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## The Offshore Tax Planning Review

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# ZERO-TAX COMPANIES: A PLAIN MAN'S GUIDE

Milton Grundy<sup>1</sup>

I went to Bermuda for the first time in 1958. It was a little place a long way away, and certainly to me quite an exotic destination. But there was one group of people who were already quite familiar with Bermuda, and they were the business people who were flying frequently between New York and Europe. In those days, this was mostly done in an aeroplane driven by propellers, and it was not uncommon to find that your flight from New York made a refuelling stop in Bermuda, before tackling the wide expanses of the Atlantic. What was special about Bermuda, of course, was that it had no income tax - a feature which it shared with the Bahamas, a group of islands quite a long way to the south, but not with any other place that anyone had heard of. I think it was these business people, with their stopovers from New York, who discovered that the absence of tax in Bermuda could be put to interesting uses. Multi-national companies established their pension funds there, and reduced their profits in various high-tax jurisdictions by insuring with a Bermuda-based captive. There also grew up a lot of private client business, mostly - I think - out of the United Kingdom, and by the early 1960s it was almost fashionable for a wealthy British family to have a trust and a company or two in Bermuda. Some of that business also went to the Bahamas, which had the advantage of being not quite so expensive as Bermuda. And both Bermuda and the Bahamas had the further advantage that, being British dependent territories they were part of the "Sterling Area", so that residents of the United Kingdom and other parts of the Sterling Area had no difficulty in moving funds there, despite the fairly ferocious exchange control regime which prevented them moving their funds outside the Sterling Area.

Nowadays, a lot of zero-tax business - perhaps most of it - is done by what we have come to know as an "international business company" or "IBC". This is a company which has a special zero-tax or low tax position in a jurisdiction which, in general, imposes taxes on income. Zero-tax companies in Bermuda or the Bahamas do not fall into this category: they arose simply from business people taking advantage of the situation as they found it, and only to a minor extent by

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<sup>1</sup> Milton Grundy MA (Cantab), Gray's Inn Chambers, London  
WC1R 5JA. Tel: (0171) 242 2642 Fax: (0171) 831 9017.

any legislative intervention by the governments concerned (although, confusingly, the Bahamas has now adopted the expression "international business company" for companies incorporated to do international business). Similarly, the zero-tax company in the Cayman Islands or Anguilla has no special tax status - both territories being innocent of income tax, though a more active role was played by the legislature in the Cayman Islands, which enacted a new Companies Law in 1961<sup>2</sup>, and a new trust law<sup>3</sup> in 1967, and a very much more active role has been played by the legislature of Anguilla, where a whole group of new laws<sup>4</sup> came into effect at the beginning of this year.

This tax haven business - and in those days we had "tax havens", and had not developed the euphemisms of "offshore business centres" and "international financial centres" - this business was visibly profitable, and in the mid-1960s Jamaica enacted a law which used for the first time the expression "international business company". Jamaica's law has since been repealed, but it was followed very shortly afterwards by an almost identical law in Barbados (which retains it with some modifications)<sup>5</sup>, Grenada (which retains it in its original form) and Antigua, (which replaced it in 1982 by the present International Business Corporations Act). I do not know who the draftsman of the Jamaican law was, but it was a very clever piece of legislation, and for its time extremely sophisticated. All these territories had income tax laws, broadly modelled on the United Kingdom system. To be an IBC, the company had to be at least 90% owned by non-residents and not be engaged in local trade. If those conditions were satisfied, the company was free of tax on its trading income and paid a tiny rate of tax on its investment income. Why was a distinction drawn between these two types of income?

The answer to this question illustrates the sophistication which lay behind this seemingly simple piece of legislation, and that is that the IBC was from the beginning intended as a treaty-shopping vehicle. United Kingdom tax treaties had been extended to these jurisdictions. They commonly provided that the recipient had to be subject to tax on dividends or royalties<sup>6</sup>, if he were to have the benefit of the treaty. Accordingly, tax was to be levied. No such stipulation, however,

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<sup>2</sup> CAP 22.

<sup>3</sup> Now, Trusts Law (Revised).

<sup>4</sup> The International Business Companies Ordinance, Companies Ordinance, Trusts Ordinance, Fraudulent Dispositions Ordinance, Limited Partnership Ordinance, Limited Duration Company Ordinance, Insurance Ordinance, Partnership Ordinance.

<sup>5</sup> See now: International Business Companies Act 1991, as amended.

<sup>6</sup> See e.g., the Grenada Treaty, Articles 6 and 7.

is to be found in the articles relating to business profits<sup>7</sup>. There was therefore no purpose in taxing these, and the IBC law provided accordingly that such profits should be wholly exempt from tax.

