

## CHAPTER 59

# CHOOSING YOUR OFFSHORE TAX HAVEN

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### *Overview*

In this chapter, you will learn what characteristics to look at when selecting an offshore tax haven.

### *Learning Objectives*

By the end of this chapter, you should be able to:

- understand what characteristics to look for when evaluating an offshore jurisdiction;
  - understand the types of asset protections that the most popular offshore tax havens offer; and
  - understand the privacy that offshore jurisdictions provide.
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Turquoise seas, pristine coral, endless and near-deserted white sandy beaches with iconic palm trees; a holiday is but a dream for most bankruptcy lawyers and their clients. This became reality for me many years ago, when I was briefed to appear in the Court of Appeal in a, then, little-known but quite exotic tax haven. I stayed. I went on to help clients establish and defend structures that put their hard-earned wealth out of harm's way, away from vexatious litigants and hostile spouses. What follows is an overview of asset protection using some of the more popular tax havens.

As a preliminary point, though, I should say that prior to considering any form of offshore structure, one should always look first at structuring within Canada. Domestic structures may be appropriate in terms of ease of establishment and cost. Since asset protection and tax structuring may be available onshore, one should always look, initially, at the means of achieving one's ambitions within the domestic context.

## JURISDICTIONS

There are many offshore jurisdictions in which a trust may be established. Some are extremely successful. For example, Cayman is the world's fifth largest banking centre with \$1.3 trillion in deposits, of which \$935 million are interbank bookings, not personal or corporate accounts. The British Virgin Islands (BVI) are home to 700,000 offshore companies. Bermuda enjoys the third highest per capita income in the world, that being US\$70,000 compared to US\$43,500 for the United States. The Turks and Caicos Islands, whilst smaller, is a niche jurisdiction, offering a friendly and efficient boutique service against a backdrop of wonderful beaches and fine hotels. Many offshore finance centres (the new name for "tax havens") are current or former British Colonies and/or associated states located in the Caribbean, North Atlantic and the Channel Islands. They are characterized by the following:

- zero or minimal income tax;
- legislated bank secrecy;
- similar legal system to Canada (based on English common law with a generally independent and non-corrupt judiciary); and
- strict regime of supervision by financial services authorities, generally headed by experienced non-local people (which require trust companies and banks to maintain heavy insurance coverage).

Most of the offshore jurisdictions provide similarly attractive regimes, so the decision as to which one to use will, to a degree, depend on personal preference. Skilled and efficient trustee and corporate services are available in most of them. One important factor to consider in selecting a jurisdiction is the ease with which one can travel there. In the modern telecommunications era, it is not essential to ever step foot in the jurisdiction. However, there is much to be gained by making at least an initial visit to familiarize oneself with the jurisdiction in general and the trustees in particular. This consideration may make the North American investor select the Turks and Caicos Islands or the Bahamas over, say, Lichtenstein or even the Cook Islands. Ease of communication having regard to time zones is also a very important factor to consider.

## ASSET PROTECTION

Historically, trusts evolved as a means of protecting assets. This was achieved by having another trusted person hold legal title of assets on behalf of (or in trust for) another. Tax considerations aside, which I will deal with below, asset protection is still by far and away the most

important reason for establishing an offshore trust. Persons of substantial means who are, or may be, at risk in the future from unwelcome litigation should give consideration to establishing a trust. Once assets are transferred into the name of the trustees, after a prescribed period, creditors are no longer able to execute against such assets. This is because the settlor has divested himself or herself of legal ownership. One may obtain asset protection by establishing trusts both in Canada and offshore. The advantage of establishing a trust in one of the offshore finance centres is their prevalent debtor-friendly regimes. These shorten the period of time in which a creditor may bring proceedings to attack the establishment of the trust/settlement of specific assets into trust. The jurisdictions range geographically from the Bahamas to the Cook Islands. Trusts established in the debtor-friendly jurisdictions are typically referred to as Asset Protection Trusts.

The Cook Islands regime provides considerable hurdles for a creditor to overcome. Firstly, he or she must seek the leave of the court in Rarotonga to even bring the action. Secondly, if leave is granted, he or she must prove beyond reasonable doubt (the criminal standard) that the transfer into the trust was made with the intention of defrauding a creditor. No action may be brought in respect of any transfer that took place before, or more than two years after the cause of action arose. If the settlement takes place within the two-year window, then the creditor must bring an action in the settlor's home jurisdiction within 12 months of the transfer of assets to the Cook Islands trust, alleging some sort of debt or damages. He or she must then commence a further action in the Cook Islands' courts within two years of the transfer of assets into the trust. If the creditor does not comply with both of these limitation periods, then the claim will be statute-barred.

