



# Tax Havens: The Fight Club of the Tax Industry

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# Overview

- The Panama Papers and Mossack Fonseca
- Background on Tax Havens
- International Tax Planning
- Government Actions
- Concluding Remarks



# Disclaimer

This presentation canvasses a general overview of tax havens in various countries and recent world events relating to tax havens. The presentation does not constitute legal or other professional advice and should not be relied upon as accurate, reliable, complete, current, timely or fit for any particular purpose, without receiving advice from a lawyer or other relevant professional. You should seek specific legal advice by contacting a your own legal counsel in relation to your specific legal issues. No one should act, or not act, on the sole basis of the this presentation. Any information, opinions, assertions or statements do not, and should not be relied upon to, replace the advice of your professional legal, tax and financial advisor. This presentation is based on tax laws in force in various jurisdictions, and world events which have occurred, as of and up to May 23, 2016.

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# The Panama Papers and Mossack Fonseca



<https://www.youtube.com/watch?v=k2APYPjTWZ8>

# Panama Papers

- Scope: 11.5 million confidential documents featuring 14,488 offshore entities connected to people in more than 200 countries and territories
- Release Date: April 3, 2016
- Time Period Covered: 1977 – 2015
- Story Breaker: German newspaper Suddeutsche Zeitung
- Holder: International Consortium of Investigative Journalists
- Major Driver: International banks

# Panama Papers

- Notable Exposed:
  - Vladmimir Putin (indirectly)
  - Lionel Messi
  - Prime Minister of Britain, President of China, King of Saudi Arabia, Prime Minister of Pakistan
  - Jackie Chan
- Industries
  - Africa's diamond trade, international art market, luxury yacht market
  - Bribery allegations around FIFA
- Closer to Home
  - Wealth manager and lawyer in Montreal

# Mossack Fonseca

- Founded in 1986 by Jurgen Mossack and Ramon Fonseca
  - Specialties: commercial law, trust services, investor advisory, and international business structures
- Firm work was 95% “selling corporate vehicles to avoid taxes”
  - Firm is estimated to have 5-10% of the global “shell company” market
- Customers
  - Big banks, big law firms
  - Ponzi schemers, Drug kingpins, Tax evaders, Jailed sex offender
- Secrecy
  - Aggressive work to protect client secrets
  - Backdating of documents
- Legal Actions in various countries



# Background on Tax Havens

# Defining a Tax Haven

- Canada Revenue Agency (CRA) ~ a jurisdiction with one or more of the following:
  - No tax, or very low rates of tax;
  - Strict bank secrecy provisions;
  - A lack of transparency in the operation of its tax system; and
  - A lack of effective exchange of information with other countries.
- Organization for Economic Co-operation and Development (OECD) ~ generally meeting one or more of the following:
  - No or nominal tax on relevant income;
  - Lack of effective exchange of information;
  - Lack of transparency;
  - No substantial activities

# What Makes a Tax Haven?

- Don't judge the book by its cover
  - Danger of leaping to the conclusion that beneficial tax results necessarily correspond to “unflattering” view of jurisdiction
- Many Jurisdictions
  - Bahamas, Bermuda, Barbados, British Virgin Islands, Cayman Islands, Channel Islands of Jersey and Guernsey, Costa Rica, Hong Kong, Isle of Man, Liechtenstein, Luxembourg, Monaco, Netherland Antilles, Panama
- Simple Example
  - Self-employed Canadian resident makes \$100,000, absconds to tax haven and deposits funds in secret bank account

# Tax Haven Economics

- Using panama papers leak to determine loss in market value
- Reviewed price data for 26,655 publicly-listed companies in 73 different countries
  - Approximately 1,100 had panama papers exposure (i.e. loss of market value)
- Findings
  - Risk-adjusted US \$222-230 billion loss in market capitalization
  - Average drop in firm value of 0.5%-0.6% around the time of the data leak
  - Firms operating in “perceivably corrupt companies” experienced decline in value
  - Firms operating in both Mossack Fonseca primary tax havens and in countries with implicated politicians experienced largest negative returns

