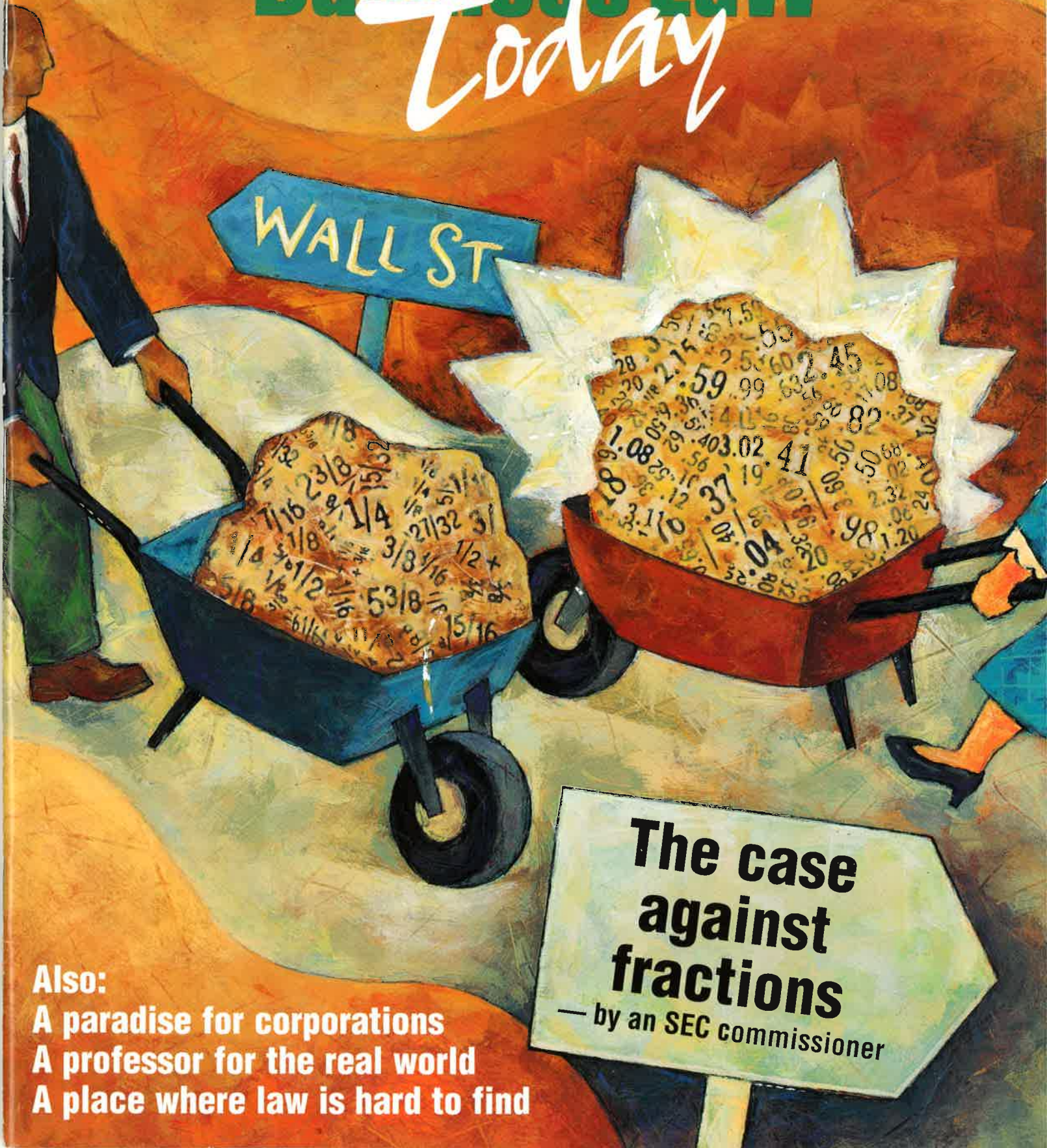


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Business Law *Today*



Also:

A paradise for corporations

A professor for the real world

A place where law is hard to find

**The case
against
fractions**
— by an SEC commissioner

A composite image featuring a sailboat on the surface of the water and a diver underwater. The sailboat is on the right side, with its mast and rigging visible. The diver is on the left side, swimming downwards. The water is a deep blue color. The sky is also blue with some white clouds. The word "Taxing?" is written in large, bold, white letters across the center of the image.

Taxing?



Once upon a time, this advice was golden: "Go west, young man, and seek your fortune." That was then. This may be now: "Go offshore, young entrepreneur ... and *keep* your fortune."

