Principles 11 and 12

Relocating the taxpayer or the taxable assets

1. Introduction

In view of their close connection, both principles are examined under the same chapter.

Tax privileges exist in several countries in order to attract certain categories of foreign taxpayers. These may either change domicile (section 2) or relocate their taxable assets, in part or in whole, without changing domicile (section 3). In practice, both forms of relocation are often combined.

The relocating strategy is often combined with splitting taxable assets, treaty shopping or maximising subsidiary deductions. In many cases, tax havens or free ports are used (section 1).

1.1 Tax havens

Although countless publications[1] and software enable the taxpayer to compare the tax burdens between different tax havens, low taxation is never the sole determining factor for emigrating. Many small tax havens do not guarantee sufficient political and economic stability to justify a long-term move. Their legal independence is often fragile. Because of their low level of tax, tax havens offer limited services, in particular with regards to health, security (for individuals), telecommunications and transport (for businesses). Neither are citizens' rights always guaranteed. Conversely, the cost of living, climate and low salaries are often seen as an advantage. However, exchange control regulations need to be checked, as well as property protection and possible double taxation treaties, the latter being quite rare in such countries.

Many companies choose to set up their registered office in a tax haven. The Caribbean and Channel Islands are favoured locations, but tax havens exist world-wide : so for instance *Vanuatu* in the Pacific, *Hong Kong* in Asia, *Liberia*, *Tunisia* and the free zone of *Tangier in* Africa, *Panama* in Central America and *Uruguay* in South America.

[1] See for example Barry Spitz, Tax Haven; Roy Saunders, International Tax System; Milton Grundy, Grundy's Tax Haven and others in the enclosed Bibliography.

In addition to low or nil tax rates, tax havens usually have relaxed company law. Minimum statutory requirements do not always protect creditors and minority shareholders, official notice requirements are practically nil, whether at the time of registration or throughout the lifetime of the company. An audit is often not a requirement, and the production of accounts may not be necessary. Moreover, the frequency of shareholders' general meetings or board meetings is left to the sole discretion of the company's beneficial owner, who is not always the shareholder. Since company names are not subject to strict regulations, it is sometimes tempting to choose a name that may generate confusion with a well-known company or charity. Finally, the responsibilities that exist are usually not onerous.

Low minimum share capital is particularly attractive to taxpayers : the authorised capital is often little more than a hundred US dollars. Creation and registration costs are equally modest ($150 in the *British Virgin Islands*, $100 in the *Bahamas*) and capital tax insignificant. Companies can be bought off the shelf by fax. There are often no residence requirements of founders, directors (bar a few exceptions) or shareholders, who can hold bearer shares.

Corporation tax is usually forfeitry and often amounts to some $100 or $200 (*Bahamas*, *British Virgin Islands* and *Panama*).

In view of the above, companies based in tax havens will obviously not be popular with tax authorities, among which some have a whole anti-tax avoidance arsenal to counter the use of offshore companies[2].
In the *United States*, the *Subpart F Income* legislation deals with this and exists since the sixties. In *Germany*, a special set of laws, known as the *Aussensteuergesetz*, literally “Tax law applicable to foreign relations”, was complemented in the year 1994 by the “*Missbrauchbekämpfung und Steuerbereinigungsgesetz* “, dated December 21, 1993. The objective of the latter is to fight abuse and compensate for the imperfections of existing laws. In *France*, provisions are found throughout the General Tax Code (*Code général des impôts*), among which : article 57 (profit transfers), article 155A (funds paid abroad in consideration of services rendered in France), article 209B (profits of companies incorporated in privileged tax countries) and article 238A (payments to foreign residents with a privileged tax status).

These measures vary greatly. So for example, the tax authorities can sometimes deny the fiscal or even legal existence of the company by piercing the corporate veil; they can refuse to deduct the company's charges; they can correct the company's profits in the case of transactions between related companies, one of which is based in a tax haven; they can exclude companies from double taxation treaties; they can reverse the burden of proof by assuming that the taxpayer is the direct or indirect beneficial owner of the offshore company in question; they can also demand that the taxpayer proves that his transactions are made at arm's length. As we can see, the legal framework to fight tax planning excesses is especially sophisticated in developed countries.

[2] See in general Rotterdam Institute for Fiscal Studies, International Tax Avoidance, Vol. A & B

1.2 Duty free zones

Duty free zones are privileged locations for taxable assets . Thus, subsidiaries are often created in duty free zones to take advantage of the tax favourable environment.

Although the taxpayer's initial intention is to minimise custom duties on export and import activities, duty free zones have gradually competed to offer additional incentives. Nowadays, tax privileges are only part of the facilities granted, which cover administrative support, financing and installation. The legal and social environment is made attractive to the company by means of flexible labour regulations, adequate protection of property rights and local incentives to staff training. Duty free zones have thus become true business areas.

From the tax viewpoint, duty free zones usually incur low, or nil indirect tax liability, including Value Added Tax or local taxes such as profit or capital taxes.

