



TRUST SERVICES, S.A.

*Fiduciary and Corporate Services to
Professional Firms, Institutions and Individuals since 1981*

OFFSHORE PILOT QUARTERLY

Commentary on Matters Offshore

March, 2007.

Volume 10

Number 1

Giving Back the Dog

Voltaire's satirical creation, Dr. Pangloss, argued that it was demonstrable "that things cannot be otherwise than they are; for as all things have been created for some end, they must necessarily be created for the best end." Voltaire treads in the footsteps of Aristotle who went to Pella, the Macedonian capital, and became the tutor of the king's young son who later became known as Alexander the Great. Aristotle believed that everything in nature has a purpose and whatever is created is never in vain. Whilst agreeing with Aristotelian virtues such as forethought and determination, I can assure you that badly planned offshore companies, trusts and foundations will not be "created for the best end" and can eventually turn out to have but one purpose: to teach you a costly lesson.

This is the tenth year that the Offshore Pilot Quarterly has been in circulation and during that time the offshore financial services landscape has changed significantly, but not the general public's frequent misunderstandings of how things work. I am still, for instance, confronted by people who believe that by simply transferring their assets to a trust, company or foundation they will automatically be isolated from personal tax and perhaps other obligations. Although many readers understand the falsity of that belief, the clientele for offshore services is indeed a broad church and one that not only embraces many nationalities but also varying levels of sophistication as well. So good advice can be invaluable.

As I read once in an article about business consultants, all of them are drawing reasonable conclusions within the limits of their experience.

This aphorism, which applies also to the rest of us, needs to be remembered when you are seeking advice on offshore matters and especially if they have a degree of complexity. Michael Skapinker, writing in Britain's Financial Times, tells a story that encapsulates and illustrates the problem very well. A shepherd is tending his flock when a Jeep screeches to a halt beside him. The driver hops out and says: "If I tell you how many sheep you've got, will you give me one?" The shepherd looks him up and down. "Ok," he shrugs. The stranger takes out his laptop, plugs it into his mobile phone and, after a little work involving NASA websites and satellite readings, says: "the answer is 931." The shepherd nods. "Choose your sheep," he says. The stranger bundles the animal into his Jeep. "Now," says the shepherd. "If I tell you what job you do, can I have it back?" Sure, the stranger replies. "You're a management consultant," the shepherd says. "How did you know?" the astonished stranger asks. "Easy," the shepherd says. "First, you charged me a fortune. Second, you told me something I already knew. And third, you know nothing about my business. Now please give me back my dog."

Consider the two American bicycle repairmen who announced in 1903 that they had built the world's first aircraft. More than two years following this statement the Scientific American magazine said the story was a hoax, even although by then the Wright brothers had made a half-hour flight covering 24 miles. A case of the Wrights and the wrongs, you could say, so be careful whom you engage – especially if you have in mind a flight capital strategy. And remember that the idea that atoms could be a source of energy millions of

©2007

*Trust Services, S.A.
All Rights Reserved*



times more potent than coal or oil was rejected by the Nobel Prize-winning physicist, Ernest Rutherford, who described the idea as “moonshine”.

Sex and Cigars

It is true that experienced advisers will entail more expense but they are always worthwhile; engaging the skilled but unscrupulous adviser, on the other hand, prepared to take on any business, might tell his unsophisticated client that placing his funds offshore in a trust will effectively protect them from all claims. Fundamentals, such as fraudulent conveyance, the terms of the trust and the possibilities of it being a sham are not even considered. Let me add that with the emergence of an increasing number of foundations (the civil code’s answer to the common-law trust) similar concerns apply.

The addition of bearer shares to the mix can be dangerous. Historically, bearer shares and bonds were frequently issued in the 19th and early 20th centuries with owners receiving bearer-form certificates as proof of title. The certificates had elaborate and attractive designs, not for aesthetic reasons but in an attempt to discourage counterfeiters. The certificate might also come with dividends or interest coupons attached, to be clipped and sent to the company when dividends were declared or interest payments fell due. Some scrippophilists who have specialised in old certificates are, for example, attracted by bonds once issued by the Imperial Chinese government and South American railroads. Today’s offshore bearer shares, however, are mostly in a completely different category and, usually, it is confidentiality and not counterfeiters that is the concern.

