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VICTORIA UNIVERSITY OF TECHNOLOGY



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The taxation and regulatory characteristics of Offshore Banking Centres (OBC's) with special reference to United Kingdom, Singapore, Philippines, Ireland, Cyprus and Australia.

A minor thesis submitted to satisfy  
the academic requirements for the  
Master of Business in Accounting and Finance.

by

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CHAPTER 1

INTRODUCTION

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## 1! INTRODUCTION

### 1.1 BACKGROUND

The term "offshore banking" has many meanings. However the common definition which is well accepted is the one that appears in Hewson (1982). This definition involves an institution that is situated in a country and which deals with foreign currencies and with non-residents. It also appears, from preliminary readings, that some countries may have been successful in establishing Offshore Banking Centres (OBC's) whilst others may have not. The indication of success as an Offshore Banking Centre includes the level of activity and the continuing nature of Offshore Banking business. The different degrees of success suggest that there may be several preconditions necessary for an OBC to be successful. Furthermore a preliminary reading suggests that successful OBC's have preconditions that assist their growth. The following characteristics may have a substantial bearing on the success of an OBC : location/time zone, political situation, economic stability, advanced telecommunication facilities, skilled personnel, the legal system, the secrecy of the banking system, foreign exchange relations and above all favourable taxation legislation and absence of certain government regulations. Absence of any of the above characteristics may inhibit the conduct of business by an Offshore Banking Centre.

Therefore, an assessment of these preconditions, should be made. This assessment will enable a study of those factors that determines whether an OBC is a success or failure. Despite the vital importance of such an assessment, little attention has been



paid to it in the recent past. However, OBC's have had phenomenal growth to such a point where they play a major role in the world of international finance, banking, and the economy as a whole.

## 1.2 OVERVIEW

Chapter 1 is an introduction to the thesis which provides background information on introduction and overview of research work. Furthermore it provides information on the objective of the research and the main hypothesis and secondary hypotheses. In addition, there is a presentation of the expected contribution to knowledge, limitations and weaknesses in key assumptions. Reference is also made to the methodology used, definition of terms and data sources.

Chapter 2 is the literature review which aims to provide a clear definition of an Offshore Banking Centre and identify the various types of OBC's. Furthermore, it provides a general framework for the assessment of the special legal characteristics of successful or unsuccessful Offshore Banking Centres.

Chapter 3 explains the research methodology employed to research the legal characteristics of successful Offshore Banking Centres. A survey has been conducted with the objective of identifying factors which enhance the development of a country to an international financial - banking centre and a commercial centre.

Chapter 4 provides a comparative analysis of the OBC's in the countries: United

Kingdom, Singapore, Philippines, Ireland, Cyprus and Australia. Each analysis consists of an introduction, location, political situation, telecommunications, personnel, a brief overview of the legal system, exchange control, banking system, special incentives, taxes, residency rules and foreign banks. Further, a comparative analysis of the legislation of the above legal characteristics is attempted.

Chapter 5, provides the findings from the survey and compares the findings from analytical research methods and interviews.

Finally, Chapter 6, provides the answers to research questions, recommendations, and suggested further Research.

### 1.3 OBJECTIVES OF THE RESEARCH

The purpose of this research is to attempt a comparative study of the taxation and regulatory characteristics and attributes of Offshore Banking Centres with special emphasis on United Kingdom, Singapore, the Philippines, Ireland, Cyprus and Australia, in order to assist in identification of key factors for success in an Offshore Banking Centre.

## 1.4 RESEARCH QUESTIONS

### a! THE MAIN HYPOTHESIS

The main hypothesis will be the following:

Do Offshore Banking Centres have special legal (taxation) and regulatory characteristics that contribute to their success as a financial centre?

### b! OTHER QUESTIONS / SECONDARY HYPOTHESES:

- 1! Do Offshore Financial Centres have other non-tax characteristics which are significant factors to their success?
- 2! Due to the absence of taxation incentives, banks in Offshore Banking Centres do not promote offshore banking transactions.
- 3! The development of an Offshore Banking Centre depends on the taxation incentives provided to non-residents.
- 4! Heavy regulation affects offshore banking business.

## 1.5 EXPECTED CONTRIBUTIONS TO KNOWLEDGE.

It is anticipated that the results of this research will make the following contribution:

- (i) Will provide a comparative analysis of the special legal (taxation) and regulatory characteristics and attributes of the host economies.
- (ii) Will assist in the identification of key factors for success in an OBC.
- (iii) This study may provide an analytical framework for other countries planning to establish a successful Offshore Banking Centre.

## 1.6 LIMITATIONS AND WEAKNESS IN KEY ASSUMPTIONS

1. This study will depend mostly on legislation analysis as a primary source as there is very little literature. Literature review is limited to the definitions, and classification of Offshore Banking centres and the General Framework for the Assessment of the special legal characteristics of the Offshore Banking Centres.
2. The above limitation will lead to the second constraint: some of the

requested information may be classified by Offshore Banking Units as confidential. In addition, government operations may have information that is restricted to the public. However, enough information may be available from other sources which will assist in overcoming this difficulty and enable this research to provide useful comparisons.

3. There are very few case studies available for studying and analysis has to be dependent in many instances on indirect information provided by public institutions, banks and government organisations. Furthermore, discrepancies may exist between the official published information provided and the working data used by banks due to the secretive nature of those entities.

Because of the time under which the research is carried out this thesis will only concentrate on the legal characteristics of 6 selected OBC's and will not deal with:

- a) Importance of Offshore Banking Centres in international trade.
- b) The economic impact of Offshore Banking Centres on the host economies.

## 1.7 RESEARCH METHODOLOGY

Research techniques will include:

### a. COMPARATIVE ANALYSIS OF LEGISLATIVE ARRANGEMENTS

This research will analyse the general and taxation factors of the six selected OBC's. The reasons for selecting those OBC's are stated in the introduction of Chapter 4. Such assessment, however, being difficult to quantify, will be mostly qualitative and will be documented, utilising not only legislation, but also secondary sources from published information and other studies.

### b. SURVEY OF BANK OFFICERS, GOVERNMENT REGULATORS AND ACADEMICS

Data will be collected by personal interviews. The design of the interview will be simple. An average interview will last about 15 - 20 minutes and will include a range of interviewees.

The writer has collected data by interviews on offshore banking with bank officers, government regulators and academics.

SUGGESTED GENERAL QUESTIONS TO BE ASKED:

- (i) What type of regulations and incentives should be provided to make an OBC a successful centre in the international arena?
- (ii) What are the advantages and disadvantages of the existing OBC's?  
(ie in the Asean Pacific Region: Hong Kong)
- (iii) What methods are used in separating transactions between residents and non-residents and avenues of controlling and checking such separation?
- (iv) To what extent is there competition between local - offshore banks?
- (v) What incentives need to be provided to promote offshore banking transactions?
- (vi) Does heavy regulation effects offshore banking business?
- (vii) Suggestions/comments on improving OBC performance.

Through this process, data collected will provide additional information which will assist in the analysis of the legislation.

CHAPTER 2

LITERATURE REVIEW

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## 2.1 LITERATURE REVIEW

The literature review will attempt to identify a clear definition of an OBC, to identify various types of OBC's, and to provide a general framework for the assessment of the special legal characteristics of Offshore Banking Centres (OBC's).

## 2.2 DEFINITIONS OF OBC's

There are a number of differing definitions as to what constitutes an OBC.

For instance, Johnson (1976) defines regional financial centres as host to foreign financial institutions, convenient to locate their offices. He claims that they are not "magnets of financial power in their own right". However, they are used as a form of branches.

In contrast Mary Cooke (1981) defines an OBC as "a place where the banking business is totally disproportionate to the needs of the domestic market".

Johns (1983) defines offshore Finance Centres as economies that attract international trade by providing special incentives. In those centres, economic activity is aimed to the needs of foreign offshore companies and investors.

Further, Choi (1984) defines Offshore Financial Centres as centres that attract foreign financial institutions and serve only non-residents. He also argues that host countries must have a significant economic size to be able to be successful as a centre.

Finally, on the definition of an International Offshore Financial Centre (IOFC), in *International Offshore Financial Centres* (1991), CCH argues that is impossible to find a concise definition. Some of those centres may be categorised as tax havens because of their favourable low taxes. These centres may be small centres.

However, some are major commercial international centres with complicated and high levels of direct and indirect taxes. Therefore, an IOFC may be defined as established offshore banking centres that are commonly used through a combination of strategies to offer international tax planning advantages.

For the purpose of this minor thesis, an OBC will be defined as a place where an attempt is made to attract offshore banking business through the provision of special incentives. This definition is adopted as it appears to be the most common definition.

## 2.3 CLASSIFICATION OF OFFSHORE BANKING CENTRES

A number of writers have attempted to classify or divide the OBC's into different classes.

McCarthy (1979) divides OBC's into:

- a) Paper centres where transactions are only on paper and an OBC could be located anywhere.
- b) Functional Centres where there is physical presence, raising, investing and lending funds.

Poinacheck (1982), refers to them as shell centres and functional centres and adopts the same definitions as those of McCarthy's definition given above.

Bhattacharya (1982) also divide OBC's into:

- a) Primary Centres; "which are an industrial base on which financial demands of customers are based, for example London and New York, and
- b) Secondary Centres which are centres in developing economies. Further, tax haven centres are a sub category. Tax havens are used just for booking transactions. However, no financial business is conducted in those centres.

Finally, Park (1982) classifies centres into:

- a) Primary Centres in industrial countries. Those centres are suppliers and users of funds. They serve as a hub of international banking and finance trading in Euro-currencies and Eurobonds.
- b) Booking Centres where funds are channelled from outside for and between non-residents (Bahamas, Cayman Islands, etc.).
- c) Funding Centres where they channel funds from outside their market area into local areas. Such a centre is Singapore; and
- d) Collection Centres which are the opposite of the previous category where they channel funds from their market area. These centres may have excess savings from low absorptive capacity.

## 2.4 GENERAL FRAMEWORK FOR THE ASSESSMENT OF THE SPECIAL LEGAL CHARACTERISTICS OF OFFSHORE BANKING CENTRES.

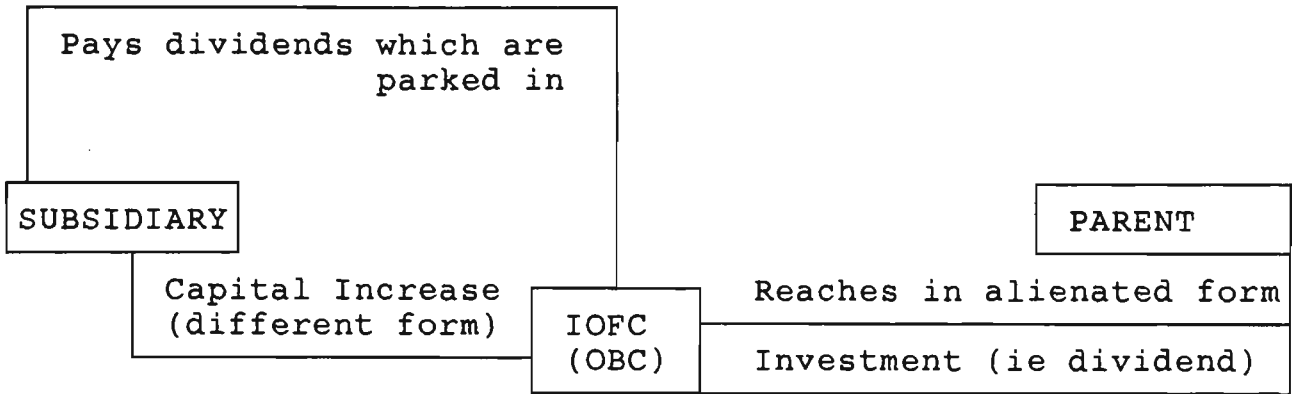
In Offshore Financial Centres (1991) CCH suggests that International Offshore Financial Centres, (IOFCs) have special characteristics. ie. low tax rates or a tax system which may in general be used to reduce the imposing international taxation. Those key characteristics are the main reasons for the popular use of IOFC's especially when a company which is located in an IOFC deals with other companies which are located elsewhere. Further, non-residents investment decisions will be affected by the taxation regimes of the countries involved. In addition, the existence of anomalies in dealing with transactions at the international arena results from the fact that some countries assess tax on source, others on residency and others on both. This may have as a consequence, that a non-resident with profits sourced in a IOFC may transfer them from a foreign jurisdiction to an IOFC to avoid the payment of taxation.

In addition, in the same CCH manual, the transactions that are mentioned above are transactions which do not fall within the categories of "sham" and "fiscal nullity". However, some tax advantages may be achieved by changing the nature of an investment. This may leave the parent company and when it reaches the subsidiary through an IOFC is in a different form. Conversely, the subsidiary may pay amounts which may either be parked in an IOFC or may reach the parent in an alienated form.

The following diagrams explain the ways in which IOFCs are used:

DIAGRAM 2.1

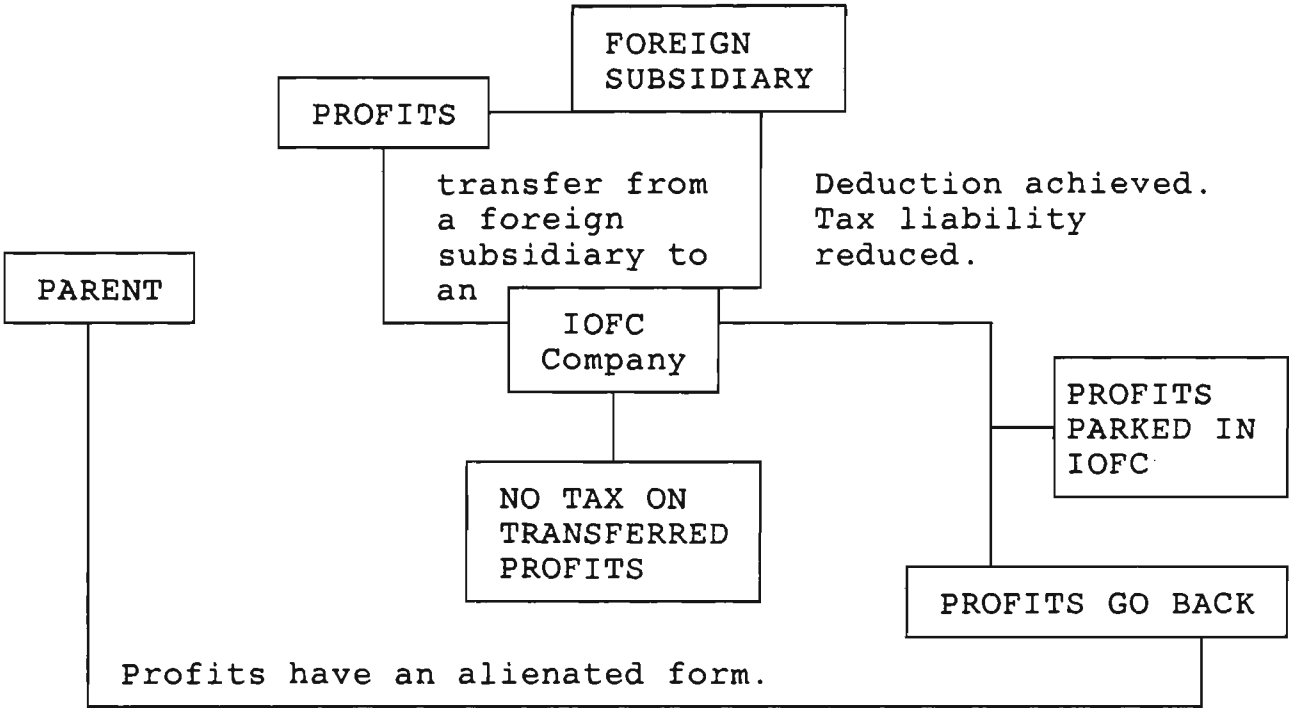
DIAGRAM SHOWING THE ALIENATION OF INCOME THROUGH AN IOFC.



It should be brought into attention that the use of foreign bank subsidiaries may facilitate the alienation of income through the use of IOFC's. Firstly an investment may leave the parent company and it may reach the subsidiary (through an IOFC) in an alienated fashion. Conversely, it may be that the subsidiary pays dividend which is parked in an IOFC or may reach the parent as something else. In the above situations, the bilateral nature of taxation is not followed.

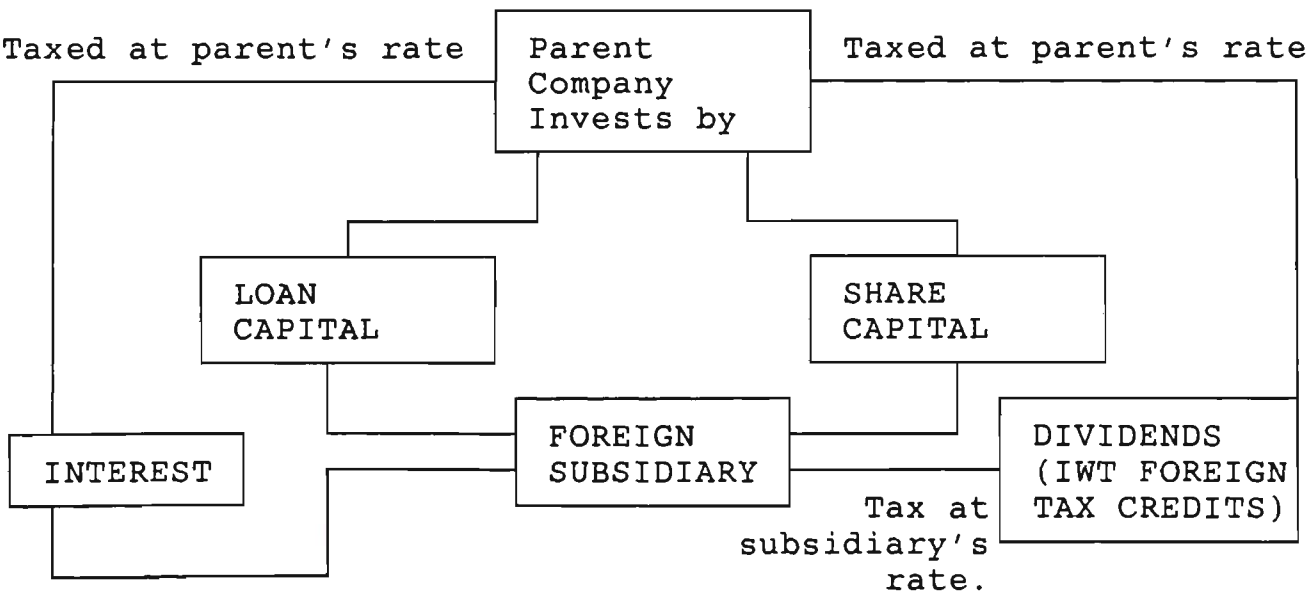
DIAGRAM 2.2

Diagram that shows the use of an IOFC as a deduction of profits.