These incentives are not the monopoly of economically underdeveloped countries, since many high tax countries offer this type of infrastructure in order to attract investments or boost whole areas of their local economy.

The *United States* have some 150 duty free zones, among which *Miami* has become particularly significant as a warehousing zone for imported goods. Local production activity is allowed in this zone.

Similarly, there are duty free zones in *Ireland* : the *International Financial Services Centre* (IFSC) in *Dublin* and the *Shannon Development Airport Zone* (SDAZ) .With respect to the IFSC, a 10% tax rate applies to approved service activities such as financial services related to banking, insurance, brokerage, portfolio management, treasury or consultancy until December 31, 2005.

The same applies to *Madeira*, a duty free zone created by *Portugal* in 1980 to boost employment on the island. As seen earlier, besides enjoying an extensive, world-wide tax treaty network, *Portugal* might benefit from the European Union's directives and regulations and it is part of its economic recovery programmes (Posei Mad). In the absence of anti-tax avoidance measures, these privileges could be extended to its duty free zone.

As in the case of tax havens, the main criteria to select a free port are not always tax related. Other factors include legal and political stability, availability of qualified staff, administrative and technical infrastructure or support, appropriate geographical location and telecommunication network, swift and easy administrative decision-making, free capital repatriation, international acknowledgement as a duty free zone and international reputation.

2. *Principle 11 – relocating the taxpayer*

2.1 Individuals

Transfer of residence is a very old strategy. In the past, the feudal monarchies could not take a census of the population, although they levied poll taxes. Basically, this was a standard tax levied on each, usually male, adult individual. Collection was made difficult by a nomadic population's tendency to move to milder tax climates as the tax collector approached.

Tax tourism has remained topical to this very day.

In principle, a change of domicile results in the termination of the taxpayer's liability in the previous country of residence. Sometimes a secondary tax obligation survives, as a result for instance of the location of the assets (property, permanent establishment, company). Some jurisdictions have extended the concept of tax liability by creating several continuing tax liabilities as a counter-measure. We could mention the so called "*exit taxes*" or the provisions specifically directed against tax havens. Lastly, US taxpayers are anyway assessed on the basis of their nationality.
Taxpayers are spoilt for choice and we shall not provide an extensive list of tax havens, as these are well publicised, but merely a list of the major European tax havens.

- The *Principality of Monaco* is a classical tax haven for taxpayers who are not of French nationality. Except for some succession taxes applicable to assets located in the Principality which range from 8% (brothers and sisters) to 16% (non-family heirs), direct descendants and spouse being exempt, no tax liability exists. Bank references to the effect that the immigrant is not likely to become a burden on the local community, are appreciated[3].
- *Ireland* is a tax haven for writers, painters, sculptors and composers. A distinction is made between resident and domiciled individuals similar to the distinction in the *UK*.
- In the middle of the *Pyrenean mountains*, *Andorra* is a tax haven for individuals with minimum assets of Pesetas 1 million, provided their effective stay exceeds 183 days per annum.
- *Campione d'Italia* is better known for its casino than as a tax haven. Only Italian citizens must complete tax returns, other residents being somehow forgotten. However, *Swiss* taxpayers will be taxed by the *Swiss* authorities if they have a business relationship with that latter country.

[3] However, see "Convention entre la République française et la Principauté de Monaco du 18 mai 1963, and exchange of notes December 9, 1966. Furthermore, us Taxpyer are anyway taxed on the basis of their nationality.

In each cases, taxpayers should study carefully the continuance of these privileges. Exotic locations include the *Seychelles*, *Sri Lanka*, *New Caledonia*, *French Polynesian Islands*, *Netherlands Antilles*, *Bahamas*, *Bermudas*, *Costa Rica* and many more.

However, taxpayers often realise that the tax aspect is not a determining factor when it comes to choosing a place of residence. Even when free of employment or business obligations, human beings are attached to their relatives and friends, and to modern infrastructures. Ideally, the solution would be to obtain a tax advantageous status in one's own country or in a country close with regard to standard of living. This often requires a combination of several tax strategies. A person who is about to retire can sometimes benefit from tax planning (e.g. in *France* for capital payments), whereas in other cases the strategy will be focused on the type of income (e.g. capital gains in *Switzerland*). Taxpayer status and type of income are sometimes combined, such as in the case of *UK* resident non domiciled individuals.
The taxpayer can also have a certain leeway in terms of domicile criteria, which vary from country to country : habitual place of residence, centre of family interest, centre of family assets, situs of professional activity and, often, country with the closest social and personal relations. The taxpayer will endeavour to obtain tax domicile in the fiscally most advantageous country. Such choices are particularly relevant when taxpayers have a dual residence, and the distinction between main and secondary residence is unclear.

In *Switzerland*, the choice of cantonal or communal domicile also offers major tax opportunities, since the tax burden varies considerably depending on the chosen location. Moreover, to this date, a change of cantonal domicile results in intermediate taxation with all the ensuing tax planning possibilities.

