him to take. If the client is the non-resident wife, about to receive massive dividends from shares in a UK company whose chairman is UK-resident and her husband,

should one not consider interposing a UK company or trust, just for "cosmetic" reasons?

This is really quite a difficult topic to address. I am talking about not telling the world what you are doing. This is not a substitute for making sure that what you are doing is lawful and proper. "Cosmetics" are an addition to tax planning. They are not a substitute for tax planning. Once I have made sure that I have the right and proper solution to the problem – whatever it is, I do not want some journalist to start a press campaign, I do not want some competitor – or some dissatisfied employee or perhaps even some disaffected spouse – to find some way to make trouble, and least of all do I want some tax official to think that making an example of me will be an astute career move.

Let me start with an example. I am a company planning to do some business in Madrid. A Spanish company will not do business with me if I am "offshore". But suppose my name is "Milton Grundy Société Anonyme" and my office is in Paris, or my name is "Milton Grundy Inc." and my office is in New York. I am in fact incorporated in Belize, but to the Spanish company I am French or American. Using an agent is a similar manoeuvre. I remember a case where an Austrian company received a lot of payments from Spain. The Austrians told nobody in Spain they were acting as agents for a Panamanian company – though they happily told the tax department in Vienna, which charged them tax simply on the fee they charged for handling the payments. The nominee company in Canada plays a similar role. These are rather primitive manoeuvres, and may depend for their effectiveness on the truth never being discovered, and one thing we have learnt from the wretched Swiss bankers, is that electronic information travels very easily, and there may well be a disaffected or bribable employee who will help it to travel.

A much better solution to this kind of problem is the limited

partnership. The limited partnership has the charm that it is in some way recognised as having an existence in the jurisdiction in which it is established, being registered with some government authority and the registry open to public inspection, while being transparent for tax purposes. There are several jurisdictions in which limited partnerships of one kind or another can be established. These include the United Kingdom and the United States – both of which jurisdictions can well be described as "cosmetic". The upshot is that so long as all the partners are resident outside the jurisdiction in which the partnership is established, and so long as the source of the income is outside that jurisdiction, there is no tax liability in that jurisdiction. This is broadly true of the United Kingdom, the United States and elsewhere. The Scottish version of the limited partnership is different from the English version in that it has a form of corporate identity, separate from that of the partners[1]. But it is still, like the English version, transparent for income tax, and not in itself taxable. It seems anomalous that we have a British corporation expressly excluded from the UK tax regime. It cannot be used as a treaty-shopping vehicle, though it has interesting possibilities in domestic tax planning, but it is undoubtedly "cosmetic". I had one interesting experience with a Scottish partnership, which may be worth a mention. The clients wanted a zero-tax trust company, quickly and at minimum cost. When I first started to practise at the Bar, you could ring up someone in any one of half a dozen common law jurisdictions, and have a trust company by tea-time. But what with issued capital requirements, money-laundering, licensing and finding willing bodies on the ground, the whole thing had become a huge performance, whereas registering a partnership agreement in Edinburgh was quick and easy.

The Delaware Limited Liability Company is a very similar entity, "cosmetic" in the same way: if the income arises outside

the United States and the members are not US taxpayers, the LLC is effectively an offshore entity with an onshore face. And the LLC does not have to be in Delaware: Delaware is a much-favoured State for the establishment of corporations, because of its low State tax on corporations, and this has given the State a certain aroma of tax avoidance. But there are plenty of other States to choose from. I have used Texas quite a lot – not a State associated with anything so fancy as tax avoidance.

Another way of providing a "cosmetic" image is to incorporate somewhere nobody has ever heard of, or at any rate, somewhere not generally known to offer a zero-tax facility. My favourite jurisdiction in this category is Botswana. Not many people know quite where it is on the map, let alone what kind of fiscal regime it enjoys. It has, in fact, the simplified version of the UK tax system which we in Britain exported to our colonies, in the form of what was known as the "Colonial Office Draft". One important feature of this was the basic concept that the criterion of taxability of a company is its *residence* in the territory, whether or not it is incorporated there. This opens the door to the use of the non-resident company. The English non-resident company, and later the Irish non-resident company enjoyed a great vogue, until the door was firmly shut – under pressure, I believe, from our European partners, to whom the whole concept no doubt seemed faintly absurd. It was in this context that I first encountered Botswana. There was a company incorporated in Botswana, but holding its directors' meetings in (if I remember rightly) Monaco. Since its income did not arise in either of these countries, it was wholly tax-free. There must be lots of former British colonies and ex-colonies with their own versions of the Colonial Office Draft, where companies are taxed by reference to their residence and not their place of incorporation. I have never had the patience to do the research, but logically there must be out there a whole heap of jurisdictions capable of hosting non-resident companies. I