The above diagram illustrates that when an IOFC is interposed, it may result in the alienation of certain types of income. Therefore tax planning utilises an IOFC in order to avoid paying tax.

DIAGRAM 2.3



The above diagram illustrates that when a parent invests in a foreign subsidiary by either loan capital or share capital, any returns in the form of interest or dividends will

be taxed at the parent's company rate. In addition, in the case of dividends the foreign subsidiary has to pay tax on declared dividends. Where IOFC is interposed, and provides a loan to the foreign subsidiary, the IOFC is taxed at the concessional rate. The parent company will pay no tax. As a result the group tax liability is reduced.

Also IOFCs provide other concessions to foreign investors such as establishing companies within their jurisdiction, provision of exemptions from local taxes and exchange control requirements, secrecy of banking concessional low tax company rates and many others.

Withholding tax is also an issue where various treaties around the world permit "shopping". For instance, Cyprus is commonly used as an interposed IOFC. Cyprus has tax treaties with many countries. Foreign companies have licences in technological products in Western Europe, from which they receive royalties. They interpose a subsidiary through Cyprus which has a tax treaty with Czechoslovakia. Czechoslovakia does not impose withholding tax, therefore there is no tax imposed on royalties.

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RESEARCH METHODOLOGY  
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## RESEARCH METHODOLOGY

### 3.1 INTRODUCTION

Many offshore financial centres claim that their success is due to the centre's advantageous geographic location, together with the tax incentives offered by their governments and the existence of a business oriented framework. A survey has been conducted with the objective of identifying the main areas that enhance the development of a country to an international offshore financial - banking centre and commercial centre. The basis of the survey is that policies followed by the authorities of an offshore centre should be compared with similar policies followed by other competing centres. In addition, certain possible areas of weaknesses in the legal and institutional framework may be identified as well as other factors which may affect offshore business operations and the attraction of foreign investors to the centre. The survey is focused on certain points:

- a! The comparison of each selected centre with competing offshore financial centres.
- b! The operation of offshore companies and banks in each competing centre.
- c! The level of taxation to offshore entities.
- d! Offshore banking conditions.

Personal interviews were conducted to obtain information required.

The interviewing method was selected rather than a mail questionnaire, to ensure that questions were clearly understood.

Categories of interviewees were as follows:

<u>Regulators of OBC</u>	<u>Offshore Banking</u> <u>Officers</u>	<u>Academics</u>
Officers of relevant government agencies  Ministry of Finance  Treasurer, Central Bank	Branch managers of:  a) regional banks  b) international banks	Researchers,  Lecturers,  Experts in international banking.

A broad variety of questions were asked because of:

- \* widely diverse backgrounds of interviewees
- \* restricted access to information by the public.

The actual interview had the following standardised questions:

- a) Which are the special (legal) or other general characteristics that contribute to the success of the selected Offshore Financial Centres?
- b) Which are the taxation and other incentives provided to non-residents that promote the Offshore Banking Centre?
- c) Which are the incentives available to Banks to promote offshore transactions?
- d) Do heavy regulations affect offshore transactions?
- e) Is there any international capital accessibility?
- f) What are the methods (I) of separating transactions between resident and non-residents and, (II) of controlling and checking such separation?
- g) Is there any competition between local-offshore banks?
- h) Give suggestions/comments on steps required in establishing a successful Offshore Banking Centre in Australia.
- i) Discuss employment/training opportunities.

The questionnaire was designed using open-ended questions which gave respondents the opportunity to answer in their own terms and give their opinion. However, one of the disadvantages of an open-ended questionnaire is the complexity involved in analysing information collected using this technique. The non-qualified new data presented a challenge for analysis and interpretation. The major task was to classify the resources into a limited number of relevant categories to prove the hypotheses. External events and different experience, attitudes and beliefs played an

important part in these findings and led to the development of further hypotheses and tested the factors found in the literature studied.

### 3.2 RESEARCH ON LEGAL CHARACTERISTICS

Special characteristics of Offshore Banking Centres, successful and some unsuccessful, may depend on the individual characteristics of the country studied.

(United Kingdom, Singapore, Philippines, Ireland, Cyprus & Australia)

Characteristics to be considered:

- a) location / time zone
- b) political situation
- c) economy as a whole
- d) communications
- e) skilled personnel
- f) legal system
- g) banking system including foreign exchange regulations and currency
- h) other legislation especially taxation.
- i) other incentives.

### 3.3 RESEARCH ON THE INCENTIVES

The other incentives and their contribution to the success of an OBC.

Other incentives are important as an OBC does not operate independently from the economy as a whole.

If the economy is thriving, business will thrive, and as a result an OBC will have more business to deal with. Other incentives will be documented utilising published information, data collected by interviews on offshore banking with bank officers, government regulators and academics.

### 3.4 FURTHER DETAILS ON RESEARCH

Further, all factors, (general and taxation variables) were measured by a ranking method. More time was spent to investigate the reliability and validity of the data collected from those interviews, and more attention was paid to single questions. Those questions which could easily be misinterpreted as a personal opinion were tested by incorporating the question with different wording.

Interviews were conducted in Cyprus, Singapore and Australia. Of the thirty people approached for interviews, ten refused to be interviewed. Interviewees were from the following three categories:

#### a) OBC REGULATORS

Four regulators were approached in Australia, two in Cyprus and one in Singapore. All regulators in Cyprus and Singapore agreed to be interviewed. Three of the four Australian regulators agreed to be interviewed.

b) OFFSHORE BANKING OFFICERS

Ten officers from the 39 OBCs in Australia were approached and six agreed to be interviewed. In addition, in Cyprus and Singapore two offshore banking officers were approached and both were interviewed.

c) ACADEMICS

Interviews were requested from eleven academics - six from Australia, 3 from Cyprus and two from Singapore. Responses were received from two Australian, two Cypriot and two Singaporean academics.

CHAPTER 4

Comparative analysis of the legal characteristics of the 6 selected OBC's:

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#### 4.1 INTRODUCTION

The six offshore banking centres were selected because of the existence of dissimilar characteristics in order to identify the factors that made them either successful or unsuccessful as offshore banking centres. The United Kingdom was selected because of its position as the most successful offshore banking centre of the world. The U.K., surpasses all centres in terms of both the number of banks and the substantial volume of business. Conversely, the Philippines was selected because it was acknowledged that direct contribution of OBU's has been minimal. This factor implied that the OBC in the Philippines may have failed. Further, Ireland was selected due to its success in spite of its proximity to the United Kingdom. One may suggest that the United Kingdom would curtail the success of a centre which is located so close to it. Cyprus was also selected as a rapidly developing offshore banking centre and a rapidly growing economy. This suggests a relationship between the growth of the OBC and the growth of the economy overall. Furthermore, the most successful centre of the South Asean Pacific area, Singapore was selected. This island country lies in the same geographic area as Australia. Singapore is the living example of a successful centre. Australia was selected as an example of a country in the same region as Singapore, which has failed to succeed as an OBC in spite of more natural resources and the vast possibilities of growing as an emerging economic power.



In addition, certain factors have been considered in order to test the main hypothesis that OBC's have special legal and regulatory characteristics. Those factors or special characteristics may contribute to the success or failure of the selected offshore banking centres. Some factors have an indirect influence on the success of the offshore banking centres. For example, the economic situation or the political stability may not seem to be associated with the success of a centre. However, this may be an important factor since the lack of economic or political stability, may jeopardise the success of a centre. Also, an assumption was made that countries which offer special incentives, such as shipping incentives, create business that an offshore banking centre requires. Without actual business, those centres will be paper centres without real commercial dealings.

The following factors/characteristics are chosen in order to be taken into account when comparing the six selected centres. These characteristics are divided into two categories:

- 1! General Factors
- 2! Taxation Factors

## GENERAL OUTLINE FOR EACH INDIVIDUAL COUNTRY

Factors to be considered:

### 1! General Factors

- (a) Location/Time Zone.
- (b) Political Economic Situation.
- (c) Communication facilities.
- (d) Skilled personnel.
- (e) Legal system.
- (f) Banking system, Secrecy & Foreign Exchange Controls
- (g) Special Incentives.

### 2! Taxation Factors

- (h) Taxation Characteristics.
- (i) Conclusion

## 4.2 UNITED KINGDOM

### INTRODUCTION

The city of London in the United Kingdom, is the leading offshore banking and financial centre of the world. U.K.'s attraction as a financial centre was mainly due to the fact that it was the host of Euromarkets.

The Eurocurrency market which originated in Europe and especially London is an international money multi-currency market. Transactions are attracted both by depositors and borrowers because of competitive prices and are not only restricted to sterling, U.S. dollars, deutschemark and yen but have reached other offshore financial centres such as Bahrain in the Middle East and Singapore and Hong Kong in the Far East. Eurocurrency banking operations are described by Harrod (1969) as "a great landmark in monetary history" as the system may separate the currency used for borrowing and lending from the location of banking which consequently separates the currency exchange rate risk from political risk.

Overseas banks have been attracted to U.K. as an offshore banking centre due to heavy regulation in their own domestic market. U.K. has given those overseas banks the opportunity to diversify their activities in search of a competitive edge.

The growth of the Euro-currency and Eurobond markets has developed markets at international level. Global access and "24-hour trading" are U.K.'s best features.

Banking and finance industries in the U.K. are faced with many opportunities. However, international competition creates a need for a high standard of internal control and risk containment procedures. As compliance with legislative requirements increases costs, this may have formed a disincentive to using an Offshore Banking Centre, however, in the case of U.K., it was more than balanced by the continuing security of the U.K. as a sound financial market.

The U.K. banking system not only is changing rapidly but other changes such as the 1992 single European market, new technology, the political crises in the Middle East and the development of the Asian dollar market may be potential factors that affect the future development of the U.K. as the premier international offshore banking centre.

## 1. General Factors

### (a) Location/time Zone

London is geographically located in North-Western Europe. It is located in the Atlantic Ocean and is very close to the mainland of Europe and is also in close proximity to Africa. Due to its location U.K. has a strategic importance for international operations as it has a comprehensive network of air and sea communications between U.K. and other international centres.

London's time zone is very convenient as it overlaps for part of the working day with such major markets as New York and Tokyo.

(b) POLITICAL AND ECONOMIC SITUATION

U.K.'s government and legislative infrastructure are amongst the most stable in the world. The English language is the major language spoken all over the world. The cultural, political and legal characteristics are recognised widely throughout the world, as major contributors to international trade.

The industrial revolution began in the U.K. in the 1700's and today Britain is still one of the world's leading industrial, manufacturing and trading nations. U.K. has large deposits of coal and iron ore, however it has to import about half of its food, as it does not have enough farmlands. The U.K. economy depends on foreign trade because it has very few natural resources and the value of imports exceeds the value of its exports. However, British banks and insurance companies make up the difference by selling their advanced services to other countries.

(c) COMMUNICATION FACILITIES

Historically Britain was the centre of international phone cable connections and has continued its central focus to develop what is probably the most advanced communications network. Great advances have been made in technology recently which have increased the sophistication of communication systems. The growth of the computer industry has had a dramatic effect on the way transactions are processed. The U.K. Stock Exchange Automatic Quotations (SEAQ) system has made a revolution in Stock Exchange business, and allowed the U.K. to continue as a centre for international information on stock exchange dealings.

U.K. has excellent transport and communication facilities. U.K. has one of the world's largest merchant communication facilities. U.K. has one of the world's largest merchant fleets. London is the centre of most international airlines and shipping companies.

(d) SKILLED PERSONNEL

U.K. has skilled personnel in all areas of science and technology. There are many grants available for the promotion of research and development.

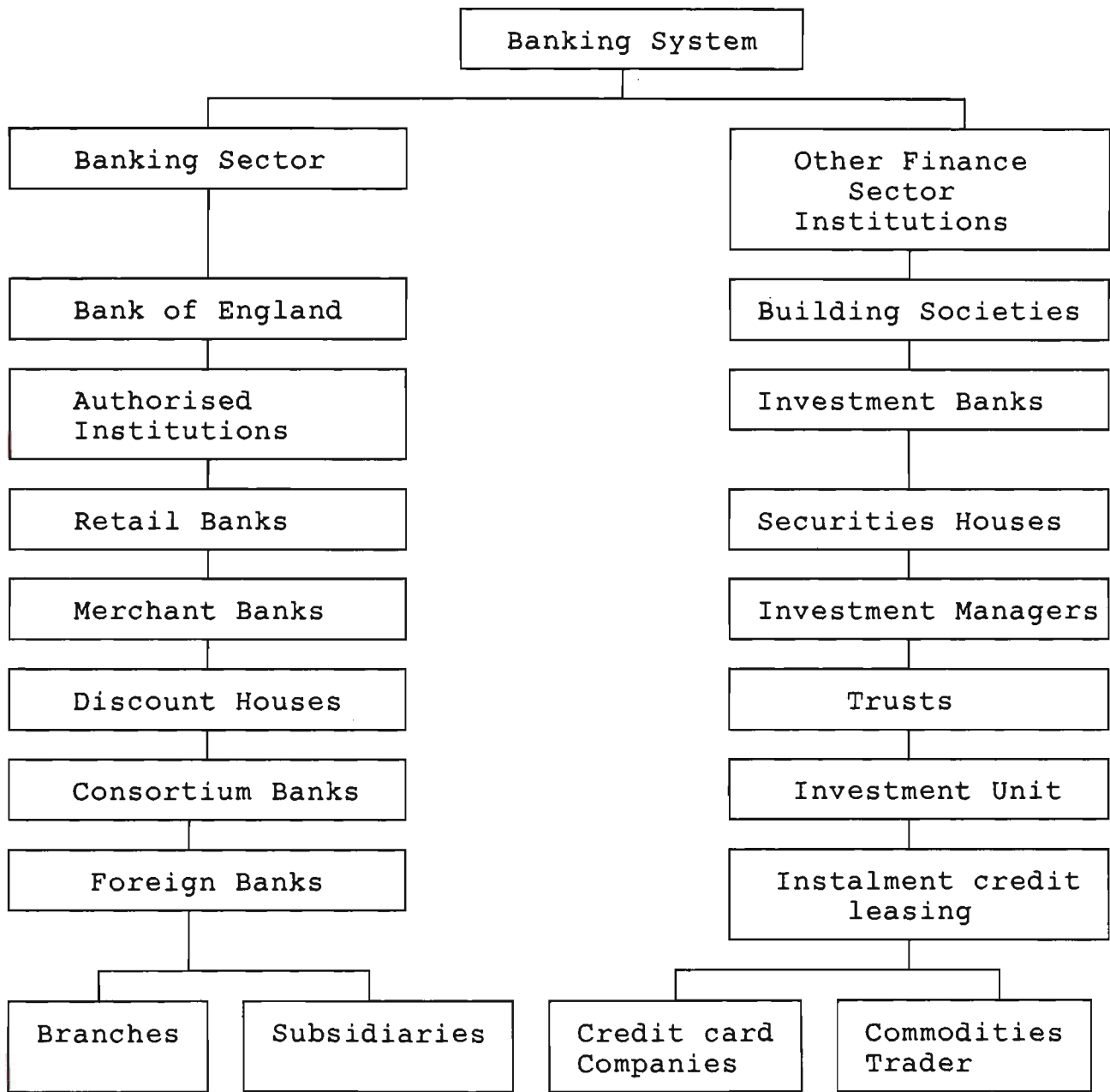
(e) LEGAL SYSTEM

U.K. is a constitutional monarchy where the queen reigns but does not rule. The Parliament makes the laws of U.K. and the House of Commons, the Lower House of Parliament is the real governing body.

(f) BANKING SYSTEM

(i) The following diagram describes the banking system in the United Kingdom.

DIAGRAM 4.2.1



HM Treasury owns the Bank of England which acts as the U.K. Central Bank, as a "bankers" bank and as the supervisory authority for other financial institutions which are authorised to take deposits.

Authorised Institutions are authorised to take deposits at competitive rates from all classes of depositors.

Retail Banks are those banks with an extensive branch network in the U.K. which offer both domestic and international services to all classes of customers. U.K.'s "big four" clearing banks are included in this category. These are Lloyds Bank, Barclays, National Westminster Bank and Midland Bank.

Merchant Banks are the banks which mainly finance trade and provide acceptance facilities which specialise in corporate finance, investment management and other term lending activities.

Discount Houses also deal with many other areas such as foreign exchange, asset management and others.

Consortium Banks are loans to areas where their shareholders are based. The shareholders in these banks do not hold more than 50% and one of them should be based overseas.

Branches and subsidiaries of foreign banks have various activities dependent on the head office needs.



Building Societies are deposit taking institutions which lend money for the purpose of buying a house. However, building societies may provide loans secured on land, and mobile homes, holding residential land and shares. Building societies are supervised by the Building Societies Commission.

Securities houses includes dealers within banking groups.

Investment Banks are involved in the arrangement of finance. They are not entitled to use the description bank because they are not allowed to take any deposits. The arrangement of finance may also be part of the other banks' business.

Investment managers operations are covered by the Financial Services Act 1986 and this was necessary because of the internationalisation of the stock market. Investment management has possibilities of a rapid increase in the future because of incentives provided by governments. Also the trend for privatisation worldwide will encourage more investment and therefore stimulation of this market.

Investment trusts are the type of investment where investors place their money in a company which invests in shares and securities from other investors companies.

Instalment-credit and leasing deals primarily in property loans and home improvements. The leasing market has decreased because it is not possible any more to use leases as off-balance sheet financing due to the introduction of the U.K. accounting standard No 21 "Accounting for leases".

Credit Card Companies Credit Card facilities are funded by banks and have international links.

Commodities traders will include trading in precious metals, coffee, grain, international freight futures market and others.

The Banking Act 1987 is the Act which deals mainly with deposit taking in the U.K. and controls the Bank of England.

There is also other legislation which regulates authorised institutions such as The Financial Services Act 1986 (U.K. investment business), The Consumer Credit Act 1974 (consumer credit), and the European Community (EC) directives.