# Panama – Why?

- Excellent financial services
- No taxes imposed on offshore companies that only engage in business outside of Panama
- Corporate and financial secrecy
- No requirement to publically register names of corporate shareholders
- Banking secrecy laws
- Generally no limits or reporting requirements on money transfers in or out of the country
- Ease of incorporation

# Panama – Specifics

- Common Reporting Standard (OECD)
  - Panama is holding out in favour of its own standard
- Bearer Shares
  - Continuing use despite being widely regarded as vehicle for criminals
- Panama Law Firms
  - Specifically marketing services “guaranteeing” that Panama will not sign agreements to exchange information with other countries

# Treaty Shopping

- Defined: A person who is not entitled to the benefits of a tax treaty with Canada uses an entity in another country with which Canada has entered into a tax treaty and, to obtain Canadian tax benefits, earns or realizes income sourced in Canada indirectly through that entity
- Example: US Person and UK Person set up holding company in Luxembourg to buy shares in Canadian companies
  - Question = Is the treaty between Canada and Luxembourg intended to benefit U.S. and U.K. investors?
- Department of Finance 2013 Consultation Paper

# Treaty Shopping

- Case: *MIL (Investments) S.A. v. Canada*, 2006 TCC 460, aff'd 2007 DTC 5437 (Fed C.A.)
- MIL was incorporated in Cayman Islands (no full-blown tax treaty with Canada) and owned shares of Canadian mining company (CanCo)
- Before MIL sold the CanCo shares, it continued into Luxembourg because CDN-LUX treaty exempted CDN capital gains tax – avoids \$65M gain
- CRA doesn't like outcome but ends up losing in Tax Court and Federal Court of Appeal



# Treaty Shopping

- OECD considers treaty shopping problematic
- Violates principal of only extending treaty benefits to parties that have sufficient connection to one of the two treaty countries
- Necessary evil for developing economy?
- What does Jurisdiction A do when its tax system is compromised as a result of benefit incurred by Jurisdiction B?
- Safeguard in Treaties
  - Canada-US Tax Treaty, Article XXIX-A
  - Denies treaty protection to taxpayers from other countries that try to set up operations in Canada in order to make use of treaty provisions

# International Tax Planning

# Principles of International Taxation

- Equity
  - Persons in same circumstance bear same tax; persons in different circumstances bear proportionally different taxes
- Neutrality
  - Capital Export Neutrality (CEN)
  - Capital Import Neutrality (CIN)
- Administrative Efficiency
  - Compliance costs for taxpayers and administrators be kept minimal
- Competitiveness and International Norm
  - Staying competitive in the world and benchmarking to international

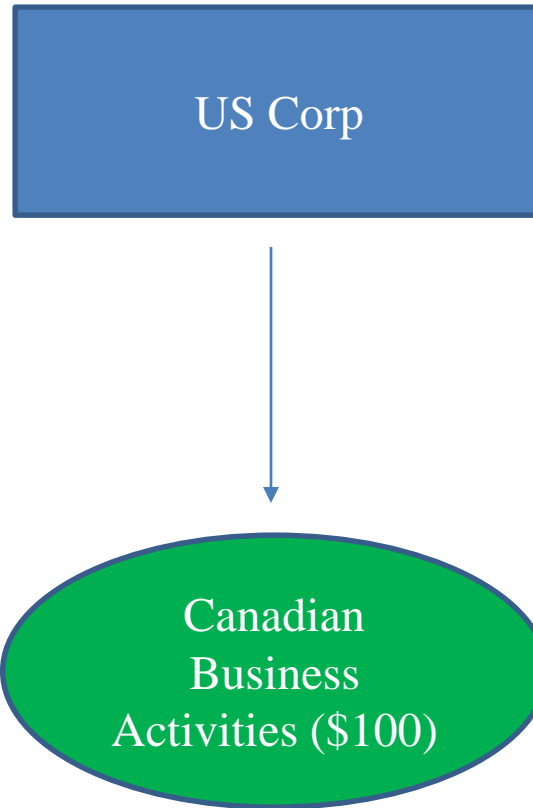
# Tax Treaties

- Canadian treaties based upon the OECD Model Tax Convention on Income and on Capital
- Main Objectives
  - Prevent Double Tax
  - Prevent Tax Evasion
- Two Primary Methods of Taxation
  - Residence
  - Source
- Numbers
  - 92 in force
  - 4 signed but not yet in force
  - 6 under negotiation/re-negotiation

