



## TRUST SERVICES, S.A.

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# OFFSHORE PILOT QUARTERLY

*Views and News on Matters Offshore*

### ***Bushwhacked***

When the antiquated Mir Space Station hurtled to earth from outer space in March of this year the force of the impact was sufficient to smash through 6 ft. of reinforced concrete. I would imagine that the announcement made by the US Treasury Secretary, Paul O'Neill, on 10<sup>th</sup> May concerning the Bush administration's position on the Organisation for Economic Co-operation and Development's harmful tax initiative, which this newsletter has been covering for some time, must have had a similar impact on the morale of the Paris-based organisation. Unlike Mir, it was an unexpected event. The OECD had been buoyed up by its previous offshore successes which saw co-operation on an unprecedented scale from most of the offshore financial services centres. Those successes concerned drug trafficking and money laundering and the OECD could not help but gain the moral high ground. But tax policy is not the province of criminals. Taxes are raised by a country according to its needs and not those of other countries. There is no common interest despite the OECD's harmonious, but hollow, utterings. Events in Europe, where squabbles have broken out over harmonisation of taxes within the European Union, bear that out.

The history of taxes leads one to conclude that the development of modern systems of taxation arose from the need to cover the financing of wars. No 25-year period since 1495 has been war-free and between 1815 and 1992 there were

210 interstate wars. War, in fact, led to the introduction of both import and excise taxes, and, more significantly, lay behind the direct taxation of wealth and income. Modern income tax was a British invention so that the war with revolutionary France could be financed. The motives then, as they are now, were selfish and concerned the sovereignty of nations. Sovereignty has been the Achilles heel of the OECD's offshore tax initiative, as reaffirmed by the US Treasury Secretary's May statement. He was concerned "that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system". Of course, for those offshore centres without sovereignty, their ultimate fate over tax policy will be sealed from distant shores; for those dependencies in the Caribbean, it will be OECD members in Europe. I can appreciate the tax face-saving exercise mounted in dependencies, but until a British-appointed Governor no longer presides at Executive Council meetings, it can only be no more than that. The art of brinkmanship, a phrase coined by the US politician, Adlai Stevenson, may still be employed on sweaty limestone islands, but the best local ministers can hope for is a compromise.

Paul O'Neill readily acknowledged the fine accomplishments of the OECD in past years, but he stated that the US will not participate in any initiative to harmonise world tax systems. Its own history from the Boston Tea Party to the



war of independence in 1776 causes the US to sympathise with those confronting dictatorial tax policies. Besides the injustice of it all, it will not have been lost on Washington that the OECD's ability to force changes offshore could be the thin end of the wedge: might not the world's biggest tax sanctuary for foreigners also eventually appear in the OECD's sights? Breaching the barriers of sovereignty in small states is one thing, but doing so in the US and subordinating the independence of its tax system is quite another.

The diminutive mahout sits on top of his elephant, disguising his vulnerability whilst skilfully guiding and controlling something much larger than himself. The OECD's bureaucrats in Paris should take lessons from India.

### ***Maxwell House***

In recent months more than just coffee has been brewing in the City of London. Rumours and speculation have percolated their way through the fabric of the banking industry in the City ahead of an official report on Robert Maxwell's failed business empire. The once-mighty publishing house magnate who started his business career by distributing newspapers and trading in caustic soda ended his life in disgrace at the end of 1991. He fell to his death off his yacht but he had already fallen from grace as an official investigation reveals. Between 1946 and 1991 Maxwell was elected a Labour MP in the UK, bought the US publishers Macmillan and became a newspaper proprietor. But it all ended with around US\$600 million missing from workers pension funds. The long-awaited report (some 10 years after Maxwell's death) places several professional firms in the UK clearly in the firing line for criticism, including Samuel Montague, the merchant bankers, and the prestigious London lawyers, Clifford Chance. I won't deny that had Maxwell's machiavellian machinations been orchestrated not in London but offshore in one of the publicity-drenched financial centres, a certain amount of glamour and spice would have been added to the story (as it was, offshore centres played only a supporting

role in the intrigue). But the report also revealed how, despite the passing of a decade, many weaknesses in the financial system still exist today and that people, not places, are usually the most important component of the business equation.

Plato likened human morality to a chariot drawn by one white and one black horse. The charioteer is the intellect, the white horse represents the soul reaching skyward and the black horse represents our desires, plunging earthwards. The charioteer has to control these 2 opposing forces, with the objective of attaining heaven. John Locke said that the discipline of desire was the background of character and when J. Pierpont Morgan was asked in 1912 by the US House Banking and Currency subcommittee's counsel whether commercial credit should first and foremost be either based on money or property, his terse reply was: "No sir; first thing is character". The onshore and offshore financial services industries have often appeared like opposing team supporters at a football match, each delighting when their team scores, but particularly when an own-goal is scored. But geography is a red herring. Safety and security is more often than not to be found in the hands of the individuals who manage your affairs and not the institutions – wherever they are – whom they represent.