It is interesting to consider to what extent these four pioneers made a success of the IBC concept. Jamaica and Grenada did not. Their recent history has been one of social stress and political turbulence, which are of course the last things you need if you are trying to develop an offshore industry. Antigua has been fairly successful, but undoubtedly the most successful jurisdiction of all has been Barbados. Barbados has some natural advantages - pretty beaches, nice climate, that sort of thing - which have enabled it to develop as an upmarket tourist destination. Barbadians are also extremely well-educated: they have a literacy rate higher than the rate we have in the United Kingdom. And Government has been extremely active - both on its own and through the Central Bank - in encouraging the development of offshore activities.

I would be giving you a quite misleading picture if I were to suggest that - even two or three decades ago - you could get a new offshore centre up and running without having to compete for business with other jurisdictions. Very serious competition was presented by Luxembourg and Liechtenstein. Liechtenstein had its IBC's nearly forty years before the phrase was invented. The much-loved and well-known Anstalt<sup>8</sup> is essentially an IBC in a civil law context. Liechtenstein is not at all a zero-tax jurisdiction. It is a serious, tax-paying country, which, way back in 1926, created certain tax-free vehicles for the benefit of non-residents, of which the Anstalt is perhaps the most familiar, if only because it is not necessary to speak German in order to pronounce it.

The Luxembourg holding company dates from 1929<sup>9</sup>. It is essentially an IBC, carved out of a tax-paying jurisdiction, but an IBC which may not do more than hold investments. It appears at first sight to be tax-free, but there is a capital duty of 1% and an annual tax on the issued capital. This annual tax is at the modest rate of 0.2%, but it is levied on the aggregate market value of a company's issued shares. In the case of unquoted companies, the market value of the shares is generally taken to be an amount equal to ten times the previous year's dividend, so that there is an effective tax of 2% on dividends declared.

Apart from Liechtenstein and Luxembourg there were - and there still are - other places in Europe which have what are effectively IBCs, though under other names. The Republic of Ireland inherited the UK tax system when it became independent,

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<sup>7</sup> In the Grenada Treaty, Article 3.

<sup>8</sup> See: Personen und Gesellschaftsrecht, Articles 534-551.

<sup>9</sup> Law of 31st July.

and the UK approach to the taxation of a company - disregarding the place of its incorporation, and looking to see where it was "managed and controlled" - has not been modified there, so one can still have a company incorporated in Ireland and resident elsewhere which is free of Irish tax except on local income. I think of the non-resident company as a kind of IBC by accident - that is to say, without any legislative measure designed to facilitate its establishment. The "accidental IBC" exists in a number of other territories which have adopted the British system of taxation<sup>10</sup>. Generally, a non-resident company paid the same annual fee to the companies' registry as was paid by a resident company. But the Governments in Guernsey, Jersey and the Isle of Man took the view that they ought to make a small charge for the privilege of using the jurisdiction on a tax-free basis. This was a fixed annual fee - the Isle of Man charging £250 and calling it a "duty", and Jersey and Guernsey charging £500 and calling it a "corporation tax".

One difficulty about using a non-resident company is that you need your statutory compliance in one place and your board meetings in another. So, if you had a company incorporated in Guernsey, looked after by accountants in St Peter Port, whose board was made up of partners in the accounting firm, you would find the partners going to Dinard or to Sark to hold their directors' meetings so that the company did not have its "management and control" in Guernsey. And there are lots of funny stories of very seasick accountants trying to hold board meetings on the quayside. It was in the context of this kind of problem that, in 1967, Gibraltar took a very interesting step<sup>11</sup>. It introduced the "exempt company", which is free of tax on its income arising outside Gibraltar. Its freedom from tax in Gibraltar does not depend on its residence, but upon a certificate of exemption issued by the Financial Secretary. Since that time, the Channel Islands and the Isle of Man have introduced their own versions of the Exempt Company but none of them have gone quite as far as Gibraltar in enabling an international business to have an open physical presence in the jurisdiction without exposure to local tax. The Gibraltar Exempt Company is a true IBC, although it carries a different name: it is a company which has a special tax regime within a taxing jurisdiction, in accordance with laws which have been enacted for the specific purpose of allowing non-residents to conduct international business from that jurisdiction on a privileged tax basis.

If I say that the IBC idea has caught on, that would be an understatement. I have drawn up a list<sup>12</sup> of twenty-three jurisdictions offering zero-tax IBCs under one

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<sup>10</sup> e.g., Barbados, Botswana, BVI, Gibraltar, Grenada, Singapore, Swaziland.

<sup>11</sup> See now: Companies (Taxation and Concessions) Ordinance 1983.