# Tax Treaties

## USA

- If permanent establishment in Canada, no U.S. tax (provided U.S. tax rate doesn't exceed 30%)
- If not, U.S. tax at relevant rates



## Canada

- If permanent establishment in Canada, tax of \$30 (assume 30% corporate rate)
- If not, only U.S. tax

# Potpourri of Methods

- Offshore Registration
  - Keep head office in HighTaxCo but shift corporate registration to LowTaxCo
- Foreign Accrual Pricing Income
  - Receive passive income from LowTaxCo which is owned by HighTaxCo
- Transfer Pricing
  - Sell from LowTaxCo to HighTaxCo at price close to FMV
  - HighTaxCo sells to customers at FMV
- Bearer Shares
  - Security wholly-owned by the physical holder of the certificate
  - Issuing firm doesn't register the owner nor track transfers of ownership

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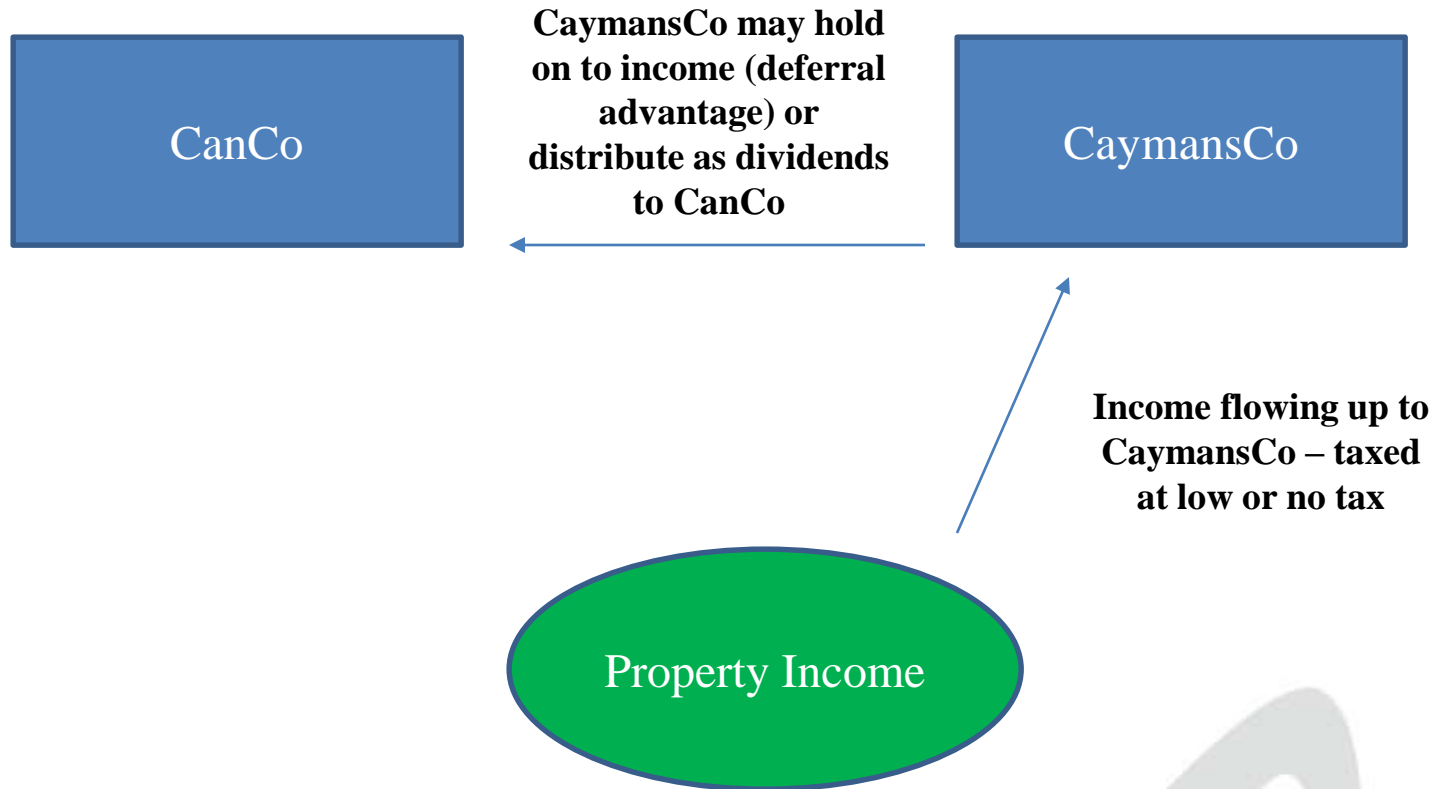
[https://www.youtube.com/watch?v=Pn10cEm8X\\_E](https://www.youtube.com/watch?v=Pn10cEm8X_E) (1:19 – 4:30)