The size of an institution is not necessarily of consequence in matters of integrity and reliability. Sometimes destiny lends dishonesty a hand, as was the case when Barings, the UK merchant banking group was ruined back in 1995. Nick Leeson, the Barings trader who created phantom trades to cover his positions, had written derivative trades based on Japan's Nikkei 225 index not moving significantly out of its trading range. Any extreme moves in the value of the financial security underpinning a derivate trade would mean that the trader lost money. An earthquake struck Kobe in Japan in January, 1995, and caused insured losses of US\$2.716 billion. The Nikkei 225 lost 11 per cent and the UK lost its oldest merchant bankers. In one of Lockheed Martin's contracts with Britain's Royal Air Force a comma was



misplaced by one decimal point. Unfortunately, the error involved the equation which adjusted the sales price (the contract was worth US\$1.61 billion) for changes to the inflation rate. The error cost the aerospace giant US\$70 million. Nasa's Mars Climate Orbiter crashed on the Martian surface before its mission had even begun at a cost of US\$125 million. All because the space scientists confused metric and imperial measurements. One team programmed the on-board computer using feet whilst another team used metres resulting in disaster when a key manoeuvre was made. In 1990 Larousse, the world's leading publisher of French dictionaries, had to recall 180,000 volumes after a mis-captioned photograph in the colour edition labelled a deadly mushroom "harmless" and a harmless one "deadly". Unfortunately, the French are avid gatherers and consumers of mushrooms.

So sophistication, size and, for that matter, location, bring no guarantees. It's worth bearing that in mind when you are making your international financial plans.

### ***Grave Issues***

One of the problems facing many people with assets offshore is what happens when they die? In last quarter's newsletter, in the segment entitled "The Breach Boys", I briefly outlined the inherent risks involved with offshore trusts when they are badly managed. There is a way, however, for you to have a trust, still control and manage the assets yourself – at least during your lifetime. At the time of your death the trust will either come to an end with your trustee distributing assets in the same way as a will, or it can continue with new beneficiaries. Even if you do not die but become incapacitated, the trustee can take over the stewardship of the assets perhaps in conjunction with a trusted adviser, so that the minimum of disruption is caused.

Normally, people compound an offshore estate problem by not even having a simple will back home when they die. At least with a will which covers their worldwide estate those offshore assets can eventually be dealt with.

"Eventually" is the operative word here because a deceased's will must be accepted by the foreign court in the jurisdiction where assets are located. Then the deceased's executor must rely on a foreign agent to gather in the assets, meet any liabilities and arrange a distribution. Besides distance, additional preliminary delays will arise when a foreign language is encountered. This will require official translation of both the will and all ancillary documents before the foreign court's approval can be obtained. In my experience, these foreign estate liquidations can take, on average, from one to two years before being completed.

It all suggests that in the right circumstances a simple offshore trust, which doubles up as a will, might be a wise choice. And because the type of trust which I am speaking of is tax-neutral, it is a vehicle with universal application and will have no adverse tax repercussions. The objective of the exercise, after all, is not to mitigate taxes but facilitate the smooth operation of an offshore estate. The trust contains no clever gimmicks and is not supported by such things as letters of wishes. It will not raise the eyebrow of even the most sceptical onshore practitioner who has been fed a constant diet of offshore trust scandals.

During the client's lifetime the trust serves as his agency and the trustee as his agent. It is usually more commercially expedient to conduct the trust's business in a corporate capacity, so a company will be incorporated and its issued shares will be owned by the trust. The trust itself will be revocable, its terms can be altered and both beneficiaries and trustees can be changed at your behest. You have complete discretion during your lifetime. It is a means by which you can achieve centralised bookkeeping for your offshore assets, placing investment portfolios, immovable property, bank accounts and shareholdings in various ventures all in the name of the company which is owned by the trust. It is also a means of achieving privacy (with apologies to suspicious OECD watchdogs) and protecting you perhaps from the prying eyes of family members or business associates. Remember also that the trust deed is a private document and so are the trust's accounts



whereas a will becomes a public document upon a person's death.

Bearer shares have been often held up as the cure-all for offshore estate planning. But with death goes any guaranteed assurance that the right person or persons will gain ownership. A fail-safe conveyance of the bearer share certificates from coffin to rightful owner is more rare than it is common. Even so, disgruntled third parties might still contest ownership, leaving the offshore representative of the deceased's company in a quandary. The wrong decision on his part could involve him in a lawsuit and perhaps adverse publicity. Experienced offshore representatives always take a cautious approach to bearer shares and clients should be encouraged to include them under the terms of an offshore will, foundation or trust. Even where the offshore representative had been granted a power of attorney by the client, that authority ends when the client dies and if the shares (whether bearer or nominative) fall under the control of an executor in another country, the offshore representative cannot make any material decisions concerning the company without the executor's permission. Everything

is in limbo until the deceased's executor has court authority to act and then files papers with the foreign court so that a foreign agent can be appointed.

It is impossible to address the many complexities of post-death management of offshore assets within the confines of this brief segment, but the potential value of a simple and straightforward trust should be apparent. Bad estate planning has brought discomfort and financial distress where none was ever intended. In some cases assets have become like hidden treasure after an owner's demise, with no map to show where they have been buried. One wonders how much of the estimated US\$16 billion of unclaimed funds in the US are owned by people who didn't get their deceased estates in order.

Aristotle wrote that you can judge the happiness of a man's life only after he has died because some unexpected event can always wreck even the most blessed lives. Death is usually the most unexpected of all events but a little planning will ensure that whilst you may be caught off-guard, at least your estate won't, whether you die happy or not.

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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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