Import-export companies, investment funds, insurance companies, bank and trust companies, leasing companies, finance companies and other international businesses have recognized the advantages of locating overseas — usually in a foreign tax haven. Such countries as the Bahamas, Bermuda, the British Virgin Islands and the Cayman Islands afford a company immunity from paying taxes there, as well as other business advantages.

In a typical scenario, a person who wants to organize a company with an international presence — possibly a company brokering cross-border transactions in raw materials, finished products or other goods and commodities, or acting as a commission agent — must first choose a jurisdiction to base its operations. Various considerations will come into play.

Of primary importance, the company's chosen location should impose no or little income tax. The principals can then concentrate on running the business — without having to consider the local tax consequences.

Also, the company's owners may highly value their privacy. In particular, the owners may not want to disclose to the world their ownership interest. Many foreign tax havens have well-entrenched secrecy laws that limit outsiders' access to information about the identity of a resident company's shareholders and details about its bank accounts. However, U.S. shareholders are subject to certain requirements regarding disclosure of foreign bank accounts and foreign corporation ownership.

The government of the country should be economically and socially stable, with little likelihood of political unrest. Further, the powers that be should encourage the establishment of business organizations by foreign nationals, with minimal regulation and little likelihood of interference with the company's planned activities.

The prospective home country must have a well-developed infrastructure with a modern telecommunications system affording immediate and reliable access by phone and fax to all locations where the company has business interests. The principals' access to information and ability to respond swiftly and decisively in a rapidly changing global marketplace must not be compromised by anything less than state-of-the-art telecommunications.

The country also should have an international airport providing direct, or minimally inconvenient, access to the world's principal economic centers. Depending on the company's business, geographic proximity to the Americas or Europe, or a location in a particular time zone, may be important.

Steinbach is a partner and Grayson is a former associate at Kleinberg, Kaplan, Wolff & Cohen, P.C. in New York City.

Hardly

Locating a business in a tax-free jurisdiction

By **HAROLD I. STEINBACH**
and **HEATH A. GRAYSON**

The principals of the new company will want to choose a country with a well-developed banking system, preferably with resident branch offices of recognized international banking institutions. Engaging bankers with a strong international presence will speed global transactions by the new entity. Moreover, using bankers with a good international reputation should afford the young company a certain respectability that may be significant in its dealings with prospective customers.

It may be desirable that the company's address lend credibility or prestige. For example, depending on the type of business in which the company proposes to engage, organization in a current or former British colony such as Bermuda or the Cayman Islands may connote financial sophistication or propriety. Other factors in choosing a place to locate include the presence of an educated work force, the availability of housing and entertainment options and whether or not English is generally spoken.

Many companies choosing offshore choose the Bahamas, Bermuda, the British Virgin Islands or the Cayman Islands as the favored tax haven. A principal economic advantage of locating in any of these jurisdictions is the absence of any income, corporation or capital gains taxes. Such countries as St. Lucia, Barbados, Trinidad and Tobago offer various incentives or reduced tax rates for companies locating their businesses there.

To illustrate, a company located in New York City or a similar high tax

The laws of many offshore jurisdictions are based on English common law.

jurisdiction with an annual income of \$1 million would pay \$450,000 in federal, state and local income taxes (assuming a 45 percent overall tax rate). Were that same company to be headquartered in an offshore tax haven and meet the required criteria for tax-free status, it would pay *no* income taxes.

The laws of many offshore jurisdictions are based on English common law. This may be desirable to principals who are from the United States, Great Britain or another English common law jurisdiction, and are familiar with the country's legal system and laws. Under English common law, courts tend to rule in a manner consistent with well-documented sources of legal precedent. Parties to an agreement can thus predict with a high degree of certainty the likely legal consequences of their actions.

Most offshore jurisdictions offer a number of different organizational forms, depending on the type of business the company plans.

For companies conducting their operations principally outside of the offshore jurisdiction (such as an import-export company with worldwide operations or an investment fund with non-U.S. investors), an international business company organized under Bahamian or British Virgin Islands law or an exempted company formed under Cayman or Bermuda law is the preferred form of organization.

In the case of an international business company, profits paid by it to its nonresident shareholders are not subject to tax. Bahamian and British Virgin Islands law provide that such company must carry out its business activities with persons outside of its place of organization. However, it is permitted to have bank accounts, prepare and maintain books and records and hire professional service companies locally.

Persons locating an offshore company in the Cayman Islands would generally form an "exempted company" — a company operating in the Cayman Islands only in furtherance of its business carried on outside of the Cayman Islands. Activities permitted by an exempted company include making contracts and maintaining bank accounts in the Cayman Islands, provided such activities further the company's business conducted outside the Cayman Islands.