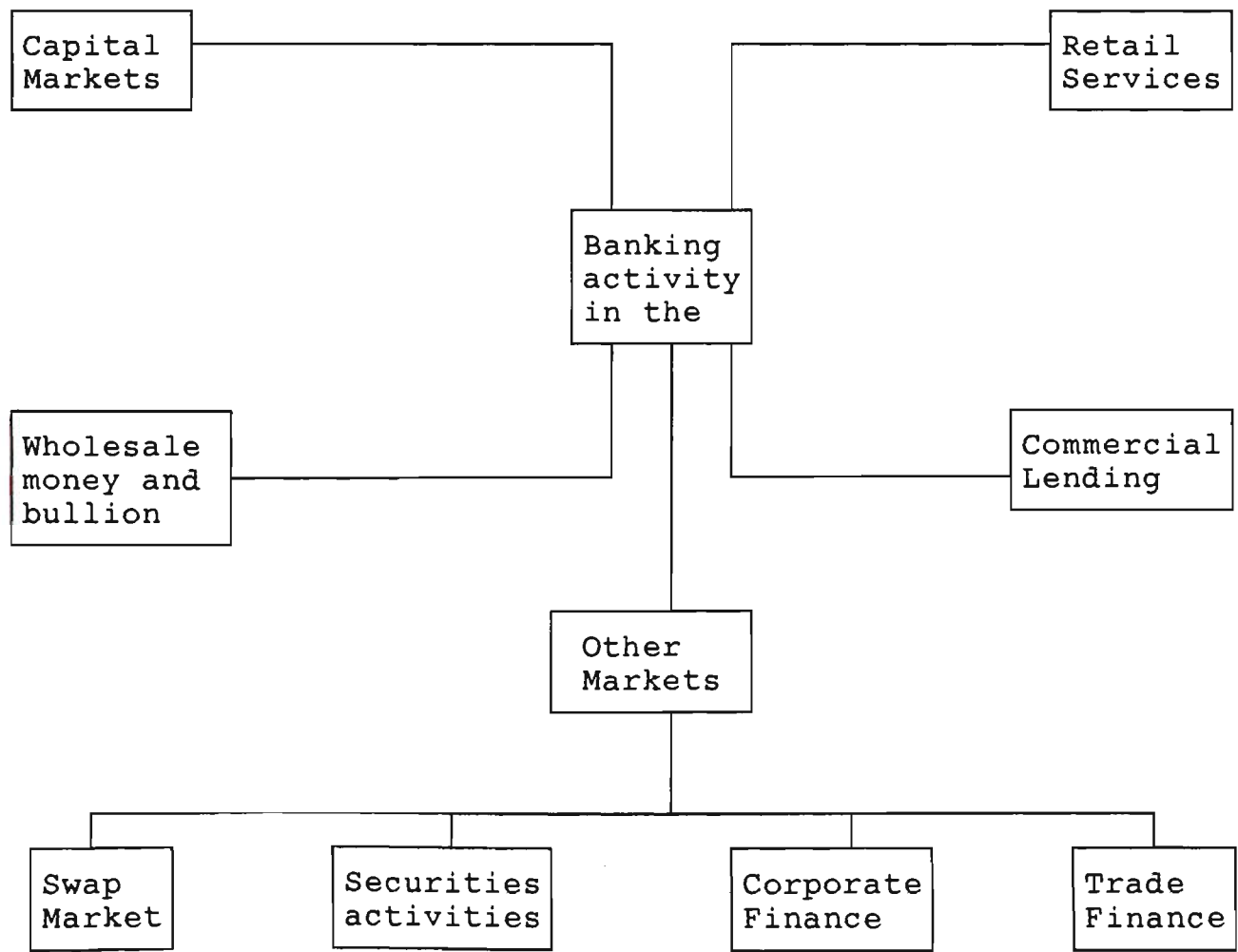
The Secretary of State for Trade and Industry has the responsibilities of regulating the investments under the Financial Services Act 1986 which most of these responsibilities are delegated to an independent private company the Securities and Investments Board (SIB) which is controlled by both the Secretary of State and the Governor of the Bank of England. SIB's main role is recognise, monitor, authorise and investigate organisations and individuals who carry on investment business activities.

Carrying on of "investment business" in the U.K. covers any right, asset or interest which may fall within specified categories ie. debentures, bonds, warrants, rights, units, options, long-term insurance contracts and others.

Carrying on "investment business" includes amongst others the following activities: buying and selling of investments, arranging dealings in investments, managing investments, advising on investments and engaging in collective investment schemes.

However, the dealing as principal in securities does not constitute investment business. In addition, both transactions between companies in the same group and between branches of the same entity are excluded.

DIAGRAM 4.2.2  
Banking activity in the U.K.



The above diagram describes, in the form of a diagram, the banking activity in the U.K. As stated above the banking activity includes capital markets, retail services,

wholesale money and bullion, commercial lending and other markets. Other markets include swap markets, security activities, corporate finance and trade finance.

(ii) U.K.FOREIGN BANKS

London has been the world's largest international banking centre for more than two decades. It has a free environment which is ideal for the establishment of foreign banks. There are many facilities provided to foreign branches and subsidiaries and multinational companies which improve any bank's international goodwill. The foreign banks participate in the leading centre of both Eurocurrency and Eurobonds and furthermore may participate in international trade of shares and securities. A foreign bank situated in London is the base where Euromarket funds can be channelled to other offshore financial centres.

As a result of being represented in the recognised leading centres of the world, a foreign bank will have an international profile. The foreign bank based in London may also provide services to the residents of foreign origin such as transferring funds to their country of origin.

London foreign banks are free to engage in banking both in the domestic and international arena. While foreign banks have a major part of their activities both in the wholesale banking and securities market at international level, they do have a wide range of services in the retail domestic area including amongst other services consumer finance, mortgage lending and venture capital.

Some London foreign banks are set up as financial services banks whereas some others operate as merchant bank subsidiaries or banks dealing with equipment leasing. However most of the overseas foreign banks are set up as branches of overseas non-resident companies.

Although branches are not considered to be U.K. residents they are taxed on direct or indirect profits which are derived from a U.K. permanent establishment which carries on business. The Head Office which is located overseas may provide interest free funds to the branch which can be used to purchase assets or for working capital purposes. If the branch pays interest to the Head Office for this capital fund the interest will be disallowed. Furthermore, the excess of market interest rates on deposits taken from the Head Office or other branches or group of companies will also be disallowed as a deduction.

Another activity of the London foreign bank branches is the borrowing of funds from the eurocurrency market which is centred on London and then lend them to their head offices contributing to the increase of the overall profits of the Foreign Bank through its increased investment. However, U.K.'s double tax agreements require that a branch which is an independent entity should lend those funds with similar conditions and commercial margin as if it were to lend those funds to third parties.

The branch is allowed a deduction of payment of certain services which benefit the Branch and are provided by the Head Office.

Loans would normally be attributed to the location where they were booked. This approach created inconsistencies as branches of foreign banks were involved in negotiating, evaluating and concluding the loan requirements and then transferring the provision of the final loan to another branch located offshore or even to another company in order to avoid paying tax on the profit margin of the loan.

Tax attribution which applies to trading that is conducted worldwide is an issue as it is not possible to attribute profits between the members dealing on an international basis. This is made more complicated with both the existence of a global booking system which has no permanent location and the arrangement between the parties that when the first operation is finalised then another starts in another location.

Tax treaties should cover the basis on which the taxation of those profits should be calculated.

(g) SPECIAL INCENTIVES

Special incentives are very important as they promote business and indirectly promote the business of an offshore banking centre and its success without business even the most well drafted OBC will be worthless.

U.K. provides various grants to assist business. These are the following:

There are assisted areas, projects which increase or create jobs in areas that need improvement may be assisted by the availability of a grant which should be negotiated before the starting of the project.

Also local authorities provide loans and other assistance to redevelopment project in specified urban areas and the City.

Further, business grants are available to assist new exports, tourism and innovating ideas in order to increase initiative and business motivation.

Both EEC and the government will provide loans to assist with high technology research and development in many areas including ex-coal-mining and steel-manufacturing. These grants may also be available to projects in assisted areas.

In addition, there are benefits provided to businesses located on designated zones. These benefits are provided in order to increase economic activity in those areas.

The following are the incentives provided:

- (a) Business assistance and grants.
- (b) Exemption from:
  - (i) local taxes
  - (ii) industrial training levels
  - (iii) the provision of the training boards
  - (iv) the provision of statistical information
- (c) No individual permission is required for conformed plans.
- (d) Certain requirements, customs procedures and other controls are decreased.

Furthermore, the Government's Export Credit Guarantee Department provides a credit insurance policy which covers risks for non-payment, bankruptcy and unfavourable political changes.

This cover does not apply to U.K. branches of foreign companies, but it covers all exports by U.K. resident companies and their subsidiaries when they were sold under the term of payment of 180 days or less.

Also, customs and excise provide authorisation to businesses that wish to operate on a free zone.

Free zones include areas in which goods can move freely without any imposing of import and custom duties and VAT. Import duty and VAT will only be imposed when goods are taken out from the designated free zones or consumed within those zones.

When goods are processed within the zone for the purpose of exporting to countries within the European Community import duty does not apply. However, VAT will apply to all goods and services processed within the free zone.

Independent commercial operators are responsible for the development and promotion of each of the free zones. They should control the entry and exit of people, motor vehicles carrying goods in order to maintain isolation of the area from the public.



## 2! TAXATION FACTORS

### h TAXATION CHARACTERISTICS

#### TAXATION OF NON-RESIDENTS

A non-resident is liable to be U.K. taxed when he is trading or carries on business in the U.K.

Trading may be defined as manufacturing or performing services or finalises contracts in the U.K. Where a tax treaty is in existence there may be a liability to U.K. tax when there is a U.K. permanent establishment or branch or agent who may finalise contracts.

### i U.K. SOURCE INCOME OF NON-RESIDENTS

Withholding tax is deducted at source at the rate of 25%. However, this rate is reduced when a tax treaty exists. Withholding tax is a final tax for a non-resident company as 10% - 15% is deducted at the source where the income was derived. No more tax is required to be paid in Australia.

Withholding tax is deducted from interest, U.K. patent and copyright royalties and U.K. rents. Interest withholding tax (IWT) may be reduced to NIL because of tax treaties.

When a group of companies and after making the appropriate elections pay each other interest, this interest would be free of IWT when those companies are 50.01% owned U.K. Dividend income from a U.K. company or non-U.K. company are also free from withholding tax. U.K. bank payments to foreign companies or non-U.K. banks for a bona-fide carrying on U.K. business are free from IWT.

Interest on Bonds listed on a recognised stock exchange will be free of IWT when interest is paid by a UK company. Furthermore, free of withholding tax are discounts provided on U.K. deep discount or zero coupon bonds issued by a U.K. as an alternative to borrowing.

However, withholding tax is imposed in the following categories of income: film and royalties, equipment leasing rentals and entertainers and sports people who are not U.K. residents are subject to IWT at 25%

The following is a diagram that shows the U.K. source income of a non-resident.

DIAGRAM 4.2.3

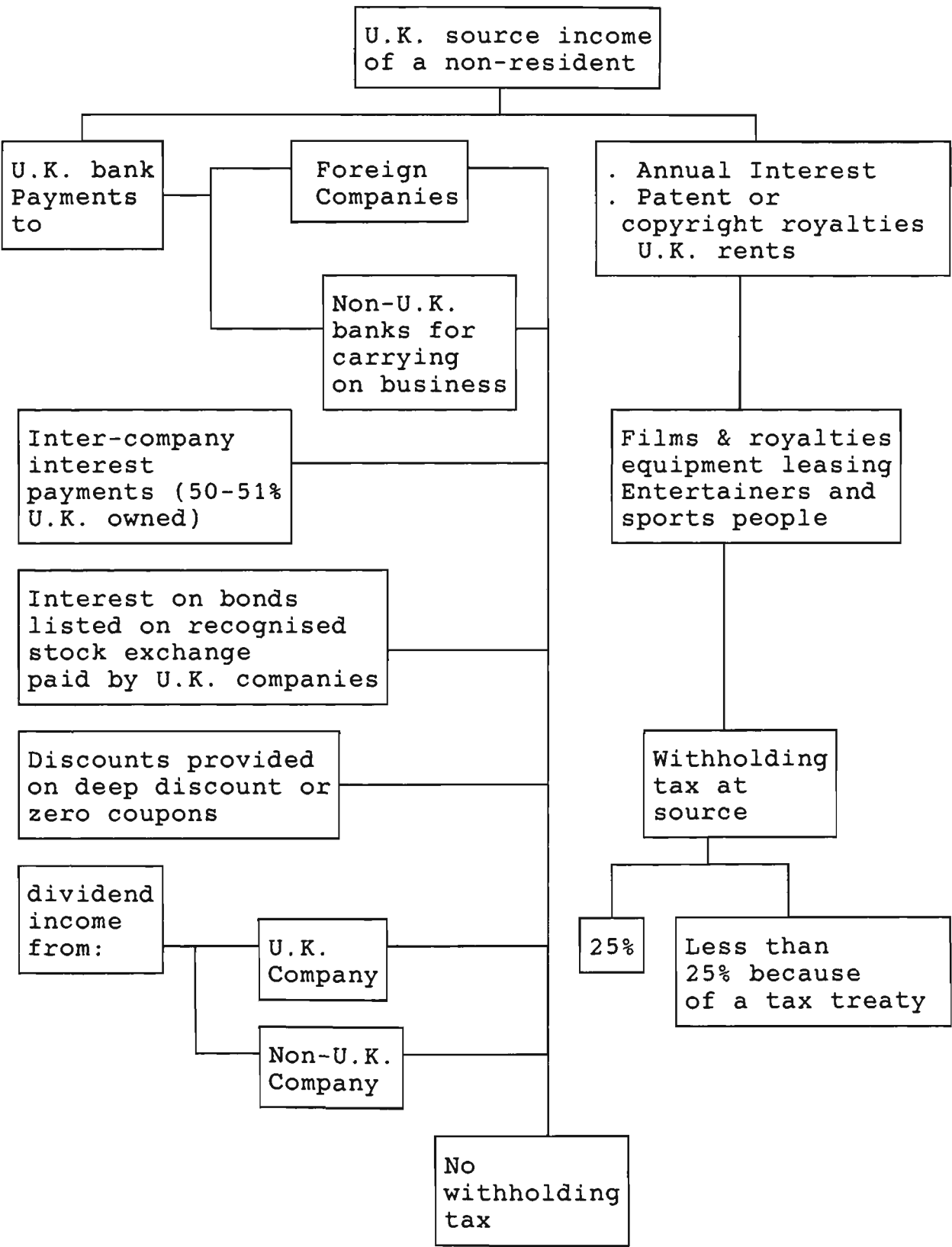


DIAGRAM 4.2.4

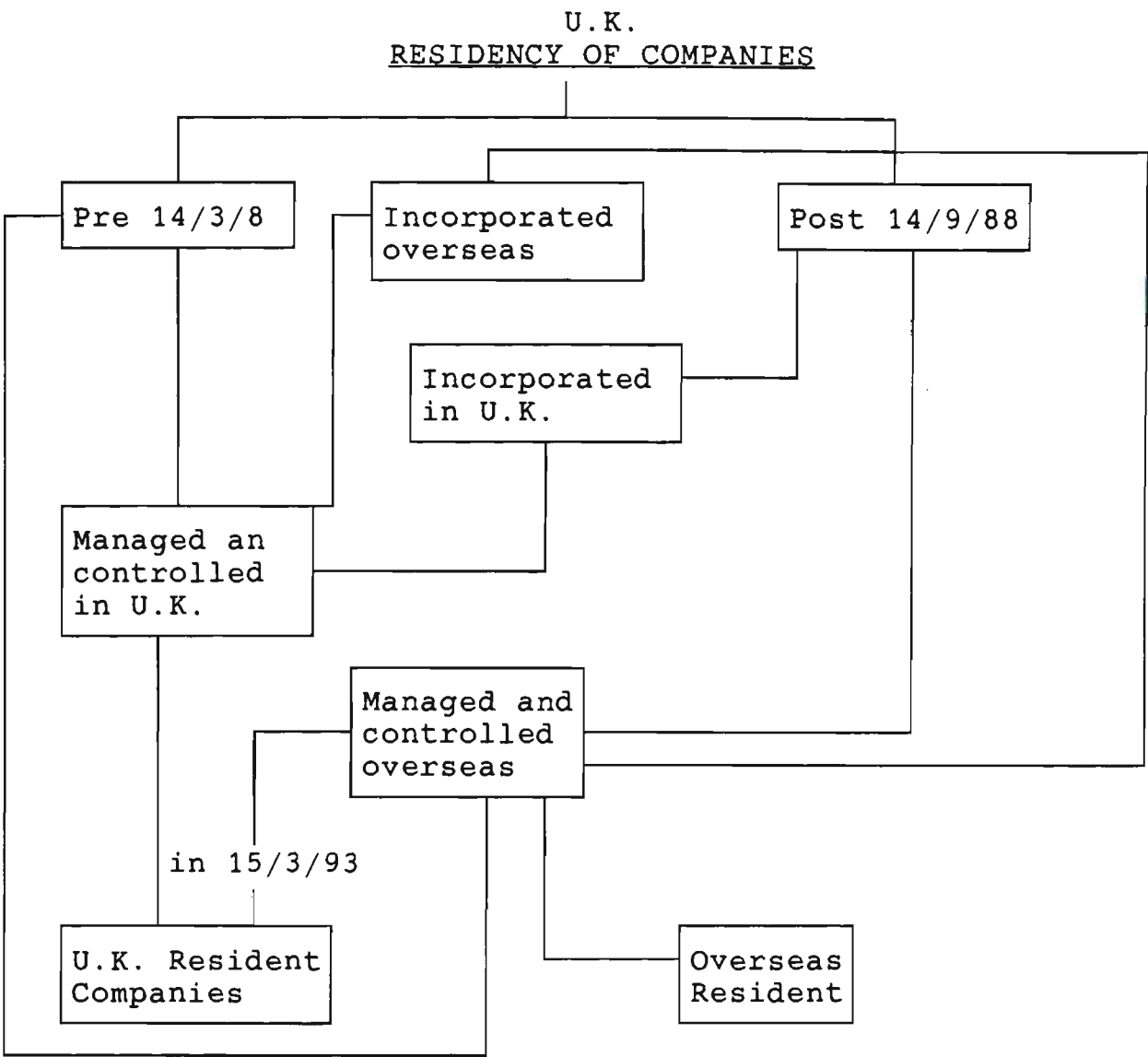


Diagram 4.2.4 shows that U.K. rules of residency have changed after 14th September 1988. Whether a company is incorporated overseas or in U.K. and has management and control in U.K. it is considered to be U.K. resident. However if it is incorporated overseas and it is managed and controlled overseas then it is an overseas resident.

