

## **Tax Planning**

Foreign jurisdiction companies and foundations are totally separate legal entities to any individual that may own or incorporate them. This very simple fact allows a company or foundation despite the fact that its owner(s) or incorporator may live thousands of miles away to be subject to the laws and taxes of the place where it has been registered or managed. Therefore, if the jurisdiction of your choice has no or little corporate taxes, then your company will have no tax obligations, though obviously your personal tax position might be different.

### **How tax treaties can be used in tax planning**

#### Introduction

A tax treaty is an agreement between two (or more) countries for the avoidance of double taxation.

The primary purpose of such treaties is to deal with the issues arising from the overlap of different tax systems, and in particular to allocate the taxing rights on income arising within the jurisdiction of the two countries involved. The sole right to tax is conferred to on the source or residence country.

Most tax treaties are bilateral and generally follow the pattern of those published by the OECD and the United Nations.

Many people think that only multi-national corporations can effectively enjoy the benefits of double taxation treaties. In reality they are available to all investors, be they small or large.

#### Historical background

With the rapid increase in the world trade, trading blocs and multi-national corporations, it became imperative that some mechanism was interposed to prevent individuals and companies from being taxed twice, or at different levels, for the same or related activities. The result, particularly after the Second World War, was the development of an ever expanding number of Double Taxation Treaties.

Together with organizations such as the OECD, the General Agreement on Tariffs and Trade and also with regional trading blocs, they lay down the ground rules for the members/signatories in respect to the exact terms and conditions that should appear in any given tax treaty.

For instance, a taxpayer resident in one country who wishes to invest in another country will not make a direct investment in that country, but instead will use a series of entities located in various jurisdictions to avail himself of the benefits in the tax treaties between countries concerned. Thus, the taxpayer is able to claim treaty benefits to which he would not otherwise be entitled.

#### Basic objectives of tax treaties

Some of the basic objectives of any treaty (based upon the O.E.C.D. Models) would include the following:

- To define the scope and taxes covered as well as the legal entities involved and their tax treaty definitions;
- To establish the criteria necessary to establish tax residence in the contracting state;

- To clearly establish when a legal entity is deemed to be trading 'in' as opposite to 'with' a contracting state;
- Define what is meant by 'immovable' property;
- Define the taxable position of dividend payments received from investments by a legal entity from the contracting state;
- Define interest and royalty payments;
- Define the position of individuals earning income from a contracting state;
- To specify the exact method by which double taxation is avoided in each member state and
- Elucidate 'Exchange of Information' details between the contracting states.

It is obvious that no contracting parties would have the intention of creating potential tax 'loopholes'. Most modern tax treaties also have anti-evasion/avoidance provisions, with the objective of preventing third party residents from utilizing such instruments merely as a tax mitigation 'tool'.

Nevertheless, the effective employment of such provisions is almost impossible, since it is universally accepted that companies are separate legal entities fully subject to the benefits and detriments of their jurisdiction of registration. To try and impose ownership criteria or general rules on their use would entrap far too many 'innocent' traders and re-create constraints on international commerce.

In outline, the benefits derived from treaty selection originate from the diversity of national requirements and differing tax regimes. Until such divergences are significantly narrowed, an almost impossible event, even within trading blocs such as the European Union, treaty selection will remain a viable and legal 'weapon' in the tax consultant's arsenal.

Examples of how treaties are used would include the following:

- Taking advantage of what is deemed 'movable' and 'immovable' property with the objective of taking advantage of different countries tax systems;
- Taking advantage of 'competence deficits';
- Maximizing tax exemptions and credits and
- Taking advantage of treaty 'Sandwiching'.

### **What is treaty shopping?**

An analysis of tax treaty provisions to structure an international transaction or operation so as to take advantage of a particular tax treaty. The term is normally applied to situations where a person not resident of either of the treaty countries establishes an entity in one of the treaty countries in order to obtain the treaty benefits, i.e. to reduce or eliminate tax. For instance, a taxpayer resident in one country who wishes to invest in another country will not make a direct investment in that country, but instead will use a series of entities located in various jurisdictions to avail himself of the benefits in the tax treaties between countries concerned. Thus, the taxpayer is able to claim treaty benefits to which he would not otherwise be entitled.

### **What is tax deferral?**

The legislation of certain countries expressly provides for the deferment of tax in certain circumstances. Such deferment may be attractive in terms of cash flow and interest saving and in the light of inflation-related considerations. Tax deferral, which is legal, means a postponement, not elimination, of a tax liability. One could for

instance use an intermediate holding company in a foreign jurisdiction in order to accumulate income, realized from other countries than the country of residence of the parent company. This would result in deferral of the tax liability, which would arise were such income repatriated.

### **What does offshore mean?**

Term usually applied to a company registered in a country (often with a favorable tax regime) other than the country or countries in which it carries on its business activities. An offshore (or non resident owned) company means a company located or based in a foreign country where the company is not subject to tax or subject to tax at a low rate.

### **How can you lower your taxes through international corporate structuring?**

#### Holding Companies

Offshore corporations often hold investments in subsidiaries and/or associated companies, publicly quoted and private companies, as well as joint venture projects. Capital gains arising from the disposal of particular investments can be made without taxation. In the case of dividend payments, reduced levels of tax on income can be achieved by utilizing a company incorporated in a zero or low tax jurisdiction that has double tax agreements with the contracting state.