Let’s look at an example of bearer shares and bad advice. An offshore company is set up by the client, an offshore bank account is opened and, say, \$500,000 deposited. The client, who is the company’s beneficial owner, has bearer shares issued which are kept by the firm representing him. The client believes (and his unscrupulous representative does not contradict him) that as long as the shares are not physically in his possession their ownership is in some no man’s land and, therefore, all income earned in the bank account is not taxable in his hands. Oh dear. The reality is

that the firm holding those bearer shares does so as bare trustee (more later) for the myth-believing client. Instead of a no man’s land there is a potential minefield for the client.

It’s all a matter of substance over form, what judges have referred to as “lifting the veil” to discover what the true intent was. English common law is firmly rooted in the United States of America; it accompanied the 102 people ferried by the Mayflower in 1620 bound for Plymouth, Massachusetts, (it has been said that 35 million Americans are descendants of its passengers). Even in 1776, the year of the American war of independence, 80% of white Americans, based on one calculation, were of British stock. Nearly two hundred and fifty years after independence, however, there have clearly been deviations between the American and British legal systems brought about especially by the US obsession with legally-defined rules in a society dominated by lawyers. It goes far beyond cosmetics, how the Englishman or the American might pronounce tomato or Iraq because, in either case, the difference does not alter the fruit’s taste or the country’s plight.

It has often meant that substance has been less important than form in the US, prompting one president, on the one hand, to draw conclusions about collaborations between sex and cigars and, on the other, encouraging American clients to believe that they can detach themselves from bearer share certificates placed in an island safe custody facility thousands of miles away from home.

Of course rules are important, but so are principles and it is the skilful application of both that is needed if your offshore affairs are to function well. Not to recognise this can be disastrous.

French Hats

Foreign estate planning often suffers from culture clash, a very real issue which, in my experience, is constantly overlooked. You must remember that you need a passport for the country you’re travelling to simply because it’s not the same as yours. Although international travel exposes you to, literally, a different world and can help you appreciate different points of view, when your stay is just for a week you can only hope to come away



with a surface understanding of the local mores. The best the visitor planning his offshore affairs can hope for (and in my opinion it is the most important element) is to get comfortable with the service provider chosen.

I'm reminded of an African guide named El Hadji who is told that corruption remains a huge problem on his continent. "Oh no", the guide responds sucking his pipe, "It's not a problem at all. If you want to bribe someone, just go ahead and do it". Here are two more examples of culture divergence. My late father was one of the Red Devils (no connection with Panamanian buses but with the colour of the beret worn) dropped by parachute at Arnhem in Holland in the second world war and could relate to the wartime story of the British parachutist wearing his red beret who, on showing an American MP his credentials, was asked: "If you're British, how come you're wearing a French hat?" He was locked up and wasn't released until the next day. Moving from soldiers to sodas, Pepsi Cola, with its blue and white colours that are commonly associated with death in China, is not the preferred beverage in Hong Kong's Chinese restaurants. Red, however, is synonymous with happiness and so things really do go better for Pepsi Cola's main, and readily recognised, rival. Bearing in mind the different attitudes encountered abroad, it follows that you should be aware that in certain instances the rules of the game which apply to your offshore business might be different from your domestic experience. Just as businessmen cannot manage people abroad the way they do at home, so it can be with the way that your foreign-based assets will be managed.

Bare Facts

Bare trustees and bearer shares were mentioned previously. Bare trusteeships can serve an important role, especially offshore, and are an integral part of the fabric of equity, itself part of the development of the 800-year old trust principle which the legal historian, Francis Maitland, stated was the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence.

In the case of the bare trust its proper application offshore can be an ideal substitute for a will, avoiding the costs and delays of probate. You

might call it a stripped-down trust. Bare, or what are sometimes called simple, trusts are very transparent, with nomineehip being the most passive form, and they are frequently used in commerce. In the commercial sense, the bare trust offers tax transparency if worded correctly as no tax liability will attach to the trust itself and at the same time privacy can be assured – which is a factor that can be advantageous in the case of off-balance sheet transactions.