# Offshore Registration

- Forming company in lower tax jurisdiction and carrying on business in higher tax jurisdiction
- CRA actively pursuing accounts registered in the Isle of Man
- 2016-17 Budget includes \$444M investment for fighting tax schemes
- CRA Offshore Compliance Advisory Committee



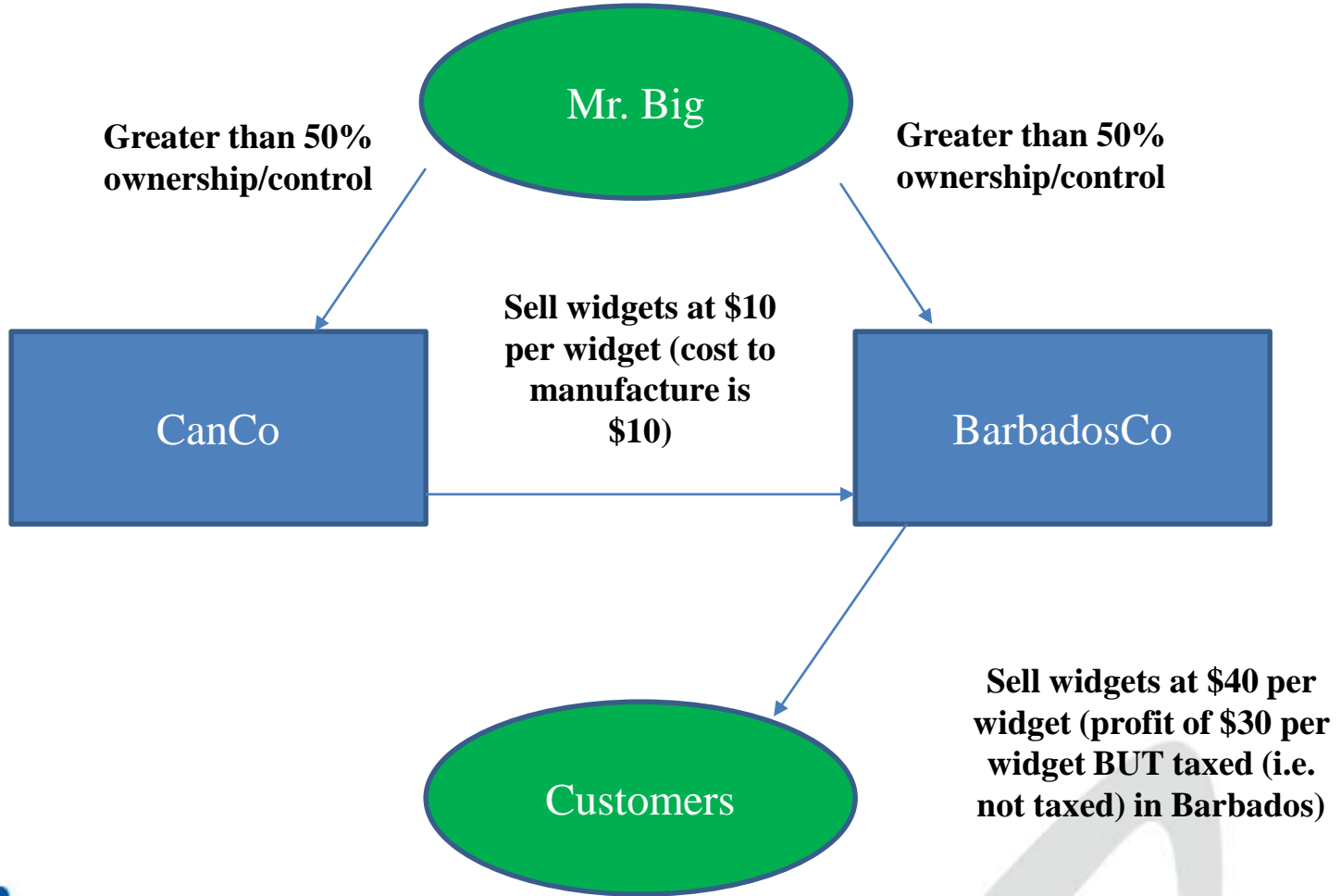
# Foreign Accrual Property Income (FAPI)