In Bermuda, an exempted company is available to non-Bermudians who

	Income tax on nonresident company*	Confidentiality laws	Variety of organizational forms	Work permits required	English spoken	Laws based on English common law
Bahamas	No	Yes	Yes	Yes	Yes	Yes
Bermuda	No	Yes	Yes	Yes	Yes	Yes
British Virgin Islands	No	Yes	Yes	Yes	Yes	Yes
Cayman Islands	No	Yes	Yes	Yes	Yes	Yes

*company carrying out its business activities outside of the offshore jurisdiction

engage in business outside of Bermuda, while maintaining a central office on Bermudian soil.

Many offshore jurisdictions also permit the use of other organizational forms, such as limited partnerships and trusts, which may themselves own trading or investment companies. Owning a company through a trust can provide principals seeking confidentiality an added layer of privacy.

The laws of many offshore tax havens also protect the privacy of a company's owners and their bank accounts. For example, in the Bahamas, Bermuda and the British Virgin Islands, information provided to a lawyer, trustee or bank officer concerning the identity of a company's shareholders and the owners of its bank accounts is carefully safeguarded under common law. Divulging such information subjects the offender to fine or imprisonment.

The Confidential Relationships (Preservation) Law adopted in the Caymans goes further. It provides that any disclosure of confidential information given to a professional person (such as a governmental official, bank, trust company, lawyer, accountant or broker) in the course of a professional relationship is punishable by a fine and imprisonment. However, such information may be disclosed:

- in connection with an investigation by certain high-ranking local police officials of an offense committed in the Cayman Islands, or an offense committed outside of the Cayman Islands that would have been an offense had it been committed locally,
- by or to certain specified senior governmental officials,
- by or to a bank in any proceeding or matter when reasonably necessary for the protection of the bank's interest, or
- with the approval of certain high governmental officials when necessary for the protection of the professional person or any other person against crime.

These exceptions will generally be construed to permit disclosure only in the case of a persuasive demonstration of the need to invoke the exception (such as by clear and convincing evi-

Many havens protect the privacy of a company's owners and their accounts.

dence of the principal's commission of a specific offense). Further, persons to whom confidential information is disclosed under any of these exceptions will themselves be bound to safeguard its confidentiality.

Several offshore tax havens (includ-

ing the Cayman Islands and the Bahamas) are parties to various treaties providing for the exchange of information in connection with the investigation of certain serious offenses (such as narcotics trafficking and money laundering). The Treaty Relating to Mutual Legal Assistance in Criminal Matters provides that parties to the treaty may request information from each other with respect to certain mutually recognized crimes involving a sentence of one year or more, and certain offenses under U.S. law (such as securities fraud, insider trading and other offenses involving fraud).

The country receiving the request will furnish the information only on determining that the request is legitimate and covered by the treaty. The treaty specifically excludes from its coverage any offenses involving tax matters.

It is important to keep in mind that the "industry" of providing a foreign tax haven is highly profitable. In addition to nicely supplementing tourism,

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"Because your blood pressure is a little high, I'm advising you to stay 'out of the loop' for a few weeks."

it attracts foreign capital, brings in government-fee revenue and helps bolster the local economy. Consequently, even in the face of international pressure to relax its secrecy laws, offshore tax havens are reluctant to do anything to make their local laws any less desirable for foreign nationals.

In most offshore jurisdictions, by appointing a nominee to hold their shares in record name, a company's beneficial owners can remain virtually anonymous. Numerous corporate service companies, trust companies and lawyers are willing to serve as nominees.

The identity of the shareholders of an international business company or Cayman-exempted company is not available for public inspection. In the case of a Cayman-exempted company, the identity of the beneficial owners is not even known to the registrar of corporations.

The principals of an investment fund (such as an investment company or private investment partnership) that offer interests in the fund to foreign (non-U.S.) persons or U.S. tax-exempt persons (such as public charities, private foundations or pension plans)

generally choose to incorporate or be formed in an offshore tax haven. By satisfying certain indicia of offshore status, they avoid income taxation of the fund in the United States. Under U.S. Internal Revenue Code Regulations §1.864-2(c)(2)(iii) (popularly referred to as the "Ten Commandments"), a foreign fund that maintains its principal office outside the United States will not be subject to U.S. tax if all or a substantial portion of the following functions are carried on at or from the office located offshore:

- communicating with its shareholders or partners (including the furnishing of financial reports).
- communicating with the general public.
- soliciting sales of its stock or interests.
- accepting the subscriptions of new stockholders or partners.
- maintaining its principal corporate records and books of account.
- auditing its books.
- disbursing payment of dividends, fees and officers' and directors' salaries.
- publishing or furnishing the offering and redemption price of its

shares or interests.