There is no universal definition of a bare trust but the following explanation provided by the Inland Revenue in the United Kingdom, even although related to tax issues, is very helpful: "a bare trust exists where the beneficial owner of the property is fully entitled to both the capital and income from the property. The property will be held in the name of the trustee but the trustee will have no discretion over what income to pay the beneficiary. The trustee is in effect a nominee in whose name the property is held. The beneficial owner is the person who benefits from, and is entitled to, the property and the income it produces".

One of the basic requirements of a bare trust is that the beneficiaries have vested (as opposed to conditional) interests in the trust property. It must be clear from the trust deed that no other person has, or can have, any vested interest in the trust property and that the trustee has no discretion as to the timing or distribution of the beneficiaries' shares of the trust property. When contemplating what Walt Whitman described as "the sure entwining arms of cool enfolding death" the bare trust can come into its own. Dealing with a deceased's offshore estate need not entail great expense, nor complex arrangements, if the assets are already in the name of a foreign company with bearer shares issued and the objective is simple: to have the assets handed over to named heirs and nothing beyond that.

This simple objective, which is usually what most people are looking for, has been obscured by the array of options available. But often the person deriving the most benefit from these options is the service provider; as a British law professor once commented, today's marketing demands are pushing the trust concept beyond its fundamentals to the extent that its very essence is being eroded.



The no-frills bare trust deed works like this. During the client's lifetime a qualified offshore trustee can serve as bare trustee under the terms of a deed (which might only be one page in length) covering the bearer shares of his client's offshore company. (This subject was touched upon in the June, 2001, issue of the Offshore Pilot Quarterly.) The company, subject to the bare trust arrangement, can be a holding company for several others owned by the client which can then all be covered by the provisions of the trust deed applicable to the holding company's shares. The subsidiary companies might be in several countries and under this structure the client retains total control of his assets.

The deed itself can be either altered or cancelled (in other words, legal ownership never passes to a trustee). Only after the client dies, and provided the deed has not been cancelled, does the bare trustee arrange the transfer of ownership of the shares (not being in nominative form simply

placing them in the beneficiary's hands achieves this) in terms of the deed's provisions instead of automatically having the underlying assets form part of the client's personal estate. Importantly, the deed is not a public document so its contents remain confidential and probate is avoided. These are features which are immensely important to many clients and this partnership between the bearer share and the bare trust counters the negative perception many onshore service providers have of bearer shares. They do indeed have their place in offshore estate planning.

So succession planning need not be intimidating or challenging— provided you get that sound advice that I spoke of (stay away from those who think that sheep bark). Hamlet spoke of “a special providence in the fall of a sparrow. If it be now, 'tis not to come; if it be not to come, it will be now; if it be not now, yet it will come – the readiness is all”. Are you ready?

Offshore Pilot Quarterly has been published since 1997 by Trust Services, S. A. which is a British-managed trust company licensed under the fiduciary laws of Panama. It is written by Derek Sambrook, our Managing Director, who is a former member of the Latin America and Caribbean Banking Commission as well as a former offshore banking, trust company and insurance regulator. He has over 40 years private and public sector experience in the financial services industry. Our website provides a broad range of related essays, including our other newsletter, Letter from Panama, which focuses on Latin America and is also written by Derek Sambrook

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.

*Bankers
HSBC Bank (Panama), S.A
Banco Panameño de la Vivienda, S.A.*

*Auditors
Deloitte.*

Physical Address: Suite 522, Balboa Plaza, Avenida Balboa, Panama, Republic of Panama.

Mailing Address: Apartado 0832-1630, WTC, Panama, Republic of Panama.

Telephone: +507 263-5252 or +507 269-2438 – Telefax: +507 269-4922/9138

E-mail: fiduciary@trustserv.com Website: www.trustservices.net

Readers may reprint or forward this newsletter in whole or in part, provided the source is stated and the material is not altered or distorted. Previous issues are available. Dissemination of this newsletter, including on websites, by parties other than Trust Services, S.A. does not carry any implied or express endorsement of the activities of such parties by Trust Services, S.A.