However the above residency rules may change where U.K. has a tax treaty with a country that specifies that a company may not be a U.K. resident, although incorporated in U.K., where its management and control is located in the tax treaty company.

DIAGRAM 4.2.5

DIVIDENDS

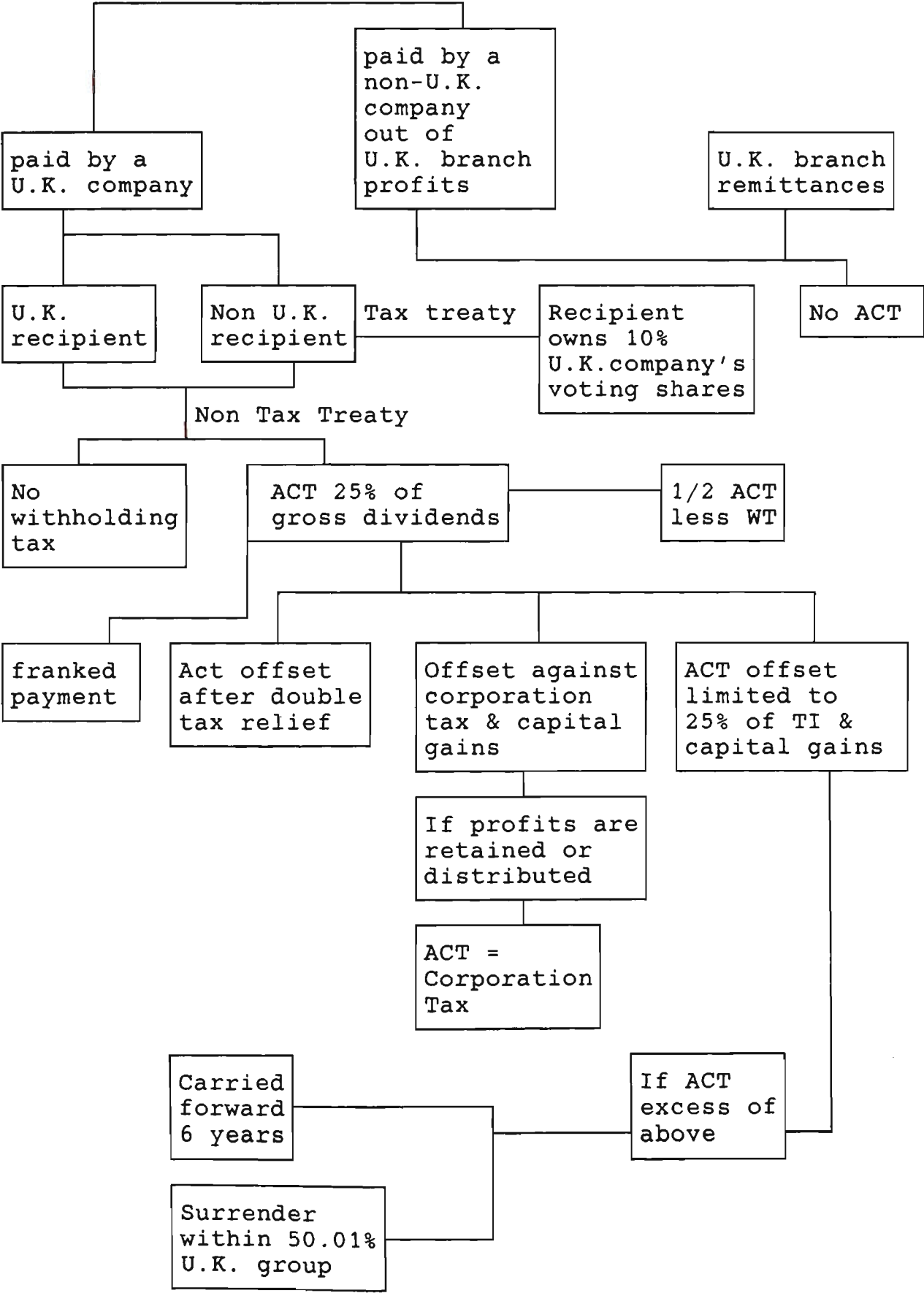
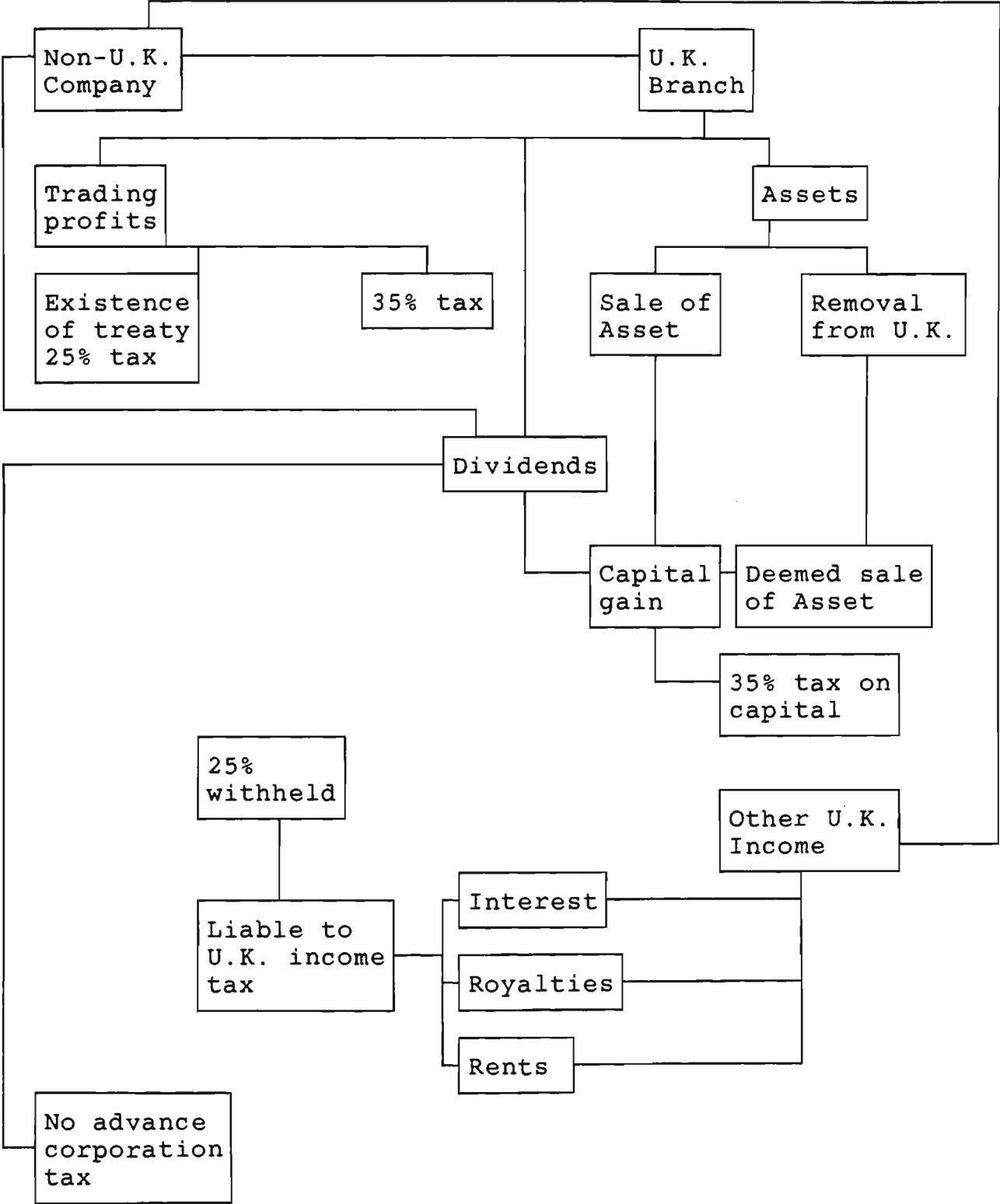


DIAGRAM 4.2.6

U.K. BRANCHES



## OTHER U.K. TAXES

Petroleum revenue tax (PRT) is a tax on profits which are derived in U.K. from oil and gas. The rate of this tax is 75% and it may be offset against any profits on which corporation tax is already levied.

Value Added Tax (VAT) is a tax imposed on the value of goods and services provided by a U.K. person including a U.K. branch and who is carrying on a business. The rate of VAT is a standard rate of 15% and apply to most goods and services. VAT also applies on all imported goods with various listed exceptions. U.K. persons may elect to register as taxable persons for VAT when they exceed the registration threshold. A quarterly return should be lodged with the Customs and Excise. The return should show the VAT on supply of goods and services and the amount, if any, of VAT that can be recovered and the amount owing to or from Customs and Excise. Supply of some goods and services are exempted or taxed at a zero rate. Goods taxed at a zero rate may be the exportation of goods and services.

These will also include construction of residential properties VAT burden is ultimately passed on to the consumer although is collected at any stage of production or distribution of goods and services.

Furthermore, banks would supply both VAT taxable and exempt services. In addition, banks are engaged in activities which are not under the VAT regime, for example, banks deal with foreign exchange dealing which is not considered to be a supply of goods or services. Although services that banks provide may be exempt others are zero rated. This would be the possibility of providing services to persons outside the EC and the Isle of Man.

Furthermore, intro-company charges, that is charges by a branch to the head office or other branches do not fall under VAT legislation because they belong to the same legal entity. In contrast, VAT would apply when U.K. incorporated bank or U.K. branch of an overseas bank apply charges to related companies. VAT, also would be accounted for where a U.K. company or a branch receive services, for example: advisory services for the business purposes.

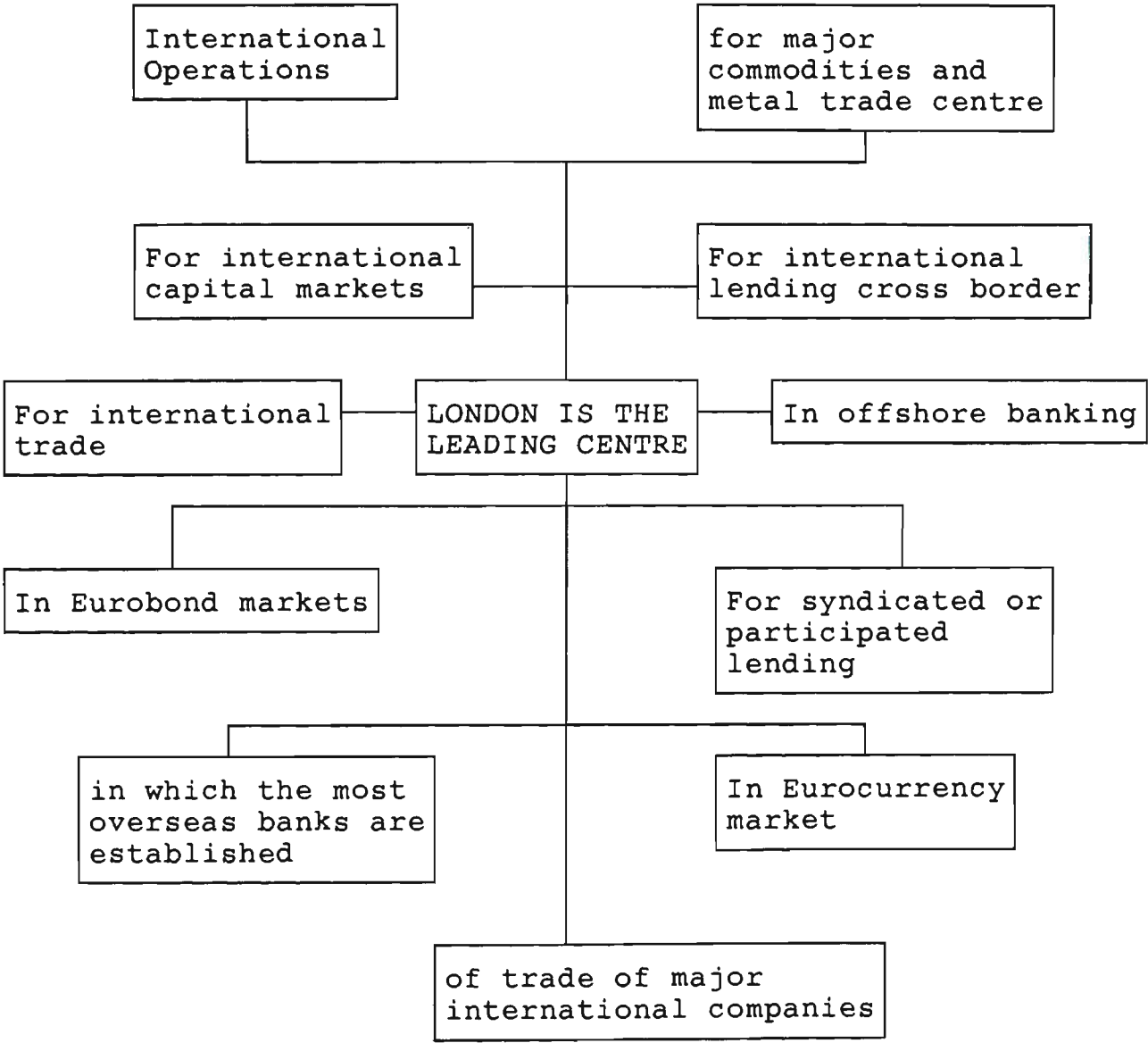
## INCENTIVES

In addition, London has a strategic location and U.K. non-residents like to be there in order to hold an administration or liaison office there for their worldwide activities. Provided that there are no high level decisions made in U.K., those non-resident U.K. company will not be liable to pay U.K. tax as they are not considered to be engaged in trading or carrying on business activities. Therefore, activities such as buying goods, collecting information or advertising products in U.K. by a non U.K. resident are not a U.K. branch activities but activities of a non-resident in a representative capacity. However, this U.K. office will only be liable on a national net profit equal to 10% and 15% tax of its overhead expenses incurred in providing those services.



DIAGRAM 4.2.7

LONDON - THE LEADING OFFSHORE FINANCIAL CENTRE.



(i) CONCLUSION

Diagram 4.2.7 shows that U.K. is the leading offshore financial centre of the world and has grown significantly due to the factors listed below:

The natural time zone that enables British Banks to conduct business with all financial centres.

U.K.'s location is also beneficial as it is close to Europe and Africa.

U.K. has also strong social, economic and political stability.

U.K. has highly advanced communication, has enhanced role as a trade centre.

U.K.'s financial system is the most advanced in the world. It is the leading centre of the world with a free environment which is ideal for the establishment of foreign banks.

U.K. has special incentives to attract business which is the foundation of a strong economic activity.

U.K.'s personnel is very skilled and U.K. has advanced research.

Exchange control is minimal.

U.K. is the host of Euromarkets.

The successful implementation of fiscal and legislative measures together with the increased efficiency and availability of services. The U.K. justifies its reputation as the leading offshore banking and financial centre of the world.

### 4.3 SINGAPORE

Singapore is a trading, commercial and shipping centre in South-East Asia. Singapore is situated on an advantageous geographic location on the crossroads of the Pacific and Indian Oceans. This location has contributed to Singapore's development as the offshore financial centre in the Asean region. In addition, the banking structure in Singapore has developed to such a state that it attracts funds from neighbouring countries when they have problems of inflation or currency problems.

However, with the development of the Euro market most of these funds began to flow to London as Singapore imposed interest withholding tax and liquidity requirements for banks. The Singapore government working with the Bank of America came up with the idea of developing the concept of establishing a currency unit, similar to the European Currency Unit as used in the Euromarket in London. This way the Bank of America could attract Asian non-resident deposits to its lending requirements. As a result of this Singapore government abolished interest withholding tax and granted its permission for the first Asian Current Unit (ACU) to Bank of America, in the late 1960's.

The Asian dollar market was then created developing Singapore into an international financial centre and boosting its economy.

a) LOCATION / TIME ZONE

Singapore is located in the centre of the south-east Asian region, has great natural resources, beautiful scenery and natural reserves and parks and a great potential for economic growth. It lies on a time zone that is 7 hours ahead of London, 2 hours behind Tokyo and 3 hours behind Sydney. Singapore's time zone is very convenient as it overlaps with the above major markets.

b) POLITICAL AND ECONOMIC SITUATION

Singapore is a parliamentary democracy with a ruling party named People's Action Party (PAP). The country's social, political and economic stability rates amongst the highest in the world. This is evident from the continuous foreign investment in Singapore.

Since Singapore's independence, the economic situation of the country has rapidly grown although Singapore has no natural resources. Singapore's economy has industries that are mainly export-oriented. Singapore has progressed to an economy that is based on international finance, higher value-added activities and technical skills.

However, the government still encourages industries which are labour intensive to increase capital investment. The Singaporean government is continually seeking new areas of growth and investment possibilities to stimulate the economy.

(c) COMMUNICATION FACILITIES

Singapore has excellent transport and communication facilities.

(d) SKILLED PERSONNEL

It has a vast educated work force with a large pool of professionals (in medicine, law accountancy and other related fields).

(e) LEGAL SYSTEM

Singapore was historically part of the British Colony and has continued with the Common Law system as its foundation law.

## f.1 THE BANKING SYSTEM, SECRECY AND EXCHANGE CONTROLS

The Monetary Authority of Singapore (MAS) was established in 1971 under the Monetary Authority of Singapore Act, 1970. It is a wholly-owned government corporation which acts as banker and financial agent of the government. The Ministry of Finance controls the Banking Sector through MAS. The Monetary Authority of Singapore performs all functions and activities except the issuing of currency that is the responsibility of the Board of Commissioners of Currency (BCC) which in exchange for gold in other countries issues Singapore currency notes and coins. Their backing is 100% in the form of external assets. MAS implements monetary and exchange rate policies and supervises all banks, financial institutions, insurance companies, investment, futures and trading advisers. MAS also acts as banker and lender to approved financial institutions and together with the Singapore Clearing House and with the assistance of Banking Pty. Ltd. acts as a Clearing House for cheques and local inter-bank settlements.

