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# The World's Best Tax Havens

How to Cut Your Taxes to Zero and  
Safeguard Your Financial Freedom

By Lee Hadnum LLB ACA CTA

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TAX GUIDE – “The World’s Best Tax Havens”

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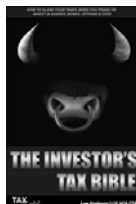
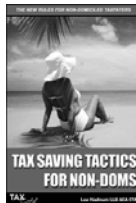
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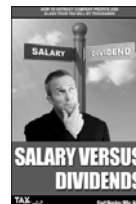
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## About the Author

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Lee Hadnum is a key member of the Taxcafe.co.uk team. Apart from authoring a number of our tax guides, he also provides personalised tax guidance through our popular Question & Answer Service, a role he carries out with a great deal of enthusiasm and professionalism.

Lee is a rarity among tax advisers having both legal AND chartered accountancy qualifications. After qualifying as a prize winner in the Institute of Chartered Accountants entrance exams, he went on to become a Chartered Tax Adviser (CTA).

Having worked in Ernst & Young's tax department for a number of years, Lee decided to start his own tax consulting firm, specialising in capital gains tax, inheritance tax and offshore tax planning. He now offers online guidance and provides unique tax reports through [wealthprotectionreport.co.uk](http://wealthprotectionreport.co.uk) and [traderstaxclub.co.uk](http://traderstaxclub.co.uk).

Lee has followed his own advice and whenever he has spare time he enjoys DIY, walking and travelling.

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## Introduction

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Offshore tax planning has become increasingly popular over the years as more and more wealthy individuals seek to escape the high taxes imposed in many of the wealthy developed countries.

Offshore tax planning has two key components:

- Understanding the tax rules in your current country of residence, and
- Understanding the tax regimes of other countries.

This book is concerned mainly with the second component: identifying countries that have low tax rates and offer you the opportunity to pay less tax.

We'll be looking at where you should go and live or buy property if you want to pay as little tax as possible. We'll also look at how offshore trusts, companies and other structures can be used.

### ***Wealth Warning!***

***Always remember that your home country's tax laws will affect your ability to use tax havens.***

Always seek professional advice before you act. International tax is a complex area and no book can cover all the angles.

### **What is a Tax Haven?**

At the outset we need to explain what is meant by the phrase 'tax haven' and summarise the benefits they offer before identifying the countries and tax planning techniques in more detail.

***A tax haven is simply a country that allows you to reduce the amount of tax you pay.***

This is a tax haven at its most basic and, although pretty obvious, it's worth bearing in mind what their purpose is without getting bogged down in the details.

Let's state at the beginning that there is nothing wrong with using tax havens provided you are careful not to break any rules in your country of residence.

Many people use tax havens to hide their money from the tax authorities in their home countries. This is not only illegal, it's foolish because one day you probably will get caught and could end up with substantial fines or even a jail sentence.

However, if you have the legal right to use a tax haven you would be foolish not to take advantage of all the opportunities you can to maximise your wealth.

There are three main types of tax haven:

- Nil-tax havens
- Foreign source exempt havens
- Low-tax havens

### **Nil-Tax Havens**

These are simply countries that do not have any of the three main direct taxes:

- No income tax or corporation tax
- No capital gains tax, and
- No inheritance tax

Many of the nil tax havens you've probably heard of or read about in novels. You may even have holidayed in some of them. They include:

- The Cayman Islands
- St Kitts and Nevis
- Dubai
- Monaco
- The Bahamas
- Bermuda
- Vanuatu
- The Turks & Caicos Islands
- Anguilla

Although there are no taxes in these jurisdictions, the tax haven governments still need to generate some revenue to provide public services. They may therefore impose small fees for company incorporation documents or annual registration fees for companies. However, these charges are fixed and usually small. If you're looking at living in one of these jurisdictions, most of these charges won't apply and you may be able to live with little state involvement in your affairs. The only tax charges that would then affect you would be import duties or local sales taxes.

### **Foreign Source Exempt Havens**

These countries do levy taxes and sometimes they can be pretty high. However, what makes them tax havens is the fact they only tax you on *locally derived income*.

In other words, if all your income is derived outside the tax haven you will not pay any tax. Good examples of foreign source exempt tax havens are:

- Panama
- Costa Rica
- Hong Kong
- Seychelles
- Singapore

This type of tax haven exempts from tax any income earned from foreign sources, provided (and this is crucial) the foreign income source does not involve any local business activity.

For example, you couldn't set up a consultancy business that was run from Panama and claim that the income generated shouldn't be subject to tax there.

Some of the other tax havens don't even allow a company to conduct business internally if any tax advantages are to be claimed.

Jurisdictions such as Panama and Gibraltar would require a company to decide at the time of incorporation whether it was allowed to do local business (and therefore taxed on its worldwide profits), or only foreign business and therefore free from taxation.

