

# A PEEK INTO THE WORKINGS OF OFFSHORE TAX HAVENS

By Ben Sewell



Ben Sewell is the Principal at Sewell & Kettle Lawyers.

Offshore havens have recently captured our imagination through the Panama Papers leak. A trove of client data (2.6 terabytes of data containing 11.5 million records) from a Panamanian law firm was leaked to the International Consortium of Investigative Journalists ('ICIJ'). The ICIJ's website provides a search engine with offshore haven company ownership information from the leaked documents as well as educational videos and articles (offshoreleaks.icij.org). The journalists are still analysing the Mossack Fonseca materials themselves and writing articles about the use of offshore havens by the wealthy and powerful around the world. The ICIJ reports the two most popular offshore havens are the British Virgin Islands and Panama. Those jurisdictions prefer the title 'offshore financial centre' to offshore haven or tax haven. The British Virgin Islands (Norman Island) was reputedly the inspiration behind Robert Louis Stevenson's pirate novel 'Treasure Island'. Today, according to the ICIJ, there is still treasure hidden in the same islands, metaphorically at least.

## Setting up an offshore haven company

Setting up an International Business Company in an offshore tax haven is straightforward and relatively inexpensive. If you use the search terms, 'set up bvi ibc' in Google you will find a large number of online incorporation services with direct links to registered agents in the British Virgin Islands. Registered agents offer to incorporate an International Business Company for a flat fee (around \$1,000 USD plus disbursements) and they also offer related services such as nominee directors, bearer shares, powers of attorney and assistance to set up offshore bank accounts.

## Snapshot

- Incorporating through an offshore haven is straightforward and relatively inexpensive.
- There is a strong incentive for Australian residents to generate income in offshore havens and evade Australian income tax through secrecy. This is likely to be an increasingly risky venture because of the tax information sharing agreements between Australia and offshore havens.
- International Business Companies can be sued under Australian corporate law if these companies trade in Australia. This is important to know when acting for a creditor of an International Business Company because Australian corporate law provides significantly more protections for creditors than the corporate law of offshore havens.

The objective of the service provider is to assist with low cost incorporation whilst meeting the secrecy requirements of their clients. The alternative to online incorporation is to contact intermediaries who engage the registered agents in the local jurisdictions and set up the arrangements for incorporation including nominee directorships. The writer predicts this will lead to the 'democratisation' of the use of offshore havens by Australians who are becoming wealthier and more internationally mobile.

The temptation to leave assets in offshore havens with tax free status is a significant risk for the Australian Tax Office and also onshore creditors.

### What is an offshore haven?

There is no single accepted definition of 'offshore haven' but any general definition would include the following elements:

1. Foreign jurisdiction: grant of incorporation under local law without any requirement to hold assets within the jurisdiction or have a locally resident director;
2. Secrecy protections: no publicly available register of shareholders or directors and the right to use bearer shares, layering and nominee directorships to maintain secrecy of ultimate ownership; and
3. Tax free status: tax free status for any business that is conducted out of the jurisdiction and no requirement to file tax returns.

### Terminology of offshore havens

The terminology of offshore havens is in stark contrast to Australian corporate law. Some of the key terms are:

- Bearer shares: a share in a company that is owned by the person who holds the physical certificate. This maintains the secrecy of the true owner of the share as there is no share register held by the registered agent.
- Corporate directorship: unlike Australia, where all directors are required to be natural persons, companies can hold directorships in offshore haven companies.
- CRS: means Common Reporting Standard, a new single global standard for collection, reporting and exchange of financial information on foreign tax residents. CRS was agreed by G20 leaders in 2013 to create a mechanism for automatic exchange of tax information between multiple countries. An Australian law that provides for the exchange of foreign

resident account information with participating CRS nations is coming into effect on 1 July 2017 (see: Tax Laws Amendment (Implementation of Common Reporting Standard) Act 2016).

- FATCA compliance: means complying with a Federal United States statute, the *Foreign Account Tax Compliance Act ('FATCA')*. To avoid prohibitive withholdings (30 per cent of payments to foreign payees) all foreign financial institutions are required to report to the United States Internal Revenue Service information about their bank accounts held by or linked to United States citizens or corporations. Australia and the United States entered into a bilateral agreement regarding FATCA compliance in 2014.
- Intermediaries: the lawyers, accountants and 'fixers' who set up offshore corporate structures with layering, nominee directorships and bearer shares to ensure secrecy whilst keeping their client in control of the assets held. The intermediaries may not necessarily be the registered agents in the offshore haven.
- International Business Company: an offshore company formed under the laws of a jurisdiction where the company's activities are limited to international business. Also known as an international business corporation.
- KYC: 'Know Your Customer' is the process of verifying the identity of a customer by a banker or registered agent. Pursuant to CRS, from 1 July 2017 Australian financial institutions will be required to disclose the foreign taxpayer identification number or an equivalent when opening accounts for foreign residents in Australia.
- Layering: ultimate ownership is made more opaque by adding multiple layers of corporate ownership and corporate directorships. In an asset tracing exercise, multiple court applications in different jurisdictions may be required to identify the ultimate owner of an offshore corporate structure.
- Nominee directorship: where a person who is the validly appointed director is acting on behalf of another person and following their instructions. This is further complicated by corporate directorships in offshore havens.
- Registered agent: international business companies are required to