# Foreign Accrual Property Income (FAPI)

- Basic Principle ~ Where a Canadian resident has a sufficiently substantial interest in a foreign corporation, the foreign corporation can and should be treated as an extension of the Canadian resident
- Mechanism 1 ~ FAPI of a “controlled foreign affiliate” of a Canadian-resident taxpayer is included in Canadian’s income
  - FAPI is typically property income and “non-active” business income
- Mechanism 2 ~ Dividends received by Canadian resident-taxpayers from foreign corporations
- Relief for any foreign taxes paid

# Transfer Pricing



# Transfer Pricing

- Arm's Length Principle: transactions between non-arm's length parties should occur as close as possible to market price
  - The “right price” = market price resulting from hard bargains
  - Addresses whether profits are different from what they would have been in the absence of “common control”
- Cameco
  - Sell uranium at fixed price to Swiss subsidiary for 17 years
  - Swiss subsidiary sells uranium on to customers at market price
- CRA has a transfer pricing review committee in its international tax division

# Bearer Shares

- Paper Certificates that belong to the person who is (literally) holding them at the time
- Legitimate Uses
  - Passing on inheritance while avoiding probate
  - Avoiding administrative costs
  - Maintaining privacy for valid reasons
- Elimination of Bearer Shares
  - Tax haven countries under pressure from 2003-2005 to eliminate them or immobilize them
  - Bans in various other countries
- Canadian Corporations Legislation
  - Federal = no bearer shares (must be in registered form)
  - Provincial = depends upon jurisdiction
- Questionable Utility
  - Can still set up bearer shares but banks won't open corporate bank accounts
  - Foreign land ownership restrictions

# Government Action

# Canada Revenue Agency

- Canada Revenue Agency (CRA) reviewing panama papers – criminal charges will be laid if necessary
- Extra \$444M over 5 years to combat tax avoidance
- CRA application to compel RBC to turn over client files linked to panama papers
- CRA ongoing discussion with KPMG over Isle of Man
- CRA had 40 audits in the works related to Mossack Fonseca prior to the panama papers leak
- Establish Offshore Compliance Advisory Committee to combat tax evasion and aggressive tax planning

# Public Safety Canada

- Public Safety Canada (PSC) taking lead role in global tax talks to address offshore accounts
- Distinction between illegal tax avoidance (CRA) and corruption (PSC)
- Department of Finance involvement as well
- Transparency International Canada – call for a public registry of Canadian companies



# Tax Information Exchange Agreements

- Exchange information to combat offshore tax evasion
- TIEAs negotiated with several tax havens
- Generally follows the OECD Model TIEA
- 22 TIEAs currently in force
- General Purpose: “exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Contracting Parties concerning taxes... such information shall include information that is foreseeably relevant to the determination, assessment and collection of such taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters”