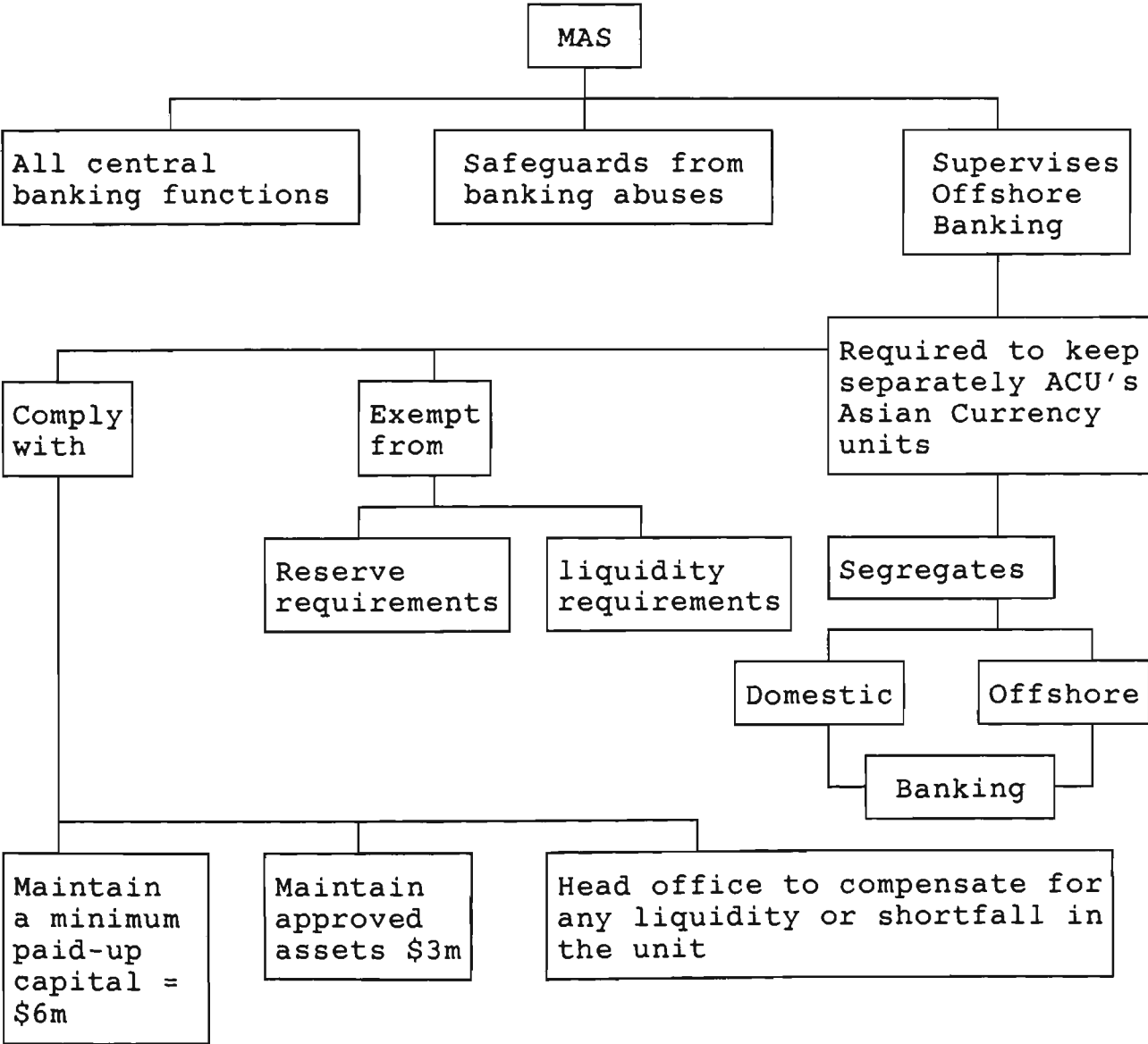
The MAS has powers to act whenever it is in the public interest to do so. The MAS may also act in the case where a bank or merchant bank cannot meet its obligations or is insolvent or about to suspend payments.

The MAS has the right to appoint a person to advise the banks or financial institutions. The Banking Act also permits MAS to revoke a bank's licence in certain cases. ie whether the bank has furnished false information when applying for a licence or is convicted of any offence or contravention under the Banking Act, or is carrying on a

business in such a way that the depositors interests are not protected, or has ceased to transact banking business either in Singapore or in its principal place of residence, or has made arrangements with creditors or has or will go into winding up or liquidation.

The following diagram shows the activities carried out by MAS.

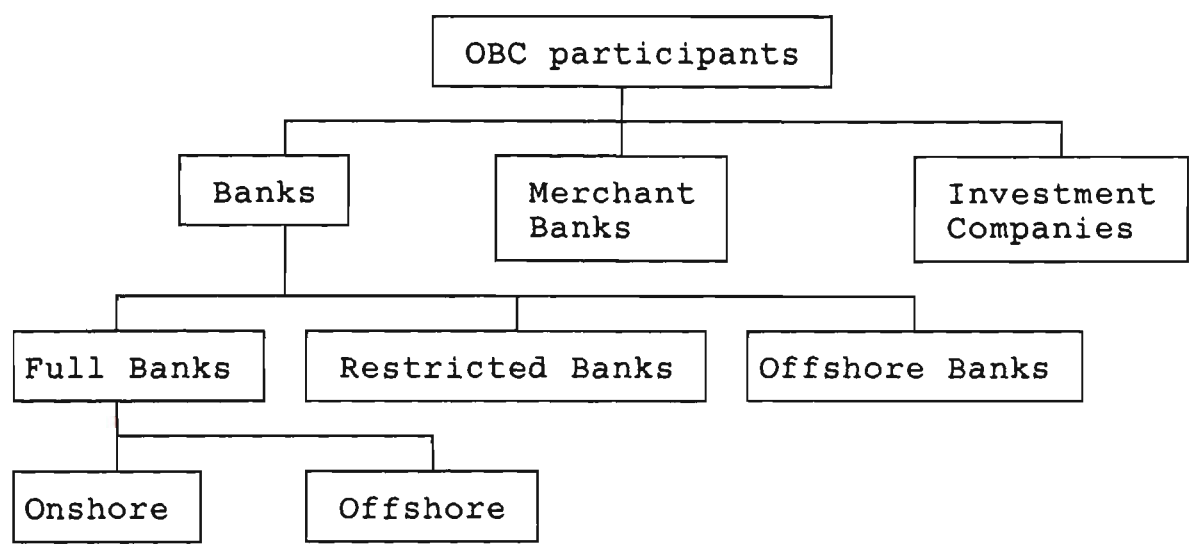
DIAGRAM 4.3.1



f.2 PARTICIPANTS IN THE SINGAPORE OBC

Singapore is a highly developed international banking centre. The following diagram shows the participants in the Singapore OBC.

DIAGRAM 4.3.2



In more detail, participants in the OBC are divided into three main categories: Banks, Merchant Banks and Investment Companies.

(i) BANKS

Banks are divided into three categories according to the type of licence issued:



### Full Banks

These banks may transact in both onshore and offshore business. They are active members in the Asian dollar market operating through the ACU's (Asian Currency Units). They are the only banks allowed to operate branches.

### Restricted Banks

Licences to restricted banks were granted to protect the fully licensed banks from competition for domestic deposits. These banks have restrictions in their operations. (ie cannot establish a branch, cannot open savings accounts or accept deposits less than a certain amount).

### Offshore Banks

Offshore licenses were introduced as an incentive to banks to consider Singapore as a centre for their international banking transactions. Offshore banks may only transact offshore. However, they can, under various conditions, transact with other banks and financial institutions in Singapore. This restriction aims to create no more competition for banks dealing with onshore business. Therefore, deposit taking and lending is restricted.

(ii) MERCHANT BANKS

MAS can grant approval to merchant banks to transact in the form of ACU's and arrange mainly syndicated loans. Their function is to arrange finance. However they are not allowed to take deposits or raise funds from the public, but only from fellow merchant banks, commercial banks, finance and insurance companies and the Post Office Savings Bank. Investment companies may also participate through ACU's, in the Asian dollar market.

(iii) ASIAN CURRENCY UNITS (ACU'S)

Financial Institutions who desire to be part of the Asian dollar market will have to set up a separate unit called the Asian Currency Unit. This is a separate bookkeeping unit known, for Asian dollar transactions, to guarantee that domestic monetary management is not disrupted by the flow of funds which come into the Asian dollar market.

ACU's conduct mainly the following business: Accept and make deposits, provide syndicated loans, borrow, investment management, deal in foreign currencies and floating Asian dollar bonds. ACU's function is explained in the following section.

### f.3 IMPACT OF FOREIGN BANK ENTRY IN SINGAPORE

Singapore is a country which has very little regulation. The entry of the foreign banks increased competition in the market especially for total assets, deposits and loans. At the same time the total market share of foreign banks has increased at the expense of domestic banks and this applied more to the commercial banking industry.

### f.4 TAX INCENTIVES AVAILABLE TO BANKS AND FINANCIAL INSTITUTIONS

As previously discussed, the ACU's are separate units, set up by a bank to record Asian dollar transactions. A special concessionary rate of tax of 10% applies on ACU "offshore income" so that financial institutions would increase their involvement in the Asian dollar market. "Offshore income" should be in foreign currencies and would apply to income from transactions such as income derived from loans to non-residents in order to be used offshore. These loans should have interest which is not borne directly or indirectly by any resident in Singapore. Offshore income may also be income derived from business of advising and confirming letters of credit on trade transactions which involve offshore countries or may be income derived from financing or re-financing offshore trade transactions with other countries irrespective of the existence of letters of credit.

Further income derived from any activities with banks or branch offices outside Singapore related to loans or fund placement, bills relating to offshore trade transactions and negotiable certificates of deposits can be considered as offshore income. The same classification applies to any income derived from management, underwriting, dealing and investing in bonds, debentures, fixed or floating rate notes, certificate of deposits, and income derived from any financial advisory services for non-residents. In addition, offshore income may be income derived from foreign exchange activities with offshore banks or branches, other ACUs in Singapore and non-residents. Income derived from any activities with ACU's, SIMEX and banks and branches and non-residents. These activities may involve gold bullion, gold futures and financial futures. The same will apply to any income derived from the provision of guarantees, performance bonds and standby letters of credit to another ACU, or non-resident (not related to a Singapore resident), income from fund management services provided to non-resident investors, income from providing services relating to remittances to an ACU or non-residents, and any income from transactions in interest rate or currency swaps for or with other ACU's and banks, branches or non-residents. Finally, income from other services related to offshore securities, may be classified as offshore income. This income derived by ACU's and securities companies approved by MAS are taxed at 10%:

- (i) when transacting on behalf of non-resident in non-Singapore dollar securities.
- (ii) from trading in non-Singapore dollar securities with:
  - a) non-residents
  - b) other ACU's and
  - c) other approved securities firms.

### INCOME DERIVED FROM SYNDICATED OFFSHORE LOANS IS EXEMPT

This exemption is designed to attract more investments. Tax exemption is provided to income which is derived by an ACU from a syndicated offshore loan which has at least three lenders and the syndication process is carried out in Singapore. Another condition is that the leading manager is an ACU in Singapore. In the case of more than one leading managers, half of them should be financial institutions in Singapore.

This scheme also includes certain under-writing facilities (ie floating rate notes, underwriting of bonds and others).

The exempt income which is derived by an ACU may be distributed to the shareholders of the bank. This income retains its nature to the hands of the recipient. Consequently it will be in the form of exempt dividends. If the shareholder is a holding company with a majority of the beneficial interest in the issued capital of the bank which receives the dividends then the holding company may distribute these dividends which will still be exempt income in the hands of the shareholders.

The Singaporean Banking Act has a prohibition of disclosure of information of customers' business with the banks. However, there are certain situations in which the banking secrecy is lifted. These include certain investigations and inspections that could be carried out under the Banking Act. If information has been given to MAS,

this information is of a confidential nature and should be kept as confidential. In addition, aggregate information could be available freely because it does not jeopardise secrecy.

There are no foreign exchange controls and potential investors are not required to ask for local capital participation. They have the right to withdraw any funds they want.

The currency of Singapore is the Singapore dollar. The Singapore dollar is valued on the basis of a fixed relationship of the Singapore dollar to a trade-weighted basket of currencies which represent the major trading partners of Singapore.

The Monetary Authority of Singapore is responsible for any exchange control transactions although exchange control is totally liberalised. This facilitates a free flow of funds between the offshore banking centres and Singapore.

g. SPECIAL INCENTIVES

A tax exemption for 10 years is given to pioneer industries which are involved in the production of new products. This exemption provides a dynamic and strongly based economy whose continuation and future plans supply the confidence needed for continuing international financial business, known, appreciated and desirable.

The exemption applies to approved industries which have both manufacturing skills, advanced technology and large capital investment. This pioneer status may also be granted to enterprises which are involved in engineering, technical and

computer-based industrial designs. More than one enterprise manufacturing the same product may be granted the pioneer status which may start from the official production date. Pioneer losses may be offset against subsequent pioneer profits. However, when a pioneer loss is not absorbed during the 10 year period, the loss may be carried forward to the post-pioneer period which may be offset against non-pioneer profits. The above is possible as long as there is a continuity of ownership not less than 50% during this pioneer period. In the case of profits from non-pioneer trade those profits are subject to normal Singapore Tax. Pioneer profits are distributed to shareholders as tax-free dividends.

Existing business may apply for exemption from tax for a period up to five years. This may be achieved because the entity wishes to expand by investing of at least S\$10 million on productive equipment. This is possible because the capital expenditure will generate additional income.

The Government may grant a tax exemption up to 90% on their export profits when the entity is engaged in the manufacture of products or is engaged in deep sea fishery for export purposes. The export sales must at least be 20% of total sales amounting to S\$100,000. As a result 90% of the export profit will be exempt from tax while the remaining 10% plus any other profits from domestic sales will be taxed at normal rates. This will decrease the tax on export profits to 10%. Those 90% profits are adjusted and are distributed as tax-free dividends to shareholders.

Furthermore, exemption applies to the export of manufactured goods or produce in Singapore where annual sales exceed S\$10. For a period of 5 years 50% of export income is tax free. Tax exemption will also apply to dividends paid out of export profits.

Entities involved in providing certain qualifying services have concessional tax treatment. These may be export of services that relate to technical services (ie construction, engineering etc.), consultancy, management, supervisory or advisory, fabrication of machinery and equipment, computer related services, professional services (ie accounting, legal, medical etc.), training services, any other prescribed services. An exempt dividend may be declared out of a 90% incremental base of the above income.

In addition, overseas income from professional, consultancy and other services has a unilateral tax credit in the case of absence of a double tax treaty with Singapore. Foreign loans for approved productive equipment may be free from IWT when they are used to buy productive equipment. This is an incentive which is provided to promote capital investment in Singapore.



Interest withholding tax would normally apply on fees and development contributions. However, when development contributions are made for the public interest, IWT may be reduced to NIL or 50%. Exemption on warehousing and servicing applies when the above services are provided for technical products which require annual capital expansion on building and equipment of at least S\$2 million.

An approved Operational Headquarters (OHQ) is granted a 10% tax concession on all income which is derived from services provided to subsidiaries located outside Singapore and additional tax exemption on all foreign sourced income. In order to be approved a company must not only have investments in subsidiaries outside Singapore but it should also provide supporting services to those subsidiaries. Supporting services would include administration and business planning and co-ordination, sourcing of new materials and components, research and development activities and other technical, marketing and sales support. Supporting services would also include any management, personnel financial and treasury and other services that might be of any economic benefit to Singapore. Therefore an OHQ application to be successful requires a level of paid up capital and a level of management and professional personnel. The aim of the OHQ Incentive Scheme was to encourage multinational corporations, including international financial institutions, to have their regional headquarters in Singapore.

Companies who are based in Singapore will be considered also as pioneer companies when they are dealing with counter-trade activities and fulfil the following conditions:

1. They have already established an international link,
2. They are dealing with specialist counter trades, at least one of the has its centre in Singapore,
3. Counter-trading is achieved by a separate established company.

Further incentives are provided to residents of Singapore, companies or individuals, when they are involved in a new venture which will benefit Singapore. Under this proposed scheme the benefits may be either economical or technological. The resident may deduct up to the full amount of investment.

In the case of a loss from the sales of shares, or from liquidation of the approved venture, a deduction is also possible. This incentive will apply to an overseas venture which has its centre in Singapore. When there is a difference between the sale and purchasing price of the shares a relief may be also provided. In the event of liquidation, the relief provided would be on losses suffered from the difference received from liquidation proceeds and the purchase price of shares.

Ships registered in Singapore carrying passengers, mail, livestock or goods under the Merchant Shipping Act are exempt from Singapore income tax on any income derived from these activities. This exemption also applies in the case of charter of those ships. As a result, to maximise the exemption, shipping entities do not claim depreciation allowance on the cost of the ships.

However, any loss incurred by shipping activities may only be offset against exempt shipping profits and may not be offset against any other income. Losses carried forward are subject to at least 50% continuity of ownership. The exempt shipping profits may be distributed as tax-free dividends to shareholders. Furthermore, shipbuilding may attract funds which increase further the business of the Singaporean offshore banking centre.

Hotels situated on Sentosa Island which service foreign visitors and therefore promote foreign investments are provided with special incentives. Incentives are reduced property taxes, allowances on buildings and others.

## 2! TAXATION FACTORS

### TAXATION CHARACTERISTICS

The government has provided various tax incentives which have the effect of reducing tax payable and of increasing foreign investment in Singapore. The foreign investor not only receives tax-free profits but is able to transfer those profits to his own country tax-free. This is achieved through the "tax sparing" article included in tax treaties (with 25 countries) where the foreign country has to provide the investor with a tax credit equal to the Singaporean tax which was waived.

- h.1 The Singaporean Income Tax Act provides tax exemptions for: interest received from moneys deposited with the Post Office Savings Bank (voluntary or mandatory), sources outside Singapore by a resident of Singapore provided that an approval has been granted by the Minister of Finance, certain Government Shares (Banks and financial institutions are not exempted), received by a non-resident company which does not carry on business in Singapore. The interest received should be from an approved bank in Singapore or from approved Asian Dollar bonds. The result is the attraction of foreign funds for the banks and improves negotiating with foreign customers in order to achieve lower interest rates.