said a moment or two ago that the United Kingdom shut the door firmly on the UK non-resident company. Actually, it was only a few years later that the door was discreetly opened again. If the English company – or the Scottish company or the Northern Irish company – is resident in a country with which the United Kingdom has a tax treaty, it can once again be treated as non-resident for UK tax. The statutory provision in its present form is s.18 of the Corporation Tax Act 2009. It would of course be silly to opt for residence in another country if the result was that the company had to pay a significant amount of tax. My favourite country of residence, in this context, is Barbados. This is not because the rate of company tax is lower in Barbados. (It is not.) But because Barbados has an element of territoriality in its system – another legacy from the Colonial Office Draft. In Barbados, they have the rule we have in the United Kingdom, that the non-domiciled pay tax on their foreign income only to the extent that they remit it, but – unlike us – they apply this to companies as well as to individuals. It follows that a company incorporated in any part of the United Kingdom can be treated as non-resident for UK purposes, if it is managed and controlled in Barbados, but will not be taxed in Barbados on its unremitted foreign income. An offshore vehicle in all but name. This element of territoriality – derived from the Colonial Office Draft, is something we find elsewhere in the Commonwealth – notably in Malaysia and Singapore. It is also a feature of the income tax code of Botswana, which means that – to go back to my earlier example – so long as the income arises outside Botswana and is not remitted to Botswana, there is no local tax liability, whether the company is resident or not. In fact, one can say as a general rule that any country with a territorial system can function as an offshore jurisdiction. Panama has perhaps exploited this advantage too much to be considered nowadays as "cosmetic", but maybe Costa Rica has not, and I am sure Uruguay has not.

Uruguay also comes into a separate category – countries which offer zero-tax facilities, but are not generally known for doing so. Top of my list in this category is the United Arab Emirates. They have achieved the amazing trick of levying no income tax, but persuading other countries to enter into Double Taxation Agreements! I know that doing business there is not very straightforward, but Dubai probably meets the criteria I am talking about here, and Ras Al Kharma and Qatar, each of which at this stage are a kind of wannabe Dubai, undoubtedly do.

Which brings me to what I think is the most interesting and versatile 'cosmetic' vehicle of all, which is the trust. Let us suppose that our Spanish company is asked to pay commission to a New Zealand company. New Zealand is not on the Spanish blacklist, and there is no problem. Let us also suppose that the New Zealand company is acting in its capacity as trustee of a settlement made by a non-resident. The Spanish company does not have to know this. Indeed, no outsider is entitled to know this. But the New Zealand trust is not taxed on income arising outside New Zealand, and can therefore be in effect a zero-tax vehicle as regards the commission. And I think it is worth remembering that a company acting as trustee does not have to have a name with "trust" in it. Indeed, if "cosmetics" is what we are aiming for, the corporate trustee should avoid having "trust" or "trustee" as part of its name. And the trustee does not have to limit its activities to holding investments, but can carry on a trade or business as trustee, so long as the trust instrument empowers it to do so. The New Zealand trust is effectively "offshore", but appears to be onshore. I believe the same result can be achieved in Australia, Ireland or Israel. People have for many years achieved the same result with a Canadian branch of, for example, a Cayman company, but the recent *Fundy* decision[2] now opens the door to using a Canadian company. And, coming to my own front doorstep,

it can undoubtedly be achieved with a UK company. As well as a non-resident settlor, you need a non-resident co-trustee, as you will see from the statutory provisions – ss.474 – 476 of the Income Tax Act 2007. But the co-trustee really is a formality: it does not matter where the co-trustee is resident, so long as it is outside the United Kingdom, and there is of course no reason for it to participate in any of the business done on behalf of the trust, or for its existence – or, for that matter, the existence of the trust – to be known to any customers or suppliers. I am a great fan of the UK "offshore" trust: apart from its cosmetic advantages, it is valuable also as a treaty-shopping vehicle. And it does not necessarily have to be governed by English law: with a BVI co-trustee, you can incorporate the VISTRA regime, or with an appropriate co-trustee you can establish a UK-based charity which is not answerable to the dictates of the Charity Commission.