The Cook Islands regime marks the high watermark of debtor friendliness. Caribbean jurisdictions such as the Turks and Caicos Islands have similar regimes but are slightly more neutral. In the Bahamas, *The Fraudulent Dispositions Act*, 1991 establishes a two-year limitation period for creditors' attacks on asset protection trusts; the attacker has to prove fraud against the settlor. Even if fraud is proved, beneficiaries who have *bona fide* received benefit from the trust are permitted to retain what has been distributed to them. In Barbados, creditors have three years to apply to set aside the terms of a trust. An intention to defraud, on the part of the debtor, must be established. A successful creditor can only set aside such parts of the trust as have caused him or her prejudice, not the balance.

Once established, as indicated above, legal title rests with the trustees, and the settlor and/or his or her family may become beneficiaries

and entitled to receive discretionary distributions. It is well settled that with a properly established trust, there is no right on the part of the beneficiaries to require payments to satisfy their creditors. Accordingly, execution against such a beneficiary could prove fruitless.

Some of the advantages of utilizing offshore trusts for asset protection purposes include the following:

- The geographic distance between Canada and the offshore centre makes an action against the trust more difficult to pursue than in Canada. To use an extreme example, the distance, as the crow flies, between Calgary and Rarotonga, Cook Islands is 11,670 kilometres. To fly there from Calgary takes a minimum of 24 hours in the air and requires one to change planes in Los Angeles and Papeete, French Polynesia.
- Foreign judgments normally are not recognized in offshore jurisdictions. A plaintiff will therefore have to litigate the entire action afresh in the offshore court, always assuming that the offshore court agrees to accept jurisdiction, which it may not.
- Should the action be permitted, then substantial costs will be incurred in prosecuting the action offshore.
- Time zone differences make it difficult to speak to lawyers by telephone. Distances preclude satisfactory conferences and briefing of witnesses ahead of travel to the offshore jurisdiction. Lawyers' hourly rates may be substantially higher than in Canada, owing to the difficulty of attracting lawyers willing to practise in such locations.

It will be logistically difficult and expensive to transport witnesses to give evidence.

The laws governing the trust will be those of the offshore jurisdiction — not those of Canada. The laws of the offshore jurisdiction are likely to be much more favourable to the debtor than to the creditor. Generally, the self-interest of an offshore finance centre is best served by a legal regime that upholds the sanctity of a trust under attack from a disgruntled creditor of the settlor. In most offshore finance centres, a high proportion of the population is employed in the trust and banking sector. Allowing trusts to easily collapse ultimately leads to the destruction of an important industry. Overseas investors will be unwilling to have their trust administered in a jurisdiction that allows the interests of overseas creditors to prevail.

The net result of the above is to discourage frivolous lawsuits and to encourage reasonable settlement offers from more legitimate complainants.

### **FREEDOM FROM PROBATE (IMPOST AND CONFIDENTIALITY)**

Upon death, details of assets that have to be probated become a matter of public record. There is no requirement to make public details of assets that one settles into trust prior to one's death. Probate fees (however described) are charged in most provinces on the value of assets probated on death. These charges cannot be levied if the assets are already settled into an *inter vivos* trust, as the assets no longer form part of one's deceased estate. This is another excellent reason to establish an offshore trust.

### **EASE OF ADMINISTRATION OF ASSETS AND CONTINUITY**

One problem that manifests itself, particularly in the context of family businesses, is that of ownership of shareholding in the holding corporation by siblings, irrespective of their knowledge of the business and involvement in its day-to-day activities. For example, one child may have dutifully entered the family business upon completion of his or her education. Another may have pursued a career as a musician. It is unlikely that the latter sibling will be able to make the same contribution to business discussions as the former. Also, health or psychiatric problems may hinder family members, who have the best intentions, from properly exercising their rights as shareholders. Family disputes and the lack of capacity can frequently bring down a family business. An offshore discretionary family trust can be utilized to overcome these problems. Ownership of shareholding is vested in the trust. The trustees decide who will sit on the board of directors. The trust receives dividends paid by the company. The trustees then distribute income received by the trust from the company according to the needs of the beneficiaries, having regard to their duties as trustees, which require them to act in an even-handed manner. Further, upon the death of any family member, there is no issue pertaining to transfer of ownership of shares. The interest of the deceased in the trust is transferred on, according to the provisions of the trust deed.