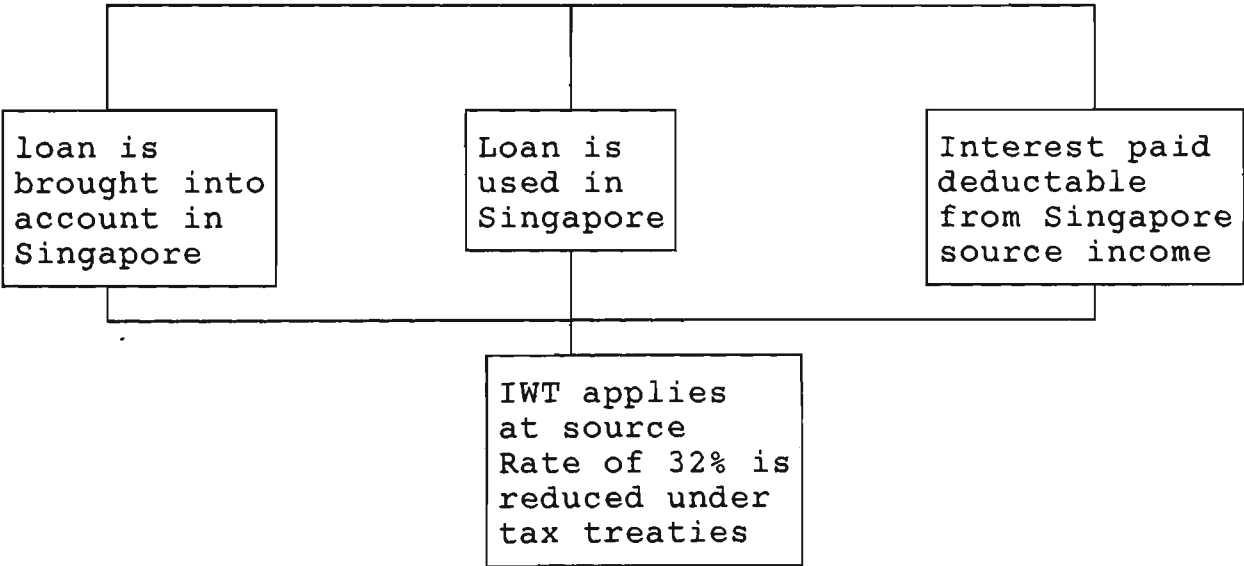
A non-resident is considered to derive interest when the loan is brought into account in Singapore, or is used in Singapore or interest paid is deductible from Singapore income. On interest derived from the above sources interest withholding tax applies at source and at a rate of 32%. However, this rate may be reduced under tax treaty agreements. Further, Diagram 4.3.3 illustrates the derivation of interest by a non-resident.

DIAGRAM 4.3.3

INTEREST

Interest is

derived when:



Singapore source interest is exempt from IWT when: is derived from fixed deposits with approved Singapore Banks, is derived from certificates of deposits, is derived from deposits in the Asian currency unit and defined as exempt under the Singapore Incentives Act.

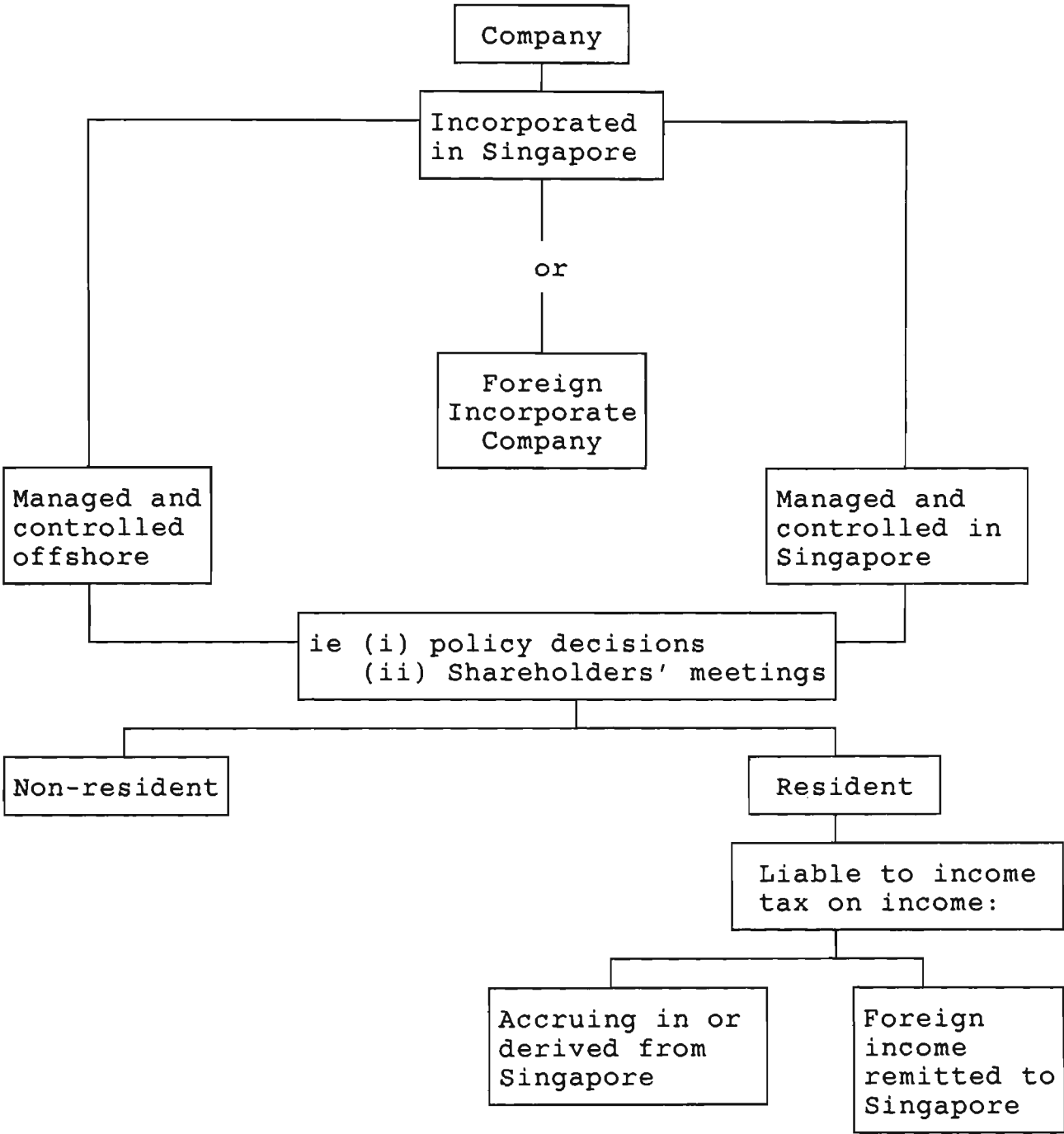
Dividends from Singapore are not subject to withholding tax at source. There is no tax imposed when: (i) a Singapore Branch remits profits to the Head Office which is situated offshore. (ii) a foreign company pays dividends out of profits that have Singapore source.

Royalties from any property registered in Singapore are subject to IWT deducted at source. However, IWT may be reduced to NIL or down to half under the Singapore Incentives Act.

Equipment, leasing, and rents are also subject to IWT. However, when the non-resident does not have a permanent establishment in Singapore it may be possible for the interest withholding tax to be reclaimed under a tax treaty. The rents when deducted from Singapore source income are considered to be derived from Singapore. Further, IWT applies to charter fees and management fees. In addition, direct tax applies on net rental income of non-resident derived in Singapore. If the employer deducts them from Singapore source income, then they are considered to be derived in Singapore and tax would apply on these fees. However, they are exempt from tax if the resident does not have a permanent establishment in Singapore.

In general, withholding taxes do not apply to Singapore source dividends. IWT apply to interest and royalties income at various rates which depend on the existence of a tax treaty. There is no tax imposed on capital gains and consequently there is no tax deduction available for capital losses.

DIAGRAM 4.3.4



The above diagram shows the company residency rules. A Singapore company is considered non-resident (even if it is incorporated in Singapore), if it is not managed and controlled in Singapore. Conversely, if it is managed and controlled in Singapore it is considered a resident, even if it is a foreign incorporated company. A resident company is taxed both on income accruing in or derived from Singapore and foreign income remitted to Singapore.

CONSTITUENT / TAXATION

DIAGRAM 4.3.5

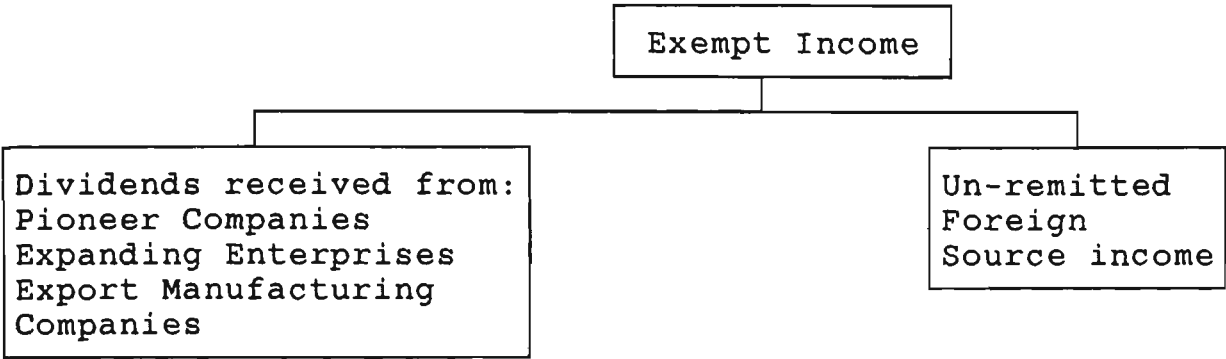
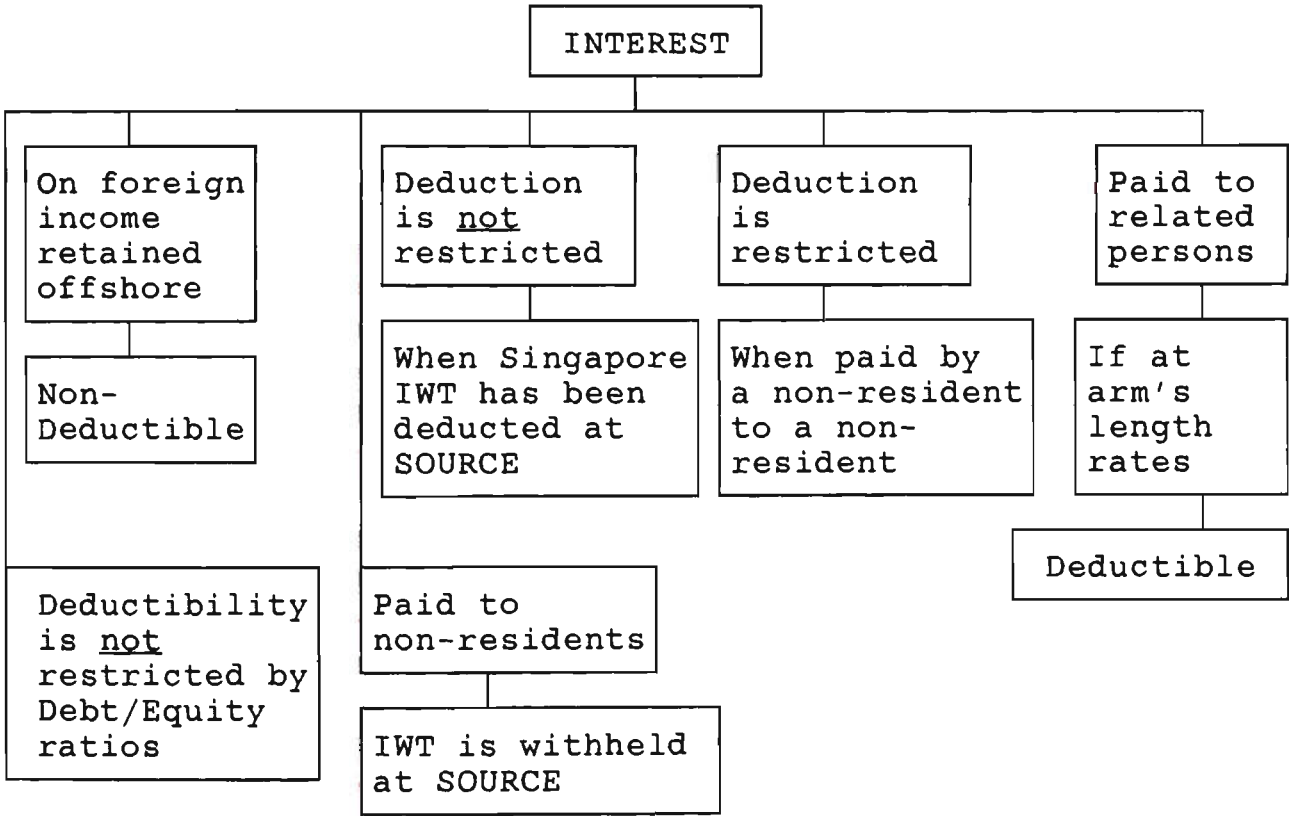


DIAGRAM 4.3.6

Derivation of Interest



TAXES AND LEVIES OTHER THAN INCOME TAX

Singapore treats tax in a minimum way and is commonly thought as a low income tax zone. However, there are a vast number of other taxes.

The following are taxes and levies other than Income: Land Tax, Stamp Duties, Sales Tax, Skill development levy, CPF (Central Provident Fund), Stamp Duty on authorised



capital of a foreign company, provided that a branch is registered in Singapore, Other taxes: Entertainment tax, film lure duty, tourist promotion duty, betting duty, private lottery duty, airport taxes, petrol duty, motor vehicle tax, and withholding taxes (which are not deductible).

### OFFSHORE FUND MANAGEMENT

Income deriving funds managed on behalf of non-residents by Singapore managers are taxed at the concessional rate of 10%. This also includes income derived from management of funds bonafide invested on behalf of non-residents in local stocks and shares.

Fund managers can participate in the scheme, if they are approved by MAS, even if they do not have an ACU licence. In addition, the income of the approved fund manager is taxed at 10%, making it attractive for managers to develop this type of international business. This offshore management arrangement appears to be unique in Singapore.

#### **h.4 INCOME DERIVED FROM INSURING AND REINSURING OFFSHORE RISKS**

This income is also taxed at the concessional rate of 10% and it has the purpose of stimulating re-insurance activities in Singapore. This also includes income from insurance of offshore risks, from accepting reinsurance covering offshore risks and

any dividend and interest income arising from investment of business of insuring and reinsuring offshore risks.

"Offshore risks" are defined in S 26 of the Income Tax Act (Singapore) and includes any risk outside Singapore which is related to direct general insurance of a non-resident or general reinsurance which is not less than 75% of the total risk of the gross offshore revenues. This appears to have special features unique to Singapore and designed to attract foreign business.

h.5 INCOME DERIVED FROM OFFSHORE GOLD BULLION, GOLD FUTURES AND FINANCIAL FUTURES BY AN APPROVED MEMBER OF THE SINGAPORE INTERNATIONAL MONETARY EXCHANGE LTD (SIMEX).

This incentive is covered by the Income Tax (Concessionary Rate of Tax for Income from Gold Bullion, Gold Futures and Financial Futures) Regulations, 1985. The 10% concessional tax rate applies to income derived by companies which are members of SIMEX from non-residents, ACU's and other SIMEX members.

The net income less 10% tax when distributed to shareholders is distributed as exempt dividends which are exempt from tax in the hands of the recipient shareholders.

## h.6 OTHER TAX RELATED INCENTIVES

These include stamp duty exemption on Asian Dollar Bonds, cheques, ACU Offshore Loan Agreement and other documents related to the loan and estate duty exemption on property of a person who at the time of death was not a resident nor had his domicile in Singapore.

## h.7 TAX INCENTIVES FOR ECONOMIC INCREASE

Any development that may benefit Singapore will be considered for assistance. Incentives are available under both the Income Tax Act and the Economic Expansion Incentives (Relief from Income Tax) Act.

For example the Capital Assistance Scheme (CAS) may provide up to 50% funding for projects which may improve and benefit Singapore. Also, Product Development Assistance Scheme (PDAS) provides funds to manufacturers who are in the process of developing new products.

There are also many other schemes in existence such as Industrial training schemes, Small Industries Finance Scheme (SIFS), which provides funds to small businesses, Investment in new machinery, Export credits and Insurance Schemes, and double deductions on certain expenditure which may be related to exports and research and development.

## i! CONCLUSION

The financial sector of Singapore has grown significantly due to several factors listed below:

1. Time zone advantage,
  2. Political stability,
  3. Rapid economic growth,
  4. Advanced infrastructure,
  5. Skilled personnel,
  6. Increased foreign investment,
  7. No exchange controls,
  8. Taxation system which operates amongst others incentives to promote offshore banking activities, offshore companies and shipping companies.
- Also the absence of withholding tax on dividends and certain categories of interest, are factors contributing to the increased business of the Singaporean offshore banking centre.

The offshore banking business in Singapore has grown at such a rate that Singapore may be considered as a model for a successful Offshore Banking Centre.

Especially, this was because of the success of the Asian dollar market which was due to the following main reasons:

- 1! the natural time zone position (GMT + 7), of Singapore enables Singaporean Banks to conduct business with all financial centres.  
  
i.e. (i) In the morning with financial centres in the Asian-Pacific region such as Hong-Kong, Tokyo and Sydney.  
  
(ii) In the afternoon with financial centres in Europe (ie London) and U.S.
- 2! Singapore's location is also beneficial. Singapore is close to all South-east Asian countries.
- 3! Singapore has very strong social, economic and political stability.
- 4! an advanced financial and telecommunications system which contribute to the development of investments and has enhanced Singapore's traditional role as a centre for trade.
- 5! the abolition of IWT in 1968 in order to make Singapore a comparable financial centre. Major international financial centres commonly having no interest withholding taxes. The interest withholding tax was on interest of foreign currency deposits earned by non-residents.

6! the taxing of Offshore transactions at the concessional rate of 10%. The following would be considered to be offshore transactions:

- Non-residents borrowing from Singapore residents.
- When transacting with a third country, any fees which are earned from providing finance, confirmation and advice.
- Income received from transactions between banks and ACU's outside Singapore.
- Income received from transactions in Asian dollar bonds and Eurobonds.

7! the exemption of syndicated offshore loans are exempt from tax, provided that most of the work is achieved in Singapore.

8! the taxing of management fees of the fund managers at the concessional tax rate of 10%.

The successful implementation of fiscal and legislative measures, together with the increase in availability and efficiency of services which are ancillary to the financial sector, ie telecommunications, transportation, and professional services has broadened the range of domestic and offshore financial activities in Singapore. As a result of the above Singapore has emerged as the major financial centre of South-East Asia.