## **Low-Tax Havens**

The final group of tax havens are countries that do have a system of taxation and impose taxes on residents' worldwide income. You may be wondering why these are still classed as tax havens. There are two main reasons:

- Some countries may have special concessions that offer considerable tax advantages in *special situations* (such as for capital gains tax avoidance).
- Clever use of double tax treaties that countries enter into with each other may allow you to *lower* your tax bill.

The problem with the well-known nil-tax havens is most developed countries do not have treaties with them. When planning your tax affairs it may be more tax efficient to use a low-tax haven, combined with a double tax treaty, than simply rely on a nil-tax haven.

### **Example**

*Let's say you own shares in a company listed on the New York Stock Exchange. For commercial reasons (in other words, non-tax reasons) you want to set up a holding company to own the shares. You could use one of the traditional tax havens such as the Bahamas or the Cayman Islands. The problem with using these countries is that US withholding tax will be deducted from dividends at rates of up to 30%.*

However, if you use one of the recognised holding company jurisdictions, such as Belgium or Denmark, there may be very little tax deducted in the US. Good examples of low-tax havens are:

- Cyprus
- The United Kingdom
- Barbados
- Switzerland
- Denmark
- Belgium
- The Netherlands
- Austria

## **Other Important Factors to Consider**

When looking at tax havens, although the amount of tax they levy is obviously crucial, this is not the only important factor.

You wouldn't, for example, want to invest your cash in an offshore account in a politically unstable country, particularly if there is a risk that your assets could be expropriated.

Therefore tax planning is only one consideration. Other important factors include:

- **Privacy.** What level of disclosure is there. Will your financial affairs be kept private from prying eyes?
- **Ease of residence.** How easy is it to obtain permission to live in the tax haven?
- **Political stability.** Is there a risk your cash could end up in the government's coffers?
- **Communications.** How good is telephone and broadband internet access and how easy is it to travel to the country?
- **Lifestyle factors.** If you want to live there, how good is schooling, the climate, and how high is the cost of living?

It's therefore a question of what you want from your tax haven: are you only concerned with the tax position or are other factors equally important?

I mention some of these other factors elsewhere in the book, although obviously many of these are subjective and would therefore need to be addressed by you personally. We'll therefore mainly be focusing on the tax issues.

## Chapter 1

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# How Tax Havens Can Help You

In this chapter we'll take a brief look at how tax havens can be used to cut your tax bill. The chapters that follow contain much more detailed information but I think it's worth explaining some of the tax planning techniques briefly before we look at some of the individual tax havens.

Most countries will tax you in one of three different ways, based on:

- **The source of your income or capital gains.** If your income is derived locally the local tax authorities will tax you on it.
- **Your country of residence.** If you are resident in a country, that country may have the right to tax you on your worldwide income or gains. The United Kingdom does this.
- **Your country of nationality.** This is rare, but is very important if it applies. Some countries such as the United States tax you if you are a national or citizen. Even if you leave the country you will still have to pay tax.

Most developed countries apply the first two rules, although the US applies all three in certain situations. It's easy to see how two countries could easily decide to tax the same income.

### **Example**

*Steve, a UK resident, has an offshore bank account in Spain. As a resident of the UK he will be liable to UK tax on his worldwide income, including his Spanish interest.*

*However as the interest has a Spanish source, Spain will also want to tax it. In this case the double tax treaty between the two countries would come to the rescue. Any Spanish tax paid would be allowed as a credit against Steve's UK tax liability.*

What if Steve used a bank in a nil-tax haven such as the Bahamas or the Cayman Islands?

In this case there would be no overseas tax as these countries do not levy tax. However, there would still be UK taxes to pay because individuals who are UK resident and domiciled are subject to UK tax on their worldwide income.

**This is crucial to understand because it dispels the myth that tax havens can be used to automatically escape taxes. Unless you are careful how you use them you will not enjoy any tax savings.**

Some books hint at keeping your income private and therefore hint at tax evasion. In many countries this is the fastest way to land in jail (or at the very least end up paying substantial penalties) and I would never advise this.

You should always disclose as much information as the tax authorities in your home country require.

Every country has different disclosure requirements. For example, the US requires separate disclosure of foreign bank accounts of which you are a signatory. Other countries such as the UK do not.

It's the secrecy that European and North American tax departments don't like and this has led to growth in tax information agreements between countries and, for example, the advent of the EU Savings Tax Directive and the proposals at the April 2009 G20 summit to crack down on tax havens – we'll look at these in more detail shortly.

In terms of the EU Savings Tax Directive this is an agreement between members of the EU (and various overseas dependencies) to automatically share information with each other about customers who earn savings income in one country but live in another.

Provided you stick to these simple rules you should be able to sleep peacefully at night. And that's far more important than escaping tax!

Tax havens are useful in lots of different ways, including:

### **Emigration**

If you fancy living abroad, one option is to live in a tax haven. Fortunately many tax havens have extremely high living standards and are beautiful places to stay. If you choose the country wisely, you may be able to completely avoid income tax and other taxes.

Emigrating to one of the nil-tax havens such as the Bahamas, St Kitts and Nevis, the Cayman Islands or the British Virgin Islands would be ideal for this purpose. US citizens cannot do this, however, because they are subject to US tax wherever they live (although there are limited tax exemptions for US citizens living abroad that can exempt the first \$92,900 of earned income).