### **PERPETUITY PERIOD**

Most offshore jurisdictions have codified their trust law to provide for a fixed term for trusts to, typically, 80 years. In 2004, the Bahamas extended their perpetuity period from 80 years to 150 years. In April

2006, the Bailiwick of Jersey amended its trust law to provide for trusts of unlimited duration.

### **POLITICAL STABILITY**

Strange as it may seem, many Canadians have fears as to the complexion of future Canadian governments, in a state that may or may not include Quebec. Some prefer the prospect of having assets held in a trust based in, say, the Isle of Man, which is politically stable and conservative. The legislature of that country, the Tynewald, is 1,000 years old, making it the oldest parliament in the world. The "offshore" world now also includes Switzerland, whose political confederation dates back to August 1, 1201. It has enjoyed legislated neutrality in international conflicts since 1815. The trust industry is prominent in both countries exemplified here.

### **CANADIAN TAX SAVING**

In a nutshell, offshore trusts are now unlikely to be of assistance in making any substantial saving of Canadian income tax. An explanation of the legislative framework is described below. However, there are other structures that will achieve this end in appropriate circumstances. As indicated above, the primary reason for client consideration should be asset protection.

### **IBCs AND DOUBLE TAX TREATY WITH BARBADOS**

Barbados, like most offshore finance centres, provides a favourable tax regime for International Business Corporations (IBCs). IBC status is given to companies that are carrying on the business of international manufacturing or international trade or commerce. Broadly speaking, these activities have to be carried out in Barbados, with exports or the provision of services being to countries outside the Caricom area. Currently, Barbados' taxation of IBCs is at the rate of 2.5% for the first US\$10 million of their profits and gains, reducing to 1% on such over \$30 million. Pursuant to section 13.1 of the *International Business Companies Act* (1991), dividends paid by an IBC to a non-resident are free from withholding tax.

Barbados has a double tax treaty with Canada, which was signed on January 22, 1980.

Pursuant to paragraph 113(1)(a) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), dividends from active business income earned by

foreign affiliates based in treaty partner countries (such as Barbados) are effectively exempt from Canadian tax when distributed to Canadian resident shareholders (individual or corporate).

### **OFFSHORE BANKING LICENCES**

Having one's own bank is a very valuable asset. It opens the door to all manner of financial transactions using funds originating from Canada. The appropriate category of banking licence is widely known in the offshore world as a "Class B" licence. This permits overseas investors to establish a bank that may conduct business with clients located anywhere but the country of the bank's incorporation.

In Barbados, this type of licence is known as an Offshore Banking Licence. Minimum capitalization is BDS\$2 million authorized and BDS\$1 million issued. These figures are due to be increased, and the Central Bank is already applying higher limits. A licensed bank pays an initial and continuing annual fee of BDS\$25,000. The Central Bank requires quarterly balance sheet reporting and filing of full annual accounts, along with a list of the licensee's directors (one of whom must be a Barbadian). There are 53 licensed offshore banks in Barbados. Offshore banks pay corporation tax on the same basis as IBCs. They are exempt from withholding tax on payments to non-residents or other offshore entities, from customs duties on goods and materials imported for their offshore business, from estate duties on any of their shares, securities or assets owned by a non-resident, and from property transfer tax on the transfer of shares, securities or other assets. Their offshore transactions are exempt from exchange control, and they are exempt from *ad valorem* stamp duty. Obtaining a banking licence is a matter of meeting fairly standard (but strict) criteria as to a good character of owners and the ability to provide skilled personnel to run the operation.

Another alternative is Panama, where the licence is known as a "restricted licence". Required capitalization is a minimum of 3 million Balboas (equivalent to US\$3 million). Panama is a sophisticated and stable world-banking centre. It has approximately 80 banks, of which 30 are operated under a restricted (overseas) licence.

### **WHICH JURISDICTION?**

Shortlist jurisdictions that have the asset protection regime and professional services that you and your advisor feel comfortable with. Go and have a look. Find out which jurisdiction leaves you with a good feeling. Sample the beaches and the fine hotels and restaurants in the context of

an easy plane ride from Canada. Find a place that you enjoy going to so that meetings with trustees and bankers are a pleasurable experience.

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