#### 4.4 THE PHILIPPINES

The Philippines encourages foreign investment as the country has considerable capital absorptive capacity. The government, understanding the importance of capital in the economic development of the country, established an offshore banking centre. This was done to attract foreign funds to be invested in Philippines not only from non-residents but also from residents. The latter, intended mainly for the savings of Filipinos working overseas who because of the country's social, political and economic instability placed their funds in other financial centres ie. Hong Kong, Singapore or even London and New York.

Banks could accept deposits in any foreign currency and because of various restrictions applied by the Central Bank, the government to facilitate foreign investments introduced Offshore Banking Units (OBU's). Geographically the Philippines is located close to the successful International financial centres of Hong Kong and Singapore which were created beforehand. For the Philippines to successfully develop and expand it would have to be able to compete with those centres for a share of their market or to develop an entirely separate market.

##### (a) LOCATION / TIME ZONE

The Philippines, which is in the middle of East Asia, consists of over 7,000 islands bounded by the South China Sea to the west and the Pacific Ocean to the east. Asean countries and Hong Kong are its neighbours.

It lies eight hours ahead of London, one hour ahead of Singapore, one hour behind Tokyo and in the same time zone as Hong-Kong.

(B) POLITICAL AND ECONOMIC SITUATION

The Philippines has been unstable socially and politically. Political assassinations of leaders has led to a high degree of social, economic and political instability. The Philippines has a heavily regulated economy which is inward oriented and underdeveloped.

(c) COMMUNICATIONS FACILITIES

The Philippines telecommunications facilities are still at their infancy stage. The telecommunication network is inadequate. Telegrams, mail, and phoning overseas usually suffer from delays.

(d) SKILLED PERSONNEL

In the financial area there is a large pool of skilled and educated people who are doing work for which they are over-qualified because of the severe unemployment. Middle East countries employ Filipinos because of the low cost of labour in the Philippines compared to other Asian countries. Filipino workers send part of their earnings back to the Philippines increasing the country's foreign exchange reserves.



(e) LEGAL SYSTEM

A parliamentary system of government exists, derived from the U.S. model. Executive power is vested in a President and the Cabinet. The National Assembly has the legislative power, and the Supreme Court and the lower court have the judicial power.

(f) BANKING SYSTEM, SECRECY AND FOREIGN EXCHANGE CONTROLS

The Central Bank has all banking, non-bank financial intermediaries and non-bank thrift institutions under its authorisation and is in charge of regulation and supervision of above institutions.

The Central Bank must:

- (i) Maintain internal and external monetary stability in the Philippines and preserve the international value of the domestic currency.
- (ii) Exercise monetary credit and exchange controls.

Some of the banks are licensed to operate as offshore banking units, and some commercial banks and other banking institutions may operate foreign currency deposit units. These are of two types:

OBU's may be branches or subsidiaries of foreign banks. They may:

- (i) accept foreign currency deposits from non-residents.
- (ii) grant loans to resident and non-resident borrowers.

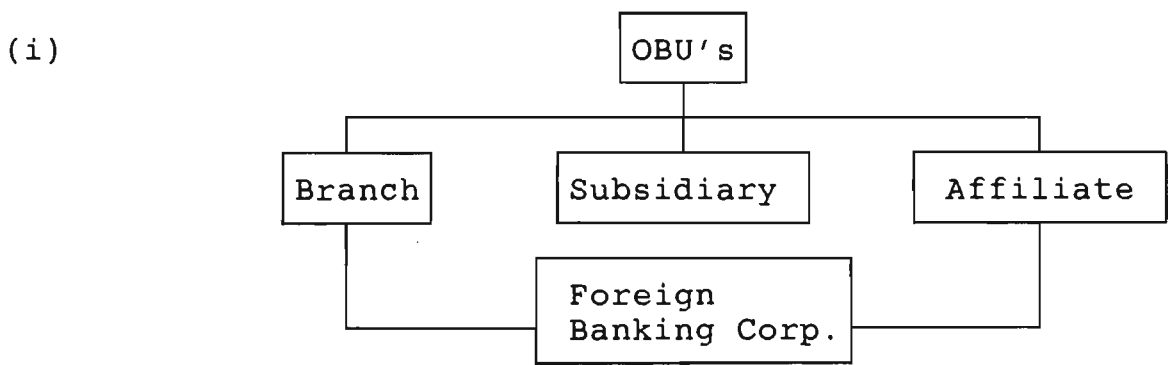
There are also the Foreign Currency deposit units (FCDU's). They may accept foreign currency deposits from residents of the Philippines.

OBU's may freely conduct foreign currency transactions with non-residents and with other offshore units. Offshore Banking Units may maintain accounts in domestic agent banks in order to pay costs and to pay local beneficiaries of non-resident Filipinos moneys from abroad.

OBU's are exempted from reserves and liquidity requirements.

The following are the conditions to be satisfied for OBU's:

DIAGRAM 4.4.1



Each OBU should be a branch, subsidiary or affiliate of a foreign banking corporation.

(ii) OBU's should use the minimum employees from overseas. In addition they should train personnel to hold specialised skilled positions in OBU's.

(iii) OBU's should keep:

- a) a deposit of \$1 million with the Central Bank or
- b) denominated government securities of \$1 million of foreign currency or
- c) assets approved by Central Bank.

OBU's may conduct amongst others the following business:

Borrow or deposit, extend loans and advances and engage in foreign exchange trading.

The Philippines OBC has dominant inter-bank sectors with funds coming from overseas but has not attracted any other investors, other than banks. Loans to non-bank customers, in contrast, are increased. This shows that offshore funds have been extensively invested.

The establishment of an OBC in the Philippines has eased the possibilities of residents to place their funds overseas. Local banks with a license of Foreign Currency Deposit Units (FCDU's) are permitted to have access to the offshore sector. As a result of this there are problems of a clear division between the offshore and onshore sectors.

Furthermore OBU's reports on financial transactions are not required to be officially examined. Although there is no evidence of the exact amounts of local capital channelled overseas to more stable Offshore Banking Centres it is believed that this is a substantial amount.

The establishment of OBU's to attract foreign inflows of capital has been successful. However this benefit has been overridden by the abuse of the OBC which has been used as a tax planning vehicle to support the inclination of Philippines citizens to place their funds in a high prosperity and economic and political stability Offshore Financial Centres.

### Taxation on Banks

Banks are taxed on: Gross Income from interest, discounts, dividends, commission, exchange profits, royalties, and rents. In addition net income is adjusted for certain not deductible items ie: extraordinary expenses, bad debts provision, provision for unrealised losses. All of the above are taxed at different rates.

All deposits with banks or banking institutions are considered as of an absolutely confidential nature and may not be examined unless the depositor has given a written permission or by a court order.

Also no official of banking institution has the right to disclose information concerning someone's deposits. Authorised banks may adopt a numbered account system and are not to ask the source of funds deposited in accounts.

Permission of the Central Bank is required to grant any new foreign investment and also when a foreign loan is made by a Philippine enterprise.

When approval is granted by the Central Bank to a foreign investment then the foreign investor has the right to repatriate all the proceeds of his investment. However profit may not be allowed to be repatriated before the end of a particular fiscal year. In addition, foreign loan repayments are allowed over the period of the loan. Further, interest payments on foreign loans are subject to interest withholding tax. All foreign royalty payments overseas by a Philippine entity are subject to Central Bank approval and to withholding tax. The Central bank has to grant approval for all capital outflows and inflows with the exception of certain banking operations.

(g) SPECIAL INCENTIVES

Special projects in investment in pioneer and non-pioneer activities. These companies must be owned by at least 60% Philippine nationals may be granted exemption from the payment of income tax. They may also be exempted from import duty or other taxes on equipment, value added tax, taxes on duties on raw materials and others.

Further, companies may be 100% foreign owned and operating in export processing zones. They must export all of their production available in j.1 plus others.

ie. Any equipment imported to be used on the "zone" is tax free and duty free, they pay no taxes except for real property tax.

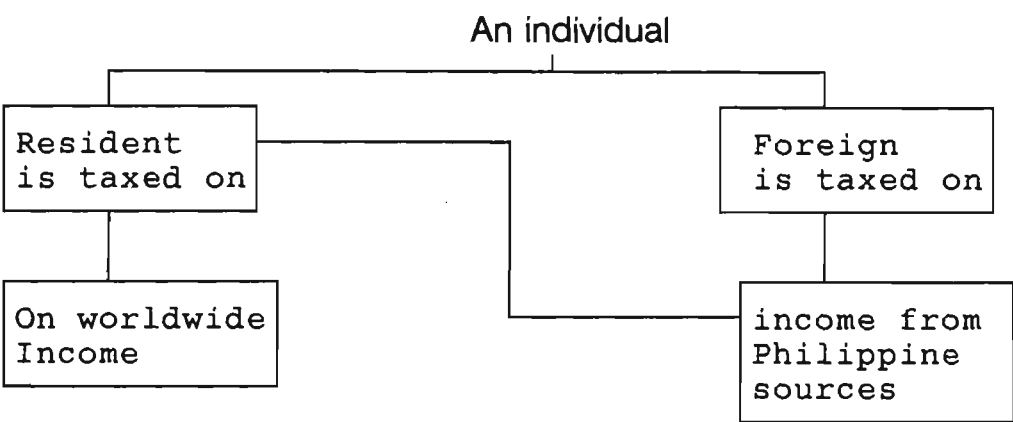
h TAXATION FACTORS

TAXATION CHARACTERISTICS

The following diagram shows that a resident is taxed on both the income from Philippine sources and on world wide income whereas a foreign resident is only taxed on income from Philippine sources.

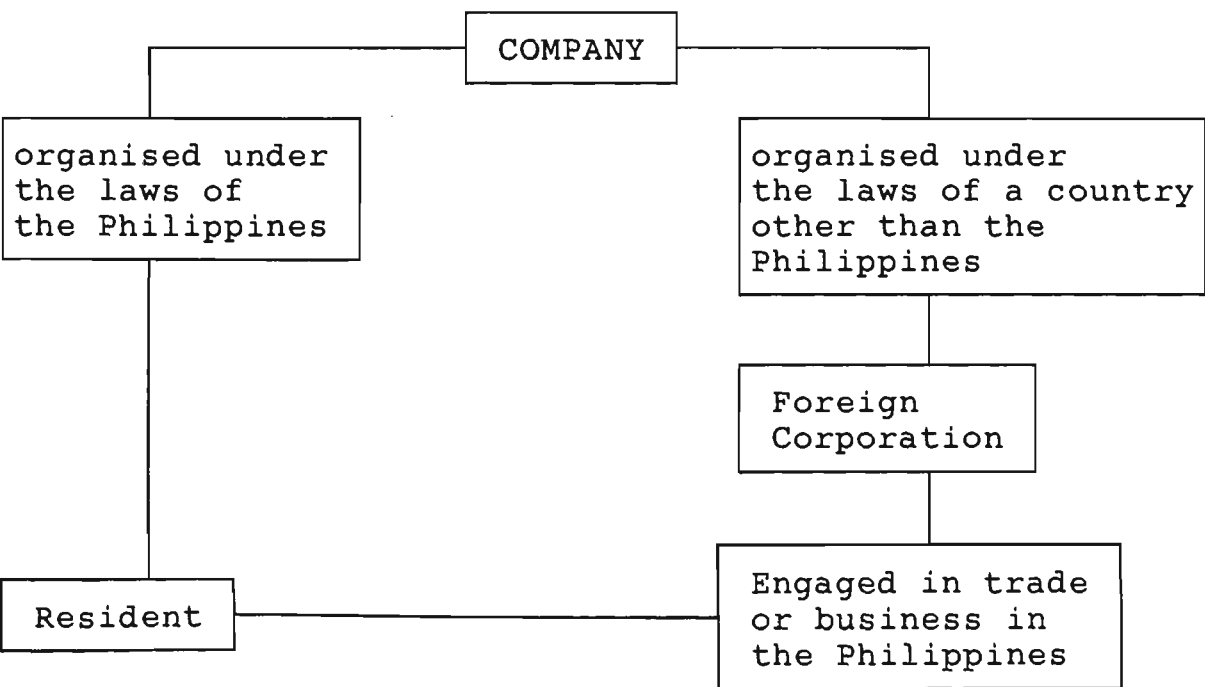
TAXATION OF INDIVIDUALS

DIAGRAM 4.4.2



TAXATION OF COMPANIES

DIAGRAM 4.4.3



The above diagram illustrates the residency rules for companies. If a company is incorporated in Philippines then it is a resident of Philippines. Conversely, if it is

incorporated overseas then to be a Philippine resident it has to engage in trade or business in the Philippines.

Trading profits received by a Philippine Corporation or resident foreign corporation are liable to corporate tax.

Exceptions apply to:

- dividends received from a company resident in Philippines,
- net capital gains from the sale of stock of a Philippine corporation.
  - (i) through a local stock exchange subject to various rates of taxes, and
  - (ii) listed and traded through a local stock exchange.
- international carriers carrying on business in Philippines,
- foreign mutual life insurance companies carrying on business in Philippines,
- interest income from foreign currency loans by offshore banking units to Philippine residents.
- interest on Philippine currency bank deposits and any other benefits from the royalties.

There are no taxes on accumulated income but capital gains apply except in the case mentioned in b).

Further, a taxpayer has to deduct IWT (at source) on interest paid on a foreign loan. Also dividend withholding tax will apply on dividends paid by a Philippine Company to a non-resident company. Tax treaties may provide decreased rate on IWT.

i. CONCLUSION

To conclude the financial sector of Philippines has the following advantages:

- (i) time zone (same as most Asian centres)
- (ii) skilled personnel

However the financial sector of Philippines has not grown due to the following factors:

- 1! Social, political and economic instability
- 2! Communication problems
- 3! Capital flight
- 4! Strict exchange controls
- 5! Not enough incentives to attract foreign investments
- 6! Heavy regulation on banking activities

The Philippines has unsuccessfully implemented fiscal and legislative measures. As a result it has failed to succeed as an offshore financial centre.



## 4.5 THE REPUBLIC OF IRELAND

### INTRODUCTION

The Republic of Ireland, called Ireland hereafter, has mixed characteristics of taxed sheltered manufacturing. These characteristics are the outcome of carefully designed structures which did not come as a natural development as in Hong-Kong. This economic policy was needed because of the need for the development of international bank facilities.

Ireland is often cited as a prime example of a successful offshore banking/financing centre. Located very close to United Kingdom, it has developed since 1949 as a commercial and trade centre. Ireland, which has great natural resources including a mild climate, agricultural land and beautiful scenery, has increased its industrial activities and foreign investment. The impressive development of a free trade zone in Shannon Airport and the Custom House Dock area in the centre of Dublin has confirmed its potential as an international trade centre. Therefore, the successful existence of international trade along with other factors including a favourable time zone, strategic location, excellent telecommunication network and airport, harbour and port facilities, advanced financial infrastructure and taxation incentives offered to non-residents has increased international investment in Ireland and has contributed vastly to the success and recognition of Ireland as an offshore banking/financial centre.

## 11 GENERAL FACTORS

### (a) LOCATION / TIME ZONE

Ireland is situated off the north west coast of Europe, 30 miles west of Great Britain. It is situated in the Greenwich Mean Time Zone.

### (b) POLITICAL AND ECONOMIC SITUATION

Ireland has been an independent republic since 1949. The government operates from Dublin, the capital city of Ireland. Ireland is a member of the European Community and has relations with most members of the European Community. Ireland has also business relations with United States and Japan. Ireland's economic policy was the 1950's stimulated privatisation and industrial revolution where industries grew rapidly.

One of the major factors for the above increase was the government's policy of encouraging foreign industry investments. This was achieved by offering incentives to export oriented companies to locate their industry all over the country, especially in areas which were less developed.

This created employment in:

- (i) manufacturing, and
- (ii) international service industries.

Goods and services to the public are provided by privately owned enterprises. Those goods and services in other countries are normally provided by their government.

Privatisation increases competition and provides better quality services with lower prices. Government agencies investigate avenues to increase foreign investment by providing substantial support to prospective foreign investors.

(c) COMMUNICATION FACILITIES

Irish telecommunication facilities are highly sophisticated and reliable, providing foreign investors with excellent service. Airport, harbour and port facilities are also commendable and reliable and underpin the needs of a safe and expanded economic base.

(d) SKILLED PERSONNEL

Personnel dealing with the financial and banking system are educated mostly at tertiary level and are highly skilled and are readily available for new ventures which are located in Ireland and assist investors with both initial establishment and further requirements needed to have a successful investment. In addition, the living conditions in Ireland are attractive to investors.

(e) LEGAL SYSTEM

The legal system is also derived from the British system and has a common law jurisdiction.