## How do the offshore havens compare to Australia?

Offshore haven characteristics	Comparison with Australia	Takeaway for solicitors
No income tax or other direct taxes	Corporate tax on profits and capital gains tax	It may be tempting for some clients to send assets to be held by international business companies to avoid tax
No requirements to file tax returns	Annual income tax returns, Superannuation returns, BAS returns	Use of offshore vehicles may be undertaken without any ongoing professional advice in Australia
Secrecy of share ownership	Information on share ownership of proprietary companies and substantial holders of public companies is publicly available	A court application in the offshore haven's jurisdiction to obtain this information may be required
Nominee directorships and corporate directorships	In Australia, companies cannot be directors of other companies and shadow directors have fiduciary responsibilities	Frustration in asset tracing is a risk with layered corporate structures and nominee and company directorships
No shadow directorship law	Where there is a nominee directorship their controller may be liable for director's duties	A shadow director of an International Business Company is not liable under the local law for breach of director's duties

have an address within the jurisdiction through a certified professional agent (usually a lawyer or accountant). The registered agent holds the register of shareholders and directors. When the International Business Company is incorporated the registered agent attends to KYC on behalf of the offshore haven's regulators.

### Example, what can you get in the British Virgin Islands that you can't get in Australia?

The material benefits for incorporating an International Business Company in the British Virgin Islands (as an example) compared to leaving assets in an Australian domiciled company are:

- incorporation within two business days provided KYC is completed;
- no tax generally, including income tax, corporate tax, capital gains tax, inheritance tax, gift tax, wealth tax or other form of direct taxation;
- corporate directors permitted;
- no nationality or residency restriction on directors or shareholders;
- appointment of nominee directors permitted and no law of shadow directorship;

- identity of shareholders and directors not publicly available unless volunteered or subject to Court order;
- bearer shares permitted;
- no requirements to lodge annual corporate returns or tax returns;
- the country is a British overseas territory and its highest Court is the Judicial Committee of the Privy Council in London; and
- no law of *ultra vires* so there is no limit on usage of the company.

### Tax information sharing agreements

Australia, like the United States, taxes its residents on their 'worldwide income' and we are required to declare 'foreign income' in income tax returns. Therefore, there is a strong incentive for Australian residents to generate income in offshore havens and evade Australian income tax through secrecy. This is likely to be an increasingly risky venture because of the tax information sharing agreements between Australia and offshore havens.



The United States leads the charge against offshore havens and its most important action was passing the *Foreign Account Tax Compliance Act* in 2010. It basically forces all banks that want to receive money from the United States financial system to disclose information about accounts held by United States citizens or corporations to the Internal Revenue Service.

The CRS is a multilateral exchange system and both Australia and a number of offshore havens (including the British Virgin Islands) are parties to it. The British Virgin Islands has agreed to begin complying with the CRS from September 2017 and therefore Australians who expect secrecy in that offshore haven may need to reconsider the risk they face.

### Suing international business companies under the Australian Corporations Act

The corporate veil around an International Business Company can be pierced by Australian law.

A company, including an International Business Company, irrespective of where it is incorporated is subject to Australian corporate law if it carries on business in Australia. The source of the law is somewhat convoluted but if you read the definitions of 'company', 'Part 5.7 body' and 'foreign company' under section 9 of the *Corporations Act 2001* (Cth) you will find that even though an International Business Company is not registered in Australia it will be subject to the *Corporations Act* if it 'carries on business in Australia'.

This is important when acting for a creditor of an International Business Company because Australian corporate law provides significantly more protections for creditors than the corporate law of offshore havens.

While CRS may be useful for the Australian Taxation Office, it doesn't offer any benefits to Australians who are creditors of international business companies. To pierce the shroud of secrecy, a court application in the offshore haven may be required to

obtain information about the directors and shareholders of the company. This is likely to be expensive and potentially a slow task if there are corporate directorships, layering and bearer shares.

### Takeaways for solicitors

- It is likely that the use of International Business Companies will grow as these vehicles become more accessible and cheaper for Australians.
- The differences between the corporate law of offshore havens and Australia are irreconcilable. If acting for Australian creditors of International Business Companies you will face a difficult task in any asset recovery action.
- Australian professional advisors should be aware of CRS and that their clients may have information about their offshore bank accounts disclosed to the Australian Taxation Office without their knowledge. **LSJ**

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