<sup>12</sup> Antigua, Aruba, Belize, British Virgin Islands, Canary Islands (Spain), Cook Islands, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liechtenstein, Madeira (Portugal), Marshall Islands, Mauritius, Monaco, Montserrat, Nevis, St Vincent.

name or another. These, however, do not include jurisdictions which offer IBCs subject to low rates of tax<sup>13</sup>, or those which make special provision for holding companies<sup>14</sup>, or those which attract offshore business for other reasons - for example, those which do not have any tax at all<sup>15</sup>, those offering non-resident companies<sup>16</sup> and those which are in this business because they tax on a territorial basis<sup>17</sup>.

From a broad overview of these jurisdictions, let me come to a closer look at two of them. The two I have chosen offer facilities of a contrasting kind. They are Monaco and the British Virgin Islands. About Monaco, Somerset Maugham said it was "a sunny place for shady people". However true that may have been in his day, there is now no reason to suppose that the Principality contains more than a statistically average proportion of scoundrels. Indeed, quite the contrary. A resident's visa is issued to foreigners only after due enquiry, and woe betide the successful applicant who only pretends to live in the Principality, for fiscal or other reasons, and actually lives elsewhere.

What fiscally distinguishes the Principality from the rest of Europe (leaving aside Sark and, I believe, Albania) is the absence of income tax on the income of individuals. This has made it possible for local enterprises to remunerate some extremely expensive talent more handsomely than is possible elsewhere in Europe. Or perhaps one should put it another way - that where there is no tax on individual remuneration, it is possible to remunerate expensive talent at a rather lower cost to the employer.

However, what is interesting about Monaco in the present context is that it permits a local administration of companies incorporated elsewhere on a tax-free basis. This has proved useful for providing the "management and control" requisite for the non-resident companies mentioned above<sup>18</sup>. Monaco has proved an attractive place also for the administration of companies whose jurisdiction of incorporation

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<sup>13</sup> Barbados, Belgium, Cyprus, Dublin (Ireland), Labuan (Malaysia), Malta, Switzerland.

<sup>14</sup> Austria, Denmark, France, Germany, Hungary, Luxembourg, Netherlands, United Kingdom.

<sup>15</sup> Anguilla, Bahamas, Bermuda, Cayman Islands, Nauru, Turks & Caicos Islands.

<sup>16</sup> Barbados, Botswana, British Virgin Islands, Gibraltar, Grenada, Ireland, Singapore, Sri Lanka, Swaziland.

<sup>17</sup> Costa Rica, Hong Kong, Lebanon, Liberia, Malaysia, Panama, Seychelles, Singapore, South Africa, Uruguay.

<sup>18</sup> See note 16 *supra*.

is indifferent to management and control, but which is too remote from the European centres in which their effective managers are situated. Thus, companies incorporated in Hong Kong, Liberia and Panama are managed in Monaco for practical rather than fiscal reasons. The Principality has the advantage that if one is going to have a meeting, this is one of the more agreeable places to have it, and the director who might find reasons to put off a meeting in, let us say, the Cayman Islands or the Isle of Man, will find time in his diary for a couple of nights at the Hermitage Hotel or down the road at the Voile d'Or.

There are nowadays companies in Monte Carlo which provide an administration and management service for foreign companies. A degree of circumspection is evidently requisite. The name of a foreign company is not blazoned on the door or otherwise made visible outside the office. Its name does not appear in the telephone directory. And postal communication to it is directed care of the management company concerned. But so long as the commercial activities of the foreign company take place wholly outside Monaco, there is no occasion for local tax to be chargeable on its profits. The success of Monaco is not a mass market success. Rents and salaries are high, and costs tend to be on the high side. But for those who want these facilities, it provides them, and it provides them in an agreeable - not to say stylish - manner.

What attitude does Prince Rainier and his Government take to the offshore activities of the Principality? Monaco is not a place you could describe as enjoying open government, but the situation - as I read it - is that these activities are not actually encouraged (Monaco has no equivalent of the Madeira Development Company or the Barbados Central Bank) but so long as a person does it discreetly, and without - as the saying is - frightening the horses, his contribution to the economy of the Principality, and indeed to its yield from value added tax, will be grudgingly appreciated.

By contrast, the British Virgin Islands is a mass market success. I think that nowadays, when people talk about an "international business company" without specifying the jurisdiction they are referring to, their listener will assume that they are talking about the BVI.

