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# OFFSHORE PILOT QUARTERLY

## *Commentary on Matters Offshore*

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### *Spirit of Reality*

The Offshore Pilot Quarterly celebrates its seventh anniversary with this issue. During these past seven years our commentaries have addressed a broad range of issues (but they have always been in the context of the offshore financial services industry) and although some of the issues were fleeting, others are perennial. It was felt appropriate in this issue to look at some of these evergreens.

During a recent conference in Panama at which I spoke, I discussed the progress so far made in bridging the gap between Panama and the Organisation for Economic Co-operation and Development in relation to international tax harmonisation, a subject also covered in the September issue of the OPQ. In May, 1998, the OECD said that a campaign should be launched to stamp out tax havens and a target of 7 years was set in which to achieve this. With just a few months remaining before the target date is reached, it will be clear to readers of the OPQ and others that the OECD was overly optimistic. Despite, admittedly, some significant success, the OECD has, to quote Robert Browning, let its reach exceed its grasp.

Offshore financial services are important to Panama. During the last 5 years, for example, some 1500 companies per month on average have been registered and in the last 3 years revenue from this source has earned the country \$67 million. Reconciliation with the OECD remains a distant goal especially when Panama is commonly seen as a pure Cayman-style tax haven whereas it has a tax system under which local operating companies, for example, pay income tax of 30%; ironically, the equivalent corporate rate in Ireland is only 12.5%.

Sovereignty has helped Panama in its dealings with the OECD. In the first issue of the OPQ in 1997 I observed that the honest investor "can draw comfort from knowing that the secrecy laws in Panama will not be swept aside from over-reach by a foreign country, whereas several prime offshore financial centres are dependent territories and are constantly susceptible to compromise because of their dependence, by definition, on a sovereign power with its own agenda of priorities". In the next OPQ issue I added that when the millennium arrives "and the attractions of some of today's leading offshore financial services centres begin to be eroded, Panama's improved banking law, efficient corporate law, well-established trust law, modern captive insurance legislation and foundation law will be even more attractive. Surely, however, what will truly make Panama a safe haven will be its sovereign independence". No developments since have caused me to waver in my convictions. Quite the opposite.

Panama may well be a safe haven, but still it is considered a pure Cayman-style tax haven by many of those who have never visited the country. The distortion makes me think of a daiquiri and Hemingway after one of my own perceptions collided with reality just a few months ago. During my trip to Cuba I was not disappointed by the Cuba libre, the evocative-sounding mix of rum and cola with a squeeze of lime that was named after the anti-colonial proclamation of Carlos Manuel de Céspedes during the island's first war of independence. It was the daiquiri at the Floridita in Havana that (not literally, I would add) brought me down to earth with a bump. It is supposed to be the Ernest Hemingway version of the famous



cocktail which was first poured into a glass at the end of the 19<sup>th</sup> century. Its creation has been credited to President Teddy Roosevelt who is said to have come up with the concoction on his yacht as he sailed around the Cuban coast. But I tend to believe the claim that the cocktail was first made in the small Cuban village of Daiquiri by two mining engineers named Cox and Pagliuchi (a name which I imagine could become a challenge to pronounce after a few glasses of the cocktail) who, short of gin and cognac, mixed limes, sugar and rum. Now, you would think that with Hemingway's reputation, his version would be superlative. It was awful, although I tried not to show my disappointment in front of Papa Hemingway whose bust was placed in the Floridita after the writer won a Noble Prize in 1954.

I suppose it's all about first-hand experience. Making that trip to see (or in my case, taste) for yourself. And on the subject of spirits, it was G. K. Chesterton who said: "Facts as facts do not always create a spirit of reality, because reality is a spirit". I'll drink to that.

### *Affairs of Men*

In centuries past the Catholic church amassed a fortune from wills which left money for prayers to be said for the souls of the departed. John Shakespeare, William's father, for example, died in 1601, the year that Hamlet was written, and left a plea, along with a spiritual, if not an actual, last will and testament, that his relatives should pray for his salvation. In today's world, salvation can concern temporal matters as well, and needs the intercession of not just prayer if one has assets offshore.

A lot of personal wealth is held in companies registered offshore, but what happens to the assets when the owner dies? Although Plato contends that nothing in the affairs of men is worthy of great anxiety, I can guarantee that not getting your affairs in order before your rendezvous with death can cause great anxiety for those left behind.

If a will exists, it will be either a domestic or an offshore one; there may be both kinds. In any case, control of the deceased's offshore assets will pass to his executor upon his demise. If

there is no special offshore will covering the company assets, there will be a delay whilst the domestic will is dealt with and the executor obtains the court's authority to represent the deceased's estate (a grant of probate or its equivalent) in the place where the will is registered. Once probate has been granted, there will be a further delay whilst the domestic will is then recognised by the foreign court that must deal with the offshore assets. Often, official translations, because of language barriers, will be needed which adds delay, as well as costs, to the process. Meanwhile, the ensuing passage of time might impact on the operations of the offshore company managing the assets.