- conducting meetings of its shareholders and directors or partners.
- making redemptions of its stock or interests.

Such investment companies generally hire a local administrator to maintain their records, hold meetings and otherwise satisfy the criteria for offshore status.

It should be noted that a recent proposal by the U.S. Department of the Treasury to repeal the Ten Commandments could eliminate the need to use an offshore administrator for soliciting investors offshore and for many other offshore functions. However, even if the proposal becomes law, it may not eliminate the desirability of offshore jurisdictions for various investment funds since, *inter alia*, some offshore investors will likely continue to prefer to invest in entities located in tax-haven jurisdictions.

To form an offshore corporation, the company's principals will need to provide the following information to the local law firm, trust company or corporate service company that will be forming the corporation:

- a proposed name for the corporation.

- the company's authorized capital.
- the names and addresses of the company's beneficial owners (and record owners if the local representatives are not acting as such) and their respective share ownership. The company's registered representative will usually require that the organizers supply reference letters for the owners.

- a statement of the company's proposed purpose.
- the names, addresses and occupations of the company's directors and officers. The company's local representative will often require reference letters and copies of passports.

The company will generally be formed within five days of filing executed organizational documents with the local registrar.

Beyond simply organizing a business offshore, the principals of a newly organized company may wish to locate some of their employees in the offshore jurisdiction. While local service companies are generally available to enter into contracts on behalf of the company and otherwise manage the company's day-to-day business activities, the company's principals may prefer to have their own employees run the business. Perhaps the employees possess certain talents (such as technical or language skills) or the company's owners have confidentiality concerns. In most offshore tax havens, such employees must obtain work permits from the local immigration board before they will be allowed to work there.

Some offshore locations boast of low unemployment and a superior standard of living. Reluctant to jeopardize this status and admit outsiders who might occupy jobs that might otherwise be filled by local residents, the authorities have put in place a burdensome work-permit application process.

The information generally requested in the applications includes:

- a description of any professional or technical qualifications of the applicant.
- whether the applicant has ever been involved in politics.
- whether the applicant or any person accompanying the applicant suffers from any disease or infirmity.
- whether the employer has in

**To protect jobs,
some do have
a burdensome
work-permit
application
process.**

place a training program.

The applicant will be required to submit evidence of his or her qualifications for the proposed position. The application must emphasize skills that are unlikely to be found among local

residents who may apply for the position (such as foreign language or specific technical skills).

For a work permit lasting a year or more, the prospective employer is generally required to advertise the position locally. The prospective employer must submit copies of the ad, together with details of any responses received, and explain why such respondents were not hired.

The applicant must provide a police certificate from his or her place of residence certifying that the applicant has no criminal record. Depending on the facts and circumstances of the particular application, the immigration board will follow up with the local police authorities and verify the accuracy of the submitted information.

Additionally, in some jurisdictions, the applicant must submit a medical certification attesting to the applicant's good health and absence of the AIDS virus. References from the applicant's banker and additional personal refer-

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ences may also be required.

The company may also be required to hire at least one local resident.

Permits are generally granted for one month to three years, and may be renewed. Renewals are generally easier to get than the initial permit.

The company may want to open up an account at a bank located within the offshore jurisdiction. The principals should choose a bank with branch offices around the world, as this will make it easier for the principals to get at their money, obtain letters of credit and otherwise transact business outside of the offshore site. The bank should have a strong reputation in global financial circles. To open the account, banks in offshore tax havens generally require the following documentation:

- certified copies of the company's organizational documents and directors' resolutions authorizing the opening of the account.
- reference letters from a well-regarded commercial bank for each of the company's directors and beneficial owners. The bank may require that each such director or beneficial owner have had a relationship with the referring bank for at least three years.
- details regarding the business of the company and the principals named on the account.

Some banks may require information regarding the source of the account's funding.

Accounts generally become operational within a few days of submission of the completed application materials.

Establishing an offshore entity takes time and the ability to navigate many potential land mines. However, under the appropriate circumstances, locating in an offshore tax haven will provide significant tax and other advantages that make the effort worthwhile.

Finally, it is important to note that this discussion provides only a general overview of the issues and considerations involved in locating offshore. Moreover, there may be a number of U.S. income tax issues (such as passive foreign investment company and controlled foreign corporation) and information-reporting issues involved.