A more improbable place for a runaway success in international business is hard to imagine. The place is quite difficult to get to. One takes a rather small plane from Antigua or San Juan, Puerto Rico to the little airport on Beef Island, which is connected by a toll bridge to the main island - Tortola, which is hilly and green and surrounded by coral beaches. From Tortola you look out over a scattering of other picturesque islands, which together constitute this British Colony. The entire population is around 20,000. I recall with some shame being in Tortola in the early 1980s, and being asked by the Financial Secretary to consider the possibility of legislation enabling zero-tax companies to be formed there. My advice was that he shouldn't waste his time. Anyone who wanted a zero-tax company could perfectly well go to any number of other places, some of which - like Antigua, the

Cayman Islands and even the Bahamas - were not all that far away. There could not be room in the market place for yet another jurisdiction for the incorporation of zero-tax companies. How very wrong I was! In 1984 they enacted their International Business Companies Ordinance. Less than eleven years later, they have over 100,000 companies on the registry, and if one reflects that each company pays Government US\$300 a year, it is evident that Government has from this source a revenue of \$30,000,000 a year - which is quite a lot of money for a Government of 20,000 people.

What has been the secret of their success? Not a specially interventionist policy of government. Government's attitude to offshore activities is not - how can one put it? - prudish, like that of the Government of Monaco, but I know of no occasion when Government ever spent any money promoting the offshore industry of the territory. I think it would be fair to say that the professional people there have played an important role in publicising the IBC. But truly I do not think that publicity is the secret of their success. I think it is really the product. They enacted the most user-friendly offshore company legislation which had up to that point been seen. It has been copied since. It was copied in Western Samoa<sup>19</sup>. The Bahamas Act<sup>20</sup> was drafted by the simple expedient of passing the BVI Law through the copying machine and changing the expression "Virgin Islands" to read "Commonwealth of the Bahamas". And indeed the draftsmen<sup>21</sup> of the Belize International Business Companies Act quite shamelessly adopted chunks of the BVI Ordinance.

What is it that was so special about the BVI's IBC legislation? First of all, it is lucid and easy to read. Secondly, it is brief: there is not a lot of it, but it confers plenty of powers on a company, and this feature enables the constitution of the company to be - by Anglo-Saxon standards - quite short. Only one shareholder is required<sup>22</sup>. Shares may be in registered form or bearer form, and may have a par value or no par value<sup>23</sup>. It is easy for the shareholders to alter the constitution of the company, including the provisions for share capital and its name<sup>24</sup>. It has proved to be a particularly attractive feature of the BVI IBC that the identity of its directors and shareholders is not public knowledge. Another attractive feature is that there is no audit requirement. I think a number of

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<sup>19</sup> International Companies Act 1987.

<sup>20</sup> International Business Companies Act 1989.

<sup>21</sup> Philip Baker and the author.

<sup>22</sup> International Business Companies Act 1984 s.3.

<sup>23</sup> *ibid* s.9(1).

<sup>24</sup> *ibid* s.16.



jurisdictions have suffered because their laws have made quite unnecessary stipulations for auditors to be appointed. I am thinking here of Barbados<sup>25</sup>, Cyprus<sup>26</sup> and Gibraltar<sup>27</sup>. An interesting provision<sup>28</sup> allows an application to be made to the court in the BVI in the event that shares of an IBC are seized abroad; the court may, if it thinks it proper to do so, order that such seizure be disregarded. The BVI is one of the jurisdictions where there is no requirement for a company to have a local director or to hold its directors' or members' meetings within the territory. The Ordinance does not require any annual general meeting, though, of course, the constitution of the company may provide for it. Nor is any form of annual return required, although there is something to be done annually, and that is to pay the \$300 to Government<sup>29</sup>.

What was perhaps the most revolutionary concept which was introduced into the 1984 Ordinance was the concept of redomiciliation of the company<sup>30</sup>. I think that this has been quite well-known in North America for a long time. A company which is incorporated in the Province of Alberta in Canada can quite easily become a company incorporated in the Province of British Columbia<sup>31</sup>: it remains the same company, with the same shareholders and the same assets and liabilities, but its place of incorporation is changed. This was quite unknown in the offshore world in 1984 and, again, it is a feature which has been copied in other jurisdictions since then. I am not sure if people have actually used this facility very much, but it certainly got the BVI talked about, and I have no doubt that if you are putting a jurisdiction on the offshore map, being talked about is one of the things you want to achieve.

Every practitioner in the international tax field needs to know something about zero-tax companies. It is not wise to try to know a great deal (better to know the fax numbers of people who do). But it is useful to be reminded, from time to time, of what is on offer. Hence this Guide.

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<sup>25</sup> Companies Act ss.147(1)(b), 152(1), 156(1).

<sup>26</sup> Companies Law, Cap 113, sch 8.

<sup>27</sup> Companies Ordinance s.124.

<sup>28</sup> International Business Companies Act s.32.

<sup>29</sup> *ibid* s.105.

<sup>30</sup> *ibid* Pt. VIII.

<sup>31</sup> The Business Corporations Act 1981 (Alberta) s.182.