It is also perhaps worth remembering that a trust does not actually have to benefit someone other than the settlor. In the classic "Thin Trust", I settle an asset on trust to pay the income to myself for life and subject thereto as I may by deed or will appoint. The trustee is now the owner of the asset: he can sue anybody for damages and can take advantage of any capital gains tax exemption in a treaty with the country in which the asset is situated. But I can get the asset – or the proceeds – back into my own hands at any time, simply by exercising the power of appointment in my own favour. While the trust exists, I am entitled to the income, and for tax purposes it is treated as my income, and not the income of the trustee. So, for example, the trustee may be UK-resident but the settlor-beneficiary non-resident. If the trust income has a non-UK source, there will be no UK tax liability – not because the trust is treated as non-resident, but because it is transparent. I think the Thin Trust has lots of uses. I remember a case where a Cayman company wanted a cosmetic vehicle to make a significant

investment in a European country. It created a UK thin trust, making the investment in the name of the UK corporate trustee, which was called something like *Amalgamated Ironfounders Ltd*. If in due course a non-resident co-trustee was appointed, the trust could look forward to enjoying treaty exemption on the capital gain when the investment was sold. There was also a rather unexpected extra benefit: some of the ultimate owners of the Cayman company were UK residents, and whereas there is machinery for attributing capital gains of non-resident companies to UK residents, even via intervening trusts, and there is machinery for attributing capital gains of non-resident trusts to resident beneficiaries, there is no machinery for attributing the gains of non-resident trusts to non-resident companies, so that the gain of the Thin Trust in this case would have no tax consequence for the UK owners.

My focus is on onshore vehicles which have "cosmetic" advantages which offshore vehicles do not have. But there is one offshore vehicle which does to my mind have cosmetic advantages – at any rate to some degree, and that is the company limited by guarantee. It is enough for present purposes to say that an offshore company limited by guarantee can be more like an offshore investment company or more like an offshore discretionary trust, depending on how its constitution is framed, but, unlike the offshore investment company and the offshore trust, it does not necessarily carry the label "tax avoidance". For example, suppose it became known to the tax authorities that your client was a member of the Aquarius Society. Would that trigger an enquiry? I suspect not. But the Aquarius Society could be a company limited by guarantee incorporated in the Cayman Islands which only family members were able to join and which owned investments, or an island, or a yacht. You will notice that the name of the company in my example does not end with the word "limited". I think that has a certain cosmetic charm, and that is why I chose the Cayman Islands

for my example – because an exempted company there has the right to do this, and the Cayman Islands and the Turks & Caicos Islands are, as far as I am aware, the only places in the world which afford this right.

I now want to look at two transactions where one might automatically reach for an offshore vehicle, but where an offshore vehicle would serve the purpose just as well. Assiduous readers of the GITC Review may recall that recent issues have included stories about taxpayers who had taken active steps to reduce their tax liabilities by taking advantage of various offshore facilities. I would now like to revisit them briefly, and see if one cannot achieve the same result, using only jurisdictions which carry no overtones of tax avoidance.

The *Fable* entitled "Le Lac"[3] plays with the rule that transactions between connected parties are deemed to take place at market value. The object of the rule is to penalise the person who transfers an asset for less, by taxing the amount of the undervalue, but it of course benefits the transferee to the same extent, because to him the asset has a base cost inflated by the same amount, so if he sells it for full value the next day, he makes a real gain but not a taxable gain. The *Fable* worked by having the transferor offshore but the transferee onshore – in the United Kingdom in this case. It did not matter that the transferor was deemed to sell for more than he got: he was not liable to UK tax. But the transferee still got the high base cost for the asset, so did not have any tax to pay on *his* gain. In my *Fable*, I did not actually say where the Bank was located, but the implication was that it was somewhere offshore, because it is an essential feature of the transaction that the Bank does not have to pay tax on a notional profit. And I think this is one of those cases where one would naturally approach an offshore bank in the first instance, because they may be expected to be receptive to a tax-driven transaction. But does one have to use an offshore bank? The parties were "connected"

for UK tax purposes because of the UK definition of "connected" is quite artificially wide[4]. Suppose we could use – say – a German bank. Or a Canadian bank. Would not that look better?