(f) BANKING SYSTEM

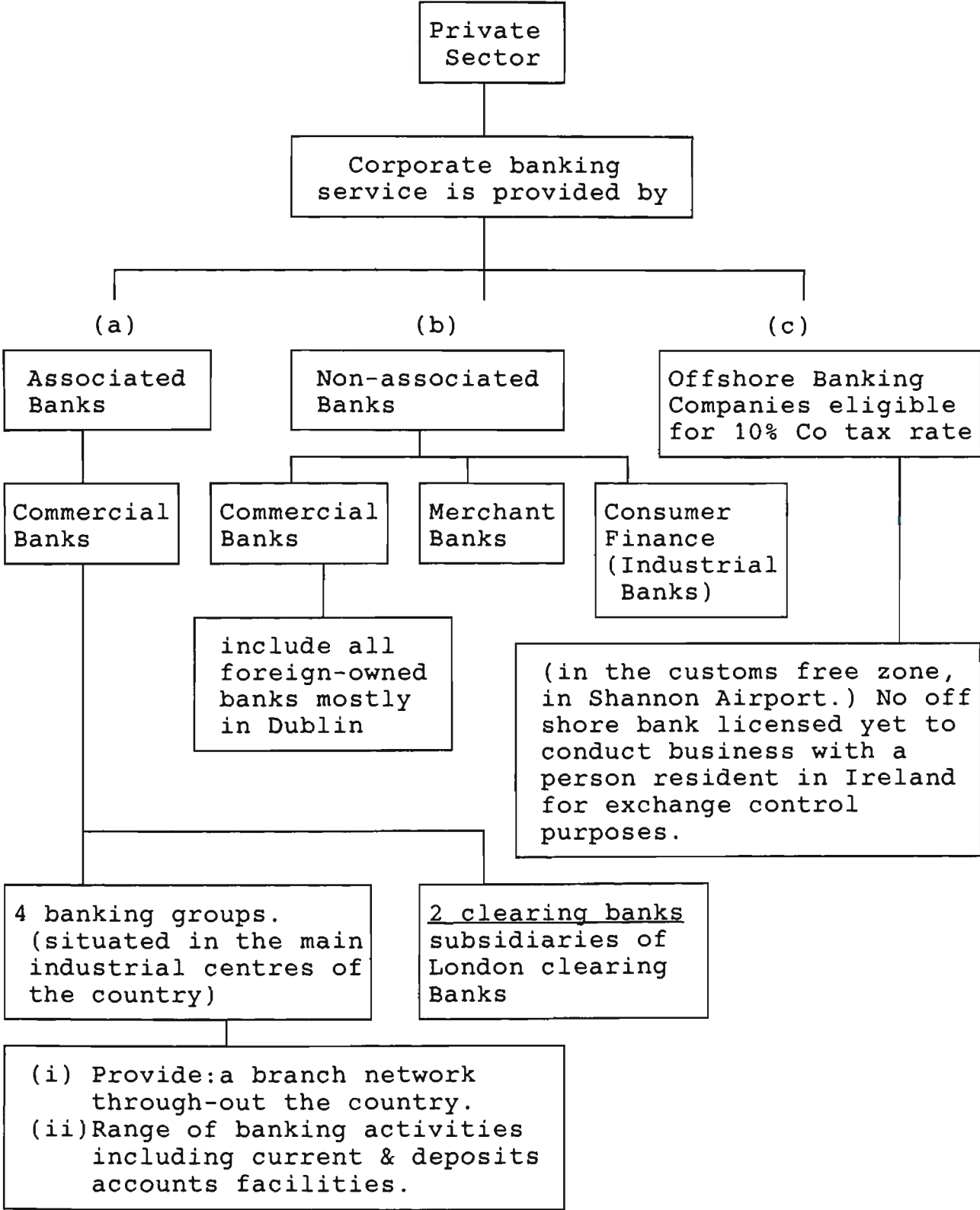
Financial infrastructure is based on the British system. Therefore it is sophisticated and provides excellent service in all sections in the local and international arena, especially with United Kingdom, United States and EC countries and Japan.

The Central Bank of Ireland controls the banking system, and issues the Irish Currency, controlling monetary policy and banking regulation. In addition, it has the main role of supervising banking in Ireland.

The banking infrastructure is also sophisticated and has prime connections internationally.

The banking infrastructure is shown in the following diagram:

DIAGRAM 4.5.1



There are also other banks that are state banking institutions and building societies or certain instalment credit and leasing companies.

### Licensing and Supervision of Banks.

The Central Bank Act, 1971, is responsible for the licensing and supervision of banks. The banking system has been influenced by the British, American, Japanese and European banks which had to strengthen their position in order to become competitive worldwide. "Becoming international" for the Irish banks has been achieved gradually. The Irish lending system is now "custom tailored" and the competition between banks for better service has developed a sophistication in the banking infrastructure requirements which provides excellency in customer service.

Bank lending with various banks on standard loans has different terms as banks work independently. Borrowing in other than the domestic currency may be facilitated without significant fluctuations because Irish financial institutions are directly linked with the Eurocurrency market.

### Finance Companies

These companies are engaged in:

- (i) treasury management operations
- (ii) foreign currency borrowing and lending

If they operate either in the Custom House Docks zone in Dublin or in the Shannon Customs Free Zone they only pay 10% tax on profit from:

- (i) the above transactions and
- (ii) on income management of trading enterprises.

When the building of low tax is achieved then income management strategy is applied to interest income which, then may make it possible to decrease the effective rate of tax on international transactions. This would be done by charges to group companies in high-tax countries. Tax treaties will be used to avoid withholding taxes (where possible).

Finance companies in Ireland do not have to meet the debt/equity ratio requirements that applied in many other countries. This lack of requirements makes Ireland an attractive place to situate one's headquarters there.

## Foreign Banks

The Central Bank has no separate classification for foreign banks. There are the Associated Banks and their subsidiaries of U.K. companies. There are countries like Japan, Italy and Federal Republic of Germany that are not represented. Foreign banks operate as branches which limits their operation ie. branches cannot operate some forms of tax-based lending. Foreign banks may offer all banking services but they mostly specialise on wholesale banking as it is useless to compete with an Associated Bank.

Foreign banks offer the following facilities: loan facilities, deposits in both foreign currency and Irish pounds, current accounts only to existing customers, foreign exchange dealings, investment management, and corporate finance.

Foreign Banks may be established in Ireland through a subsidiary company or a branch of a foreign company. A foreign bank, to be granted a license to operate in Ireland has to provide the Central Bank the following:

- (i) the possible benefits to Ireland
- (ii) the applicant's objectives
- (iii) the portion of representation in the applicants home country.



The Central Bank may be requesting the following from an applicant:

- 1) applicant should be an established financial institution in home country,
- 2) minimum share capital requirement of one million Irish pounds.
- 3) ability to comply with regulations.
- 4) guarantee by the parent company (in the case of a subsidiary),
- 5) management and control in majority may be required to be of Irish nationality or citizens of other EEC members,
- 6) senior management should be experienced in banking and proper and fit persons,
- 7) introduction of improved banking techniques that will benefit the economy of Ireland and attract new investments.

In addition, the applicant foreign bank must satisfy the Central Bank that although a foreign bank, it has both consistent economic targets and monetary policy with the Central Bank.

Finally, banks have devised three schemes to take advantage of tax incentives provided to investors. These are: preference share finance, leasing of machinery and equipment, and section 84 finance.

In preference share finance, some resident companies have trading income which may be fully tax free due to export sale relief or under the tax free zone exemption. Banks invest in redeemable preference shares in those resident companies. The bank receives its return as a preference dividend which has no tax. As a result the bank can lend funds at a lower rate, usually 1% or 2% over 50% of cost of funds.

Further, capital expenditure on new machinery and equipment can be taken up to 100% of cost in the first year.

Also the following diagram shows section 84 loans.

DIAGRAM 4.5.2

Section 84 loans (non restricted)

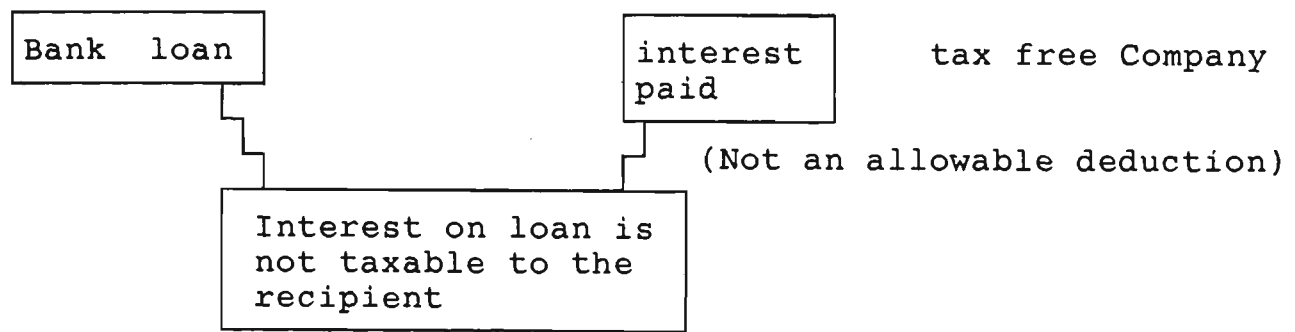
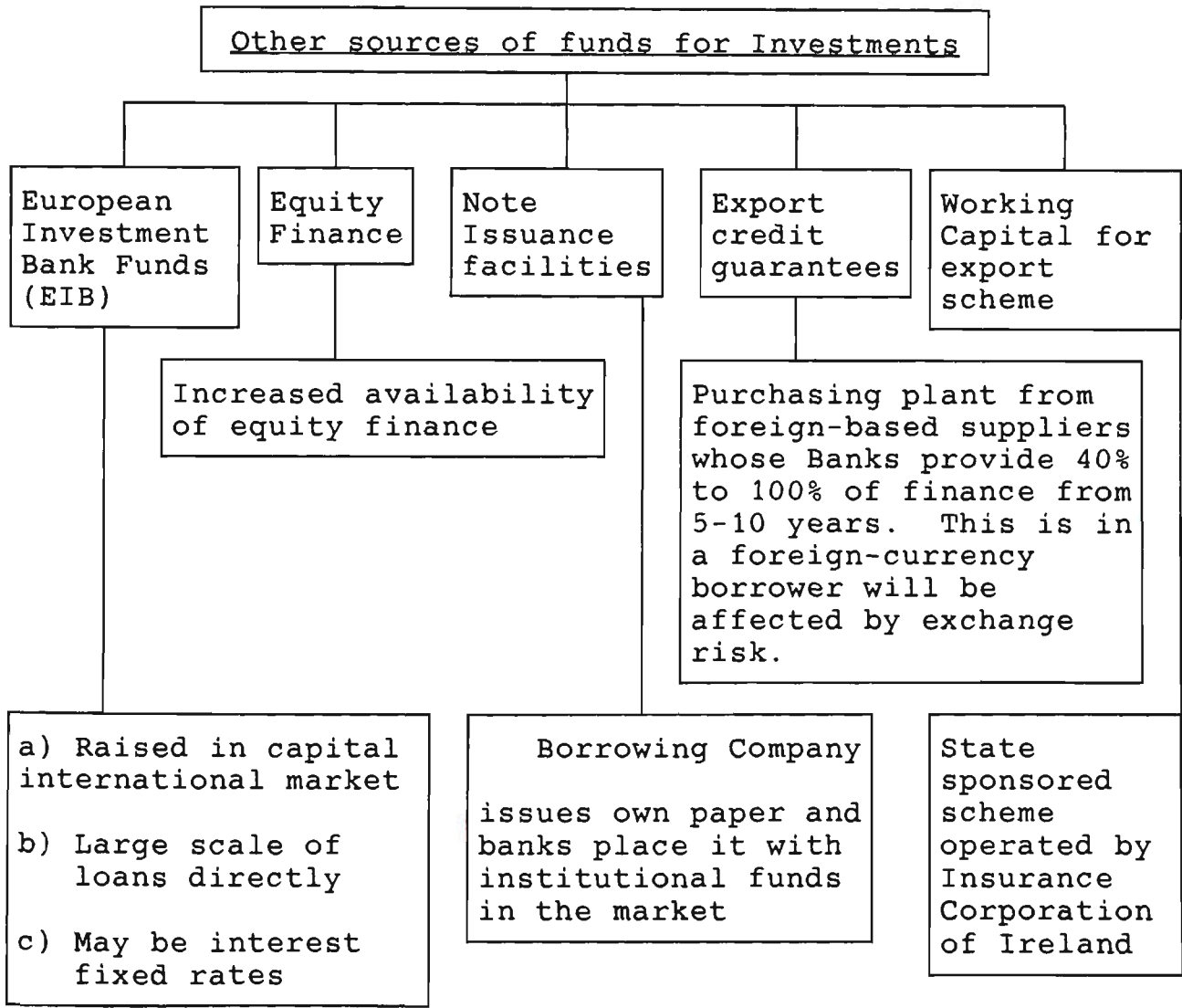


DIAGRAM 4.5.3



Further, the Taxation Department may investigate only under court order and only in very few cases because the client and the banks have a confidential relationship. Ireland authorities under certain double tax treaties may provide information to both Irish and Foreign tax departments.

The major concern of monetary policy makers is the deficit of the balance-of-payments. The Central Bank of Ireland issues statements on the growth in the private-sector credit. The Central Bank calls for supplementary deposits from banks in order to implement credit controls. This action magnifies the private-sector lending.

Foreign exchange controls are administered by the Central Bank of Ireland and their main purpose is to safeguard the country's reserves of foreign currency. Another purpose for these controls would be to control the changes of the movements on the balance of payments. This is achieved by not reducing the foreign currency reserves and by limiting the flow of speculative funds.

Companies Incorporated in Ireland and branches of foreign incorporated companies come under the exchange control regulations. Therefore there are exchange control regulations for the following transactions:

a) <u>Payments for exports</u>  In foreign currency or in Irish account  from a non-resident account.	b) <u>Receipts for imports</u>  Receipts for imports must be received  within 6 months of supply of import.
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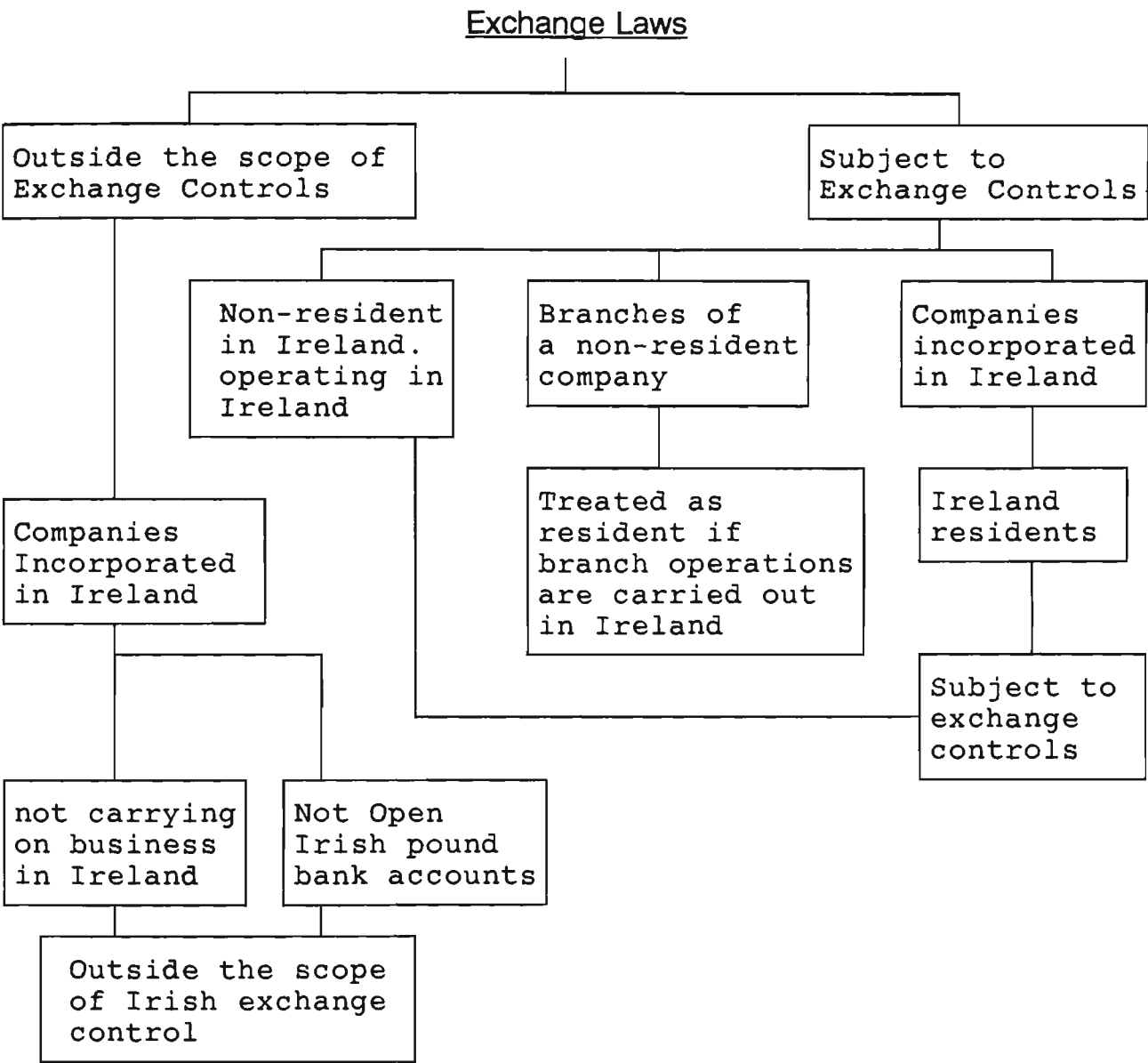
It is easy to gain permission for foreign investments in excess of IR£ 1 million into and out of Ireland as non-residents should finance fixed asset investments from non-resident resources.

If a company is situated on the "free zones" it is only subject to exchange control regulations when trading in local currency.

It is important to note that a company incorporated in Ireland is not subject to exchange controls when it does not carry on business in Ireland or has any bank accounts in Irish currency. (The above incentive is to be abolished in 1992)

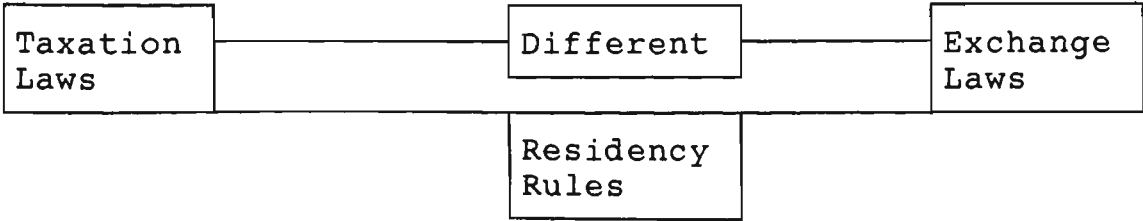
This diagram will illustrate the exchange laws that operate in Ireland.

DIAGRAM 4.5.4



The following diagram highlights the fact that residency rules in Ireland are different under Taxation Law and under Exchange Laws.

DIAGRAM 4.5.5  
RESIDENCY RULES



Exchange Controls are imposed on:

- (i) imports
- (ii) exports
- (iii) portfolio investments
- (iv) overseas bank accounts

Approval must be sought for all the above and in addition for any investments in European Community countries. Irish residents may not invest in other overseas countries without the Central Bank's approval. They should also obtain exchange control permission to open and maintain bank accounts overseas or Foreign Currency accounts with Irish banks.

However, non-residents (not including European Community Investors) may finance fixed assets through moneys from abroad. Permission is easy to obtain to send profits or interest to overseas investors, or they could repatriate profits by way of inter-company loans.

(g) SPECIAL INCENTIVES

United States are the leading investor in Ireland. However United Kingdom, Germany and Japan can also be included as part of the major investors. Ireland may allow accumulation of low-taxed trading profit but imposes high taxes on investments. (This does not apply to returns of the Irish government securities)

Tax free investments will apply when the investor is

- a) a non-resident and
- b) a 90% resident subsidiary (parent resident in a tax treaty country).

### INDUSTRIAL DEVELOPMENT AUTHORITY (IDA)