Then there is intestacy which is the worst-case scenario. Without a will anywhere an executor has still to be named and so even before a grant of probate can be obtained there will be a delay while families decide who to appoint as executor. Often family rivalries (and the fact that some members may live in different countries) can exacerbate the process. And intestacy doesn't guarantee that the eventual beneficiaries will be the ones that the deceased would have chosen.

Very often, the far-sighted company owner has established either a trust or a foundation. A trust, inter alia, is a will with all the extras, you could say, but without the need for probate. Usually a special offshore trust has been created to set out clearly the manner in which the offshore company assets are to be managed and how they are to be dealt with after the owner's death. It's also true that the offshore company's assets can fall under a domestic trust (rarely a foundation), but this is less common.

Offshore foundations are popular, especially in Panama which has particularly attractive laws concerning them. In Panama a foundation is known as the "Foundation of Private Interest", but it is also called either a "Private foundation" or a "Family foundation". It is the civil code equivalent of the common law trust and performs the same functions. It is more akin to a company, however, except that instead of having shareholders, the foundation has beneficiaries.

The frequent failure to cover the contingency of death, either onshore or offshore, is what I



describe as the Achilles' heel of estate planning which is illustrated by the following actual case. An individual from central Europe opened a bank account in the Cayman Islands back in the 1980s. A large sum was placed on deposit in his personal name and he did not want a trust. His wife was not added as a signatory on the account, in order to create a joint tenancy so that at least there would be a right of survivorship if he died and she survived. A year or so passed and his wife contacted the bank in Grand Cayman to say that her husband was dead. She thought that by also sending a copy of his death certificate the bank could release the money to her. It was explained to her, however, that the only legal representative of her late husband was his executor and that the authenticity of his appointment would need to be recognised in the Cayman Islands before anything further could be done. It was nearly another year before the process moved forward and a translation of the executor's appointment by the foreign court was accepted by the Cayman court so that the bank could release the money. A simple trust from the outset would have avoided all the problems and delays that were encountered.

Some common sense from the Book of Common Prayer says it all: "We have left undone those things which we ought to have done; and we have done things which we ought not to have done".

### ***The Curse of Frankenstein***

But even with intestacy avoided and a plan of succession in place, that doesn't mean that anxiety will not follow. The following actual (though disguised) case clearly shows why. The facts were that Mr. O, let's call him, (an associate of the late Red Adair, famous for putting out oil fires) ran a very successful business which provided specialised equipment to international oil companies worldwide. The administration and accounting for the worldwide lease agreements and supporting services were all managed offshore and the company through which the operations flowed was owned by an offshore trust. The important point here is that the success of the entire offshore structure hinged on the validity of the trust underpinning

it. If the trust was void, in other words, the entire edifice would crumble and any tax advantages (considerable) would be lost. The resulting financial conflagration on his death would have been impossible for even Red Adair to put out.

I was asked to review the trust deed and I found that it had a fatal flaw. The trust had been settled under Cayman law and needed to have a termination date – known as the rule against perpetuities. But when the trust deed had been drafted, a perpetuity provision had been omitted which, in essence, meant that, firstly, the beneficial interests that were to pass on the company owner's death were defective and, secondly, the tax consequences would be disastrous.

Fortunately, the situation could be salvaged but what had happened in this case has an all-too-familiar ring. The trust deed had been prepared by amateurs who had done with scissors and paste what today, using a computer, would be called "a copy and paste job"; parts of several precedents had been combined to create the deed. What had originally been intended to be a Liechtenstein trust had become, through their doctoring, a Frankenstein trust.

So look for experience in a practitioner. As an article by Dorothy Leonard and Walter Swap in the Harvard Business Review put it: "We would all rather fly with a pilot who has taken off, flown and (especially) landed in all kinds of extreme weather than with one who has always enjoyed smooth conditions". It applies, of course, to domestic and offshore pilots. Turn to the Casablanca checklist before boarding your offshore flight:

- Deal with professional firms who are licensed in the jurisdiction where their principal office is located.
- Do business with professional firms who, if appropriate, are audited, preferably by an international firm.
- Consider obtaining references and also find out how long the business has been operating.



- Review the calibre of management, particularly their qualifications and experience.
- If possible, always visit the firm before conducting business.
- Take tax and legal advice when necessary.
- Don't base your choice on the lowest fees tariff in the mistaken belief that there is never any correlation between cost and competence.

Why is it called the Casablanca checklist? Because, as Rick Blaine in French Morocco discovered in 1941, the fundamental things apply as time goes by. And although the checklist appeared in the OPQ June, 1998, issue it is worth repeating. Especially if you want to avoid creating Frankenstein trusts or foundations which, like the good doctor's monster, will lie dormant on their slabs until events bring them to life.

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*Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice before making offshore commitments.*

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