Another option may be to establish yourself in one of the foreign source exempt havens and put your money in an offshore bank account. In this way you will also not pay one penny in tax.

Finally, you could go and live in a low-tax haven if it offers concessions that suit your particular circumstances. For example, you could go and live in South Africa or New Zealand if you have a big property investment portfolio and want to escape or reduce capital gains tax.

### **Diverting Profits**

Tax havens are often used to divert profits from a country with high tax rates to a country with low tax rates. They're also used to divert interest, royalties and management charges.

Unfortunately this is not very easy to do in practice – the country where the income is sourced is likely to have rules preventing you from doing this. However, it is possible in certain circumstances.

### **Example**

*Patrick owns a company called Compco that manufactures and sells computers. His company is located in a country with a corporation tax of 30%. Patrick decides to become non-resident and live in a tax haven, while still doing work for the company.*

The advantage is that there will be no income tax to pay in the tax haven. Furthermore, provided the cost of his services is set at a reasonable commercial rate, Compco may be allowed a tax deduction for the full amount paid to Patrick. This means there will be no corporation tax on the money paid to Patrick.

Diverting income from a high-tax country to a low-tax country is one of the key benefits of using offshore tax havens.

### **Double Tax Treaty (DTT) Manipulation**

As mentioned earlier, low-tax havens are often used to take advantage of double tax treaties. Using double tax treaties to avoid taxes can result in big savings and this makes some of the low tax destinations that have lots of double tax treaties very popular.

#### **Example**

*Pedro conducts business in the United States but through an offshore company located in Cyprus.*

Provided Pedro does not actually have a fixed place of business in the United States or act via an agent (the treaty defines this as having a 'permanent establishment' in the US – more on this later in the book!) the income from the business will pass to that company with little or no US tax being paid because of the tax treaty between the two countries, provided the Cyprus company is a resident of Cyprus.

If income is paid to a person or company in a jurisdiction with no tax treaty with the US, the profits will be subject to US tax, at a rate as high as 35%.

Now that the money is sitting in the Cyprus company, it could be extracted free of Cypriot taxes to a non-resident.

This example illustrates how complex offshore tax planning with tax havens can be. Everyone's situation is different, hence the need for professional advice.

## **Capital Gains Tax (CGT) Planning**

In recent years many individuals have moved abroad to escape capital gains tax. Most are property investors who have made huge profits during the global real estate boom of recent years.

If they sold their properties without moving they'd see a large chunk of their profits going to the taxman in their country of residence or the country where the property is located.

Avoiding a big tax bill is particularly important where properties have been heavily remortgaged to enable the investor to withdraw the equity (paper profits).

Investors with large debts over some properties may actually end up with insufficient cash to cover their capital gains tax bills. Therefore they look for any opportunity, including moving overseas, to escape paying tax.

Tax havens are also used to escape CGT by entrepreneurs who've had enough of the rat race and want to sell their companies.

Using offshore company arrangements or emigrating to countries that don't charge CGT on overseas disposals can drastically reduce the tax liability.

### **Example**

*Tony, a UK resident, has a big property portfolio with profits in excess of £1 million.*

*He wants to sell the properties and minimize the tax payable by moving offshore.*

The UK doesn't usually impose capital gains tax on non-residents (unless they're conducting a trade from the UK) and Tony therefore decides to move to the Bahamas, sell his property portfolio and avoid paying UK capital gains tax.

**The downside to this is that he would need to stay overseas for five complete UK tax years to avoid the gains being taxed if he returns.**

Five years is too long for many people. It used to be possible to get around this by emigrating to a country with a suitable tax treaty with the UK (Greece was one such country).

Unfortunately the UK closed this loophole in the 2004 Pre Budget Report and UK emigrants are therefore usually tied in to a five year absence.

(Having said that, they could still spend a couple of months per tax year in the UK without bringing the gain back within the scope of UK taxes. The key issue here is showing that they have established their new life and home overseas.)

### **Inheritance Tax (IHT) Planning**

If there's one tax people resent above all others it's inheritance tax. In the UK the rate of inheritance tax is 40%. Paying 40% tax on your **assets** is much worse than paying 40% tax on your **profits**. Furthermore, your assets will, for the most part, have been built up out of after-tax income – meaning that they are effectively taxed twice.

The good news is there are ways that tax havens can help you reduce your inheritance tax bill. By transferring some of your wealth into an offshore trust or company you can escape the tax in certain circumstances because the trust/company becomes the new owner of the assets. Your estate will then have fewer assets to tax.

Many countries don't subject offshore trusts and companies to IHT and, if they do, it's usually an amended form of tax. Hence the correct use of offshore entities can maximize your wealth and minimize your taxes.

Once again it's important to stress that offshore tax planning is a complicated area and you should always obtain detailed professional advice from a qualified tax adviser in your country of residence. In particular, there will probably be anti-avoidance rules (most high-tax countries have them) that may apply and careful 'navigation' in these circumstances is essential.

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