An intermediary company is established in a jurisdiction with a suitable treaty. For example, the company will be used for investments in the European Union, since corporate entities registered there can avail themselves of the EU Parent/Subsidiary Directive. The Netherlands has an extensive double tax treaty network with many Eastern European countries and countries of the former Soviet Union, and the use of Dutch companies for inward investment into these countries provides a tax efficient structure. More over if the holding company in the Netherlands is the subsidiary of a Netherlands Antilles company, which anticipates for a tax efficient exit.

#### Trading

If a firm has significant business in a third party jurisdiction it is often possible to reduce the overall tax position by transferring management and control to a more tax efficient area. For example, if a Dutch firm purchased a given type of good in Italy for resale to the Middle East it would seem inappropriate to say the least that such a transaction should be subject to Dutch corporation tax. A potential solution would be to set up a company in a low tax area such as the Netherlands Antilles to specifically control these transactions. If this is done correctly and does not offend the anti-avoidance provisions it should be possible to benefit from for example the Netherlands Antilles corporate tax regime.

#### Investments

Netherlands Antilles/Tax Exempt companies can often be used as an investment entity in order to allow money /assets to grow in a tax friendly environment with you, as opposed to the tax inspector, deciding if, when and how much money should be repatriated.

#### International Consultancy

With the growing demand for professional consultants to work outside their usual country's of residence there is often the possibility of greatly reducing or even eliminating individual and corporate tax consequences - often using Netherlands Antilles or Anguilla companies. The reason that this possibility arises is that it is often possible to legally free oneself from the tax system of ones home country for a fiscal year or more.

During this expatriate period it may then be possible to avoid the tax system(s) of the chosen host jurisdictions by limiting ones period of residency in any given country to between 4 and 6 months. These being the normal European 'breathing' periods before full local tax obligations exist. The purpose of the company is to provide a fiscally beneficial entity to issue necessary invoices, and/or act as a controlling vehicle for future 'home' country remittances.

### Property Companies

A very popular practice is that a real property item is purchased by an offshore company which is registered as the proprietor in the Land Registry, and if the proprietor of this company (i.e. The beneficiary owner of the real property in question) wants to sell the real property, it is sufficient to sell the shares of his or her offshore company and thus avoid the real property transfer tax. (the proprietor - the offshore company is the same). The above-mentioned structure is only possible in those jurisdictions where it is possible that a foreign entity owns the real property in question. In the jurisdictions where this is not possible, the real property can be owned in such a way that it is purchased by a company there which is owned by a foreign offshore company.

This way it is possible to achieve:

- Asset protection (you are nowhere listed as proprietor)
- Avoidance of inheritance tax (after the death of the proprietor the bearer of the shares becomes a new proprietor), real property transfer tax, etc. (the proprietor is the person who owns assets of the offshore company)
- Protection from forced inheritance or from heirs at law.

In certain circumstances there are significant tax advantages in having properties held by appropriate domestic and/or Netherlands Antilles mechanisms (often by using double taxation treaties).

Further, by using appropriate tax treaties it may also be possible to arrange "back-to-back" loans to virtually eliminate domestic tax liability on rental payments.

### Family Protection

One of the major objectives of many tax mitigation clients is to ensure that wealth established during their lifetime is not wasted by future generations/circumstances. To avoid this, tax planning firms can often provide a whole range of 'tailor-made' companies, trusts, foundations and establishments which can be used together with many of the other tax mitigation mechanisms already outlined. In particular, they can often be formulated to allow, whilst the original founder is alive, for initial investment flexibility followed by a fixed structure upon his or her demise. In addition, with the correct advice, asset protection schemes can also legally avoid the forced heirship provisions of civil law jurisdictions.

## Intellectual Property

In many cases Netherlands Antilles/tax exempt companies can be very successful in exploiting the various international withholding tax rates for dividends, royalties and interest. For example, it is very common, for a nominal consideration, to transfer patent, copyright or trademarks in favour of an appropriate Netherlands Antilles/tax exempt company before significant appreciation. Once acquired it then being possible to issue intellectual property (IP) sub-licenses or exploitation rights to appropriate third party structures.

Offshore companies are an ideal tool for administration and management of licenses. For example, a majority of software companies license their users through companies, which are established in an offshore jurisdiction, or through a firm, which is not established in a classical offshore jurisdiction, but is controlled by such a firm.

Typical examples of such users include without limitation:

- software companies;
- companies doing business in information technologies;
- licenses and copyrights to books, articles, music, films, etc.
- certification authority, publishers of professional certificates, etc.

## Yacht/Vessel Registration/Management

There has been a great transfer of merchant navy registration from traditional areas like Britain, Norway and Greece to Offshore shipping jurisdictions such as Panama, Liberia, the Isle of Man, Cyprus and the British West Indies. Correctly advised, an individual can also benefit from such low tax environment through the use of Netherlands Antilles company. Apart from the lower registration fees it may also be possible to rent or charter a vessel without any significant, or even any tax repercussions.

Such benefits together with the ability to maintain a respectable flag - if a vessel is registered in the Netherlands Antilles it is fully entitled to fly the Dutch flag as if it was a native Dutch vessel - have meant that few private yachts of any size are today registered in their home territory. In addition, in certain circumstances it may also be possible to purchase a yacht through the Isle of Man with a local tax exempt company and then reclaim back any VAT paid by registering for VAT on the Island.

## Possibility of transferring domicile to a new country

A number of offshore jurisdictions make it possible to transfer domicile from one country to another one. A company established e.g. in the Netherlands or in another country can be re-registered in Curacao, while keeping its name, registration date and possibly the company registration number as in its original home country.