# Organization for Economic Cooperation and Development



<https://www.youtube.com/watch?v=qZQ-WkM7puI>

# Organization for Economic Cooperation and Development

- Global Forum on Transparency and Exchange of Information for Tax Purposes
- 134 member countries committed to transparency and exchange of information
- Peer review process to ensure implementation of standards
- Compliance ratings

# Organization for Economic Cooperation and Development

- Base Erosion and Profit Shifting
  - Tax planning strategies that exploit gaps and mismatches in tax laws to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid
- Key Action Plan Items
  - Automatic exchange of information
  - Digital economy
  - Interest deductions
  - Treaty benefits
  - Transfer pricing
  - Dispute resolution mechanisms
  - Tax treaties

# Concluding Remarks

# International Efforts

- International Information Sharing Efforts
  - Canada, U.S., U.K., Europe, South Africa, Iceland
- OECD – International Standards on Tax Transparency
  - Systems for review of country safeguards and country mechanics for exchange of information
- Tax Treaties
  - Continued creation of treaties with new countries and updating of existing treaties to address compliance deficiencies

# Moral Questions

- Should we allow individuals to set up offshore entities to minimize tax?
- Should we ignore breaches of privacy because it concerned “bad people doing bad things”?
- Do individuals and companies have an obligation to pay a certain amount of tax?
- What is the best approach to tax compliance? Coercion or persuasion?

# Right to Pay Less?

“Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciated the [taxing authority] or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”

*Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1 at 19 (HL)

“Taxpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability”.

*Copthorne Holdings v. The Queen*, 2011 SCC 63, at paras. 49 & 65



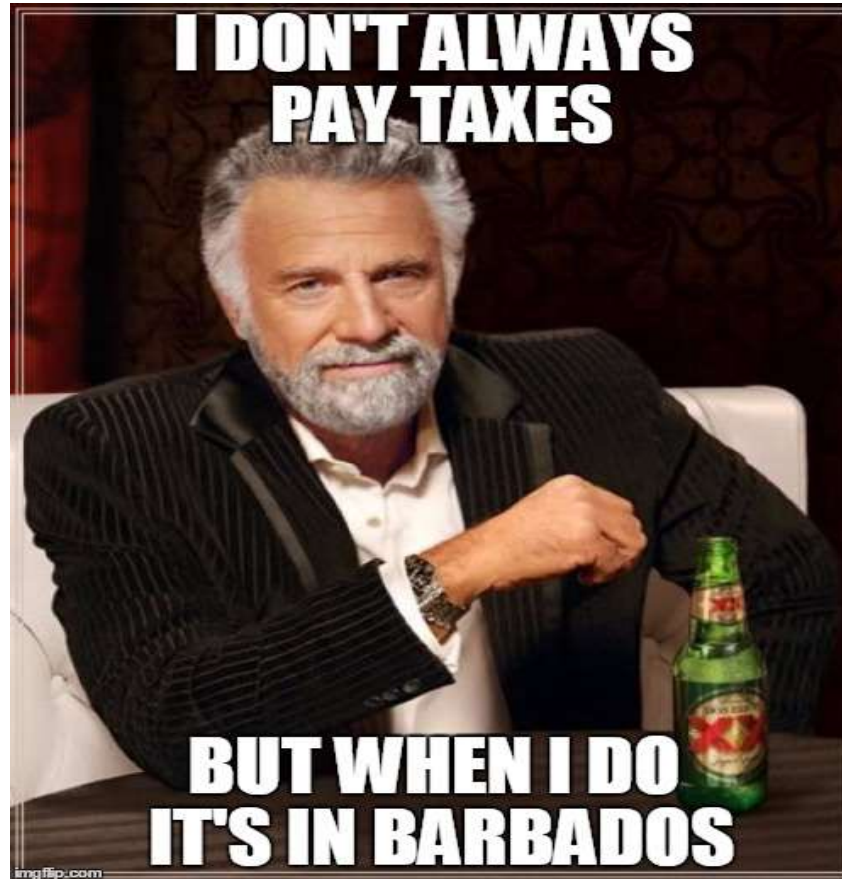
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# Questions?



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