2.2 <u>Businesses</u>

Companies are subject to special regulations and should carefully examine the law applicable to country of origin and destination prior to changing their tax jurisdiction. A simple change of registered office can be enough, whether it coincides or not with the liquidation of the existing company. However, as seen earlier, the place of central management and control is sometimes a major factor. In other cases, the company can either retain a permanent establishment in the country of origin, or choose not to relocate and favour the creation of such an establishment abroad. A company could also relocate as a taxpayer whilst retaining or creating taxable assets in one or several third countries.

In all cases, the tax authorities will check whether the foreign location is genuine or fictitious : does the company have substance or is it a mere shell created to generate transfer pricing ?

The tax consequences of a registration transfer also need assessing at the levels of withholding tax, consumer and indirect taxes.

3. Principle 12 – relocating taxable assets

3.1 Individuals

Individuals can also tax plan by assigning a new tax liability to assets without changing domicile. Income tax liability criteria vary from country to country. In some jurisdictions, income is taxed on the basis of territoriality whilst in others resident individuals are taxed globally (universality principle).

Asset location is a determining factor in countries abiding by the territoriality principle. Optimal tax planning consists in residing in one such country while receiving income exclusively from abroad. However, these principles are usually combined and the taxpayer's major concern will therefore rather be to avoid dual taxation. This can be reduced or even eliminated by double taxation treaties or by unilateral methods such as exemption (with or without progression of tax rates) or tax credit.
Note that in the *United States of America*, nationality is an important criteria for tax assessment.

Most taxpayers probably under-estimate the tax planning possibilities available In terms of succession. They will seldom acquire property abroad to achieve partial relocation of the tax liability. As seen earlier, a taxpayer could in some case purchase a property in a jurisdiction free of gift tax and gift it to the ultimate beneficiary, thereby avoiding all gift or inheritance tax in his country of domicile. This strategy is fully justified in view of inheritance tax rates in excess of 50% for non family beneficiaries. It is easy to buy a property in a jurisdiction where there is no gift tax and to transfer it for nothing to the beneficiary in question who can then sell it to secure cash. The costs involved in brokerage, research, taxes and other registration or transfer duties should not prevent such a transaction from being economically viable.

For example, it can be advantageous for some European taxpayers to buy a property in the *United States* to favour one's spouse, since bequests to spouses do not generate an inheritance tax liability in most U.S. states.

The location of the deceased's movable assets must be carefully planned in the context of inheritance tax. The case of the *United States* is particularly relevant, since this country attracts a great number of foreign investors. Heirs could be unpleasantly surprised upon the death of the holder of the assets, even where a double taxation treaty exists. If the deceased is an American citizen domiciled in *Switzerland*, he is subject to a 55% tax rate whenever the estate exceeds USD 3 million. He may also be subject to tax at his last place of domicile. Although double taxation treaties signed by the *United States* enable him to invoke a tax credit, this is often limited to tax paid abroad on the assets located at the last place of domicile and, conversely, to tax paid at the last place of domicile for US located assets. All assets located in third countries could therefore be subject to dual taxation.

Similarly, receiving American source income can generate a tax liability, even if the taxpayer is not of American nationality. However, relocation can be easily achieved for movable assets such as securities quoted on the stock market. A taxpayer can buy American share certificates instead of American shares. Shares in foreign investment funds are not US investments, although the funds may actually hold exclusively American securities.

Taxable assets often include movable assets relocated to jurisdictions with low withholding tax rates. To reduce tax competition, European Union finance ministers suggest that either there is an exchange of information with the country of the taxpayer, or there is a withholding tax on interest presently planned at a rate of 20%.

Finally, taxable assets may be brought to a foreign taxpayer, as in the case of a transfer to a company of property or local income generating assets. Since the company does not die, this may even allow to avoid inheritance tax in many high taxation countries (*United States*, *Canada*, *Great-Britain* to name but a few).

3.2 Enterprises

A company will rarely relocate its taxable assets solely for tax purposes.

In principle, creating a permanent establishment abroad permits the relocation of taxable assets without modifying headquarters location. The definition of a permanent establishment and its treatment at international level should be carefully examined in each jurisdiction in order to avoid double taxation. The study should cover the method used to determine profit allocation, the treatment of interest due, the definition of exchange rates and the assessment of asset transactions.

Creating a subsidiary gives birth to a new taxpayer. The issues of profit transfer, anti-tax avoidance measures and possible withholding tax refunds, should be carefully examined.

A company acquiring property abroad also generates a transfer of taxable assets as a result of the change in tax determining sovereignty.

Finally, changes of jurisdiction may sometimes involve more than two countries, as is the case when the taxpayer moves from country A to country B, while relocating his activity from country A to country C.

Conclusion

The development of public transport and telematics undoubtedly favours the mobility of taxpayers and assets alike. As potential emigrants compare the tax conditions offered by different countries, tax authorities will often advocate the harmonisation of tax systems, and even tax rates. In this respect, one may wonder whether indirect, consumer taxes are not more appropriate than direct taxation.