My second *Fable*, which was entitled *Nigel*,[5] is one which does not depend on the niceties of UK statutes, but on more general concepts. We are all familiar with the discretionary trust. Suppose I have an interest in a discretionary trust with assets worth £10m. What I have – taken by itself – has no ascertainable value. But if all the other beneficiaries are, say, my brothers and sisters, the family as a whole would have an asset worth £10m. And if we could sell our interests to a single purchaser – call him "Mr. X", Mr. X could bring the trust to an end and collect the £10m. Now let me play that sequence in reverse. Mr. X has all the interests in a discretionary trust with assets of £10m. My siblings and I buy all the interests for a total price of £10m., plus – of course – a little profit to Mr. X. Suddenly, my siblings are all poorer, and so am I. The taxman wanting wealth tax or inheritance tax may think I made a poor investment. So may my creditor, or estranged spouse. But the decline in my net assets is real. From a UK point of view, such a transaction is especially interesting, because it side-steps a lot of attribution rules for income tax and capital gains tax, but its effectiveness for estate taxes does not depend on any technical rules, but follows from the simple facts of the situation.

Can we now shift our gaze from the discretionary asset to the discretionary liability? In this *Fable*, the story is that a company was doing business in a high-tax country. I did not say which country it was, and it did not really matter, though I guess my unconscious model was the United Kingdom. The company was marketing the services of a resident individual, whom I called "Nigel". Nigel might have been a pop singer who wrote his own songs or an IT consultant who wrote his own programmes: the essential feature of him was that there

were different aspects to the overall services he provided – three in this case. Each aspect was vested in a separate Thin Trust for him and his family, and each of the three trustees contributed its own aspect to the marketing company, so that the marketing company could sell all aspects of Nigel's services. The trustees now grant a five-year licence of Nigel's services to the marketing company, so that the marketing company has to pay Trust A for the A services, Trust B for the B services and Trust C for the C services. The aggregate amount payable to all three of them is agreed. In my example, it is 80% of what the marketing company receives from sub-licensing the services. But the way in which that aggregate amount is to be divided between the three trusts is left for later agreement.

The five years now pass. The marketing company has collected £10m. and owes £8m. to the trustees. The £8m. has not been taxed – not in the hands of the marketing company, for which it ranks as a deduction, and not in the hands of the trustees, because none of them is entitled to any of it. Now Nigel has found a purchaser, who will buy his three trust interests for £8m., less a turn for itself. In the original version of the story, Nigel was a UK resident, so I worried that the proceeds of sale might be caught by the provisions which tax capital sums derived from services[6]. So I sent him off to be resident in Barbados during the tax year in which the sale took place. As it turned out, this was the only offshore element in the transaction, but, interestingly, I originally devised the transaction as one which would take place wholly offshore, and I only gradually realised that it could equally well be done onshore.

Well, so much for my *tour d'horizon* of onshore vehicles effectively functioning as offshore vehicles. Before I get lynched by half the practitioners in the field, let me hasten to add that I am not in any way hostile to offshore vehicles: I have spent a lifetime working with them, and I know that offshore business keeps the wheels going round to an extent of which the general

public has no idea whatsoever. Mrs. Thatcher was known for the expression TINA – There is No Alternative. The burden of my song here is that Mrs. Thatcher's acronym has no application to the world of international tax planning: where we feel that an onshore alternative may be appropriate, there may well be a suitable one.

*Adapted from a talk given by the author to the ITPA in Cannes in June 2012*

*Endnotes*

1 Partnership Act 1890 s.4(2).

2 *Fundy Settlement v. Canada* 2012 SCC 14.

3 GITC Review Vol IX No 1.

4 TCGA 1992 s.286

5 GITC Review Vol X No 1.

6 ITA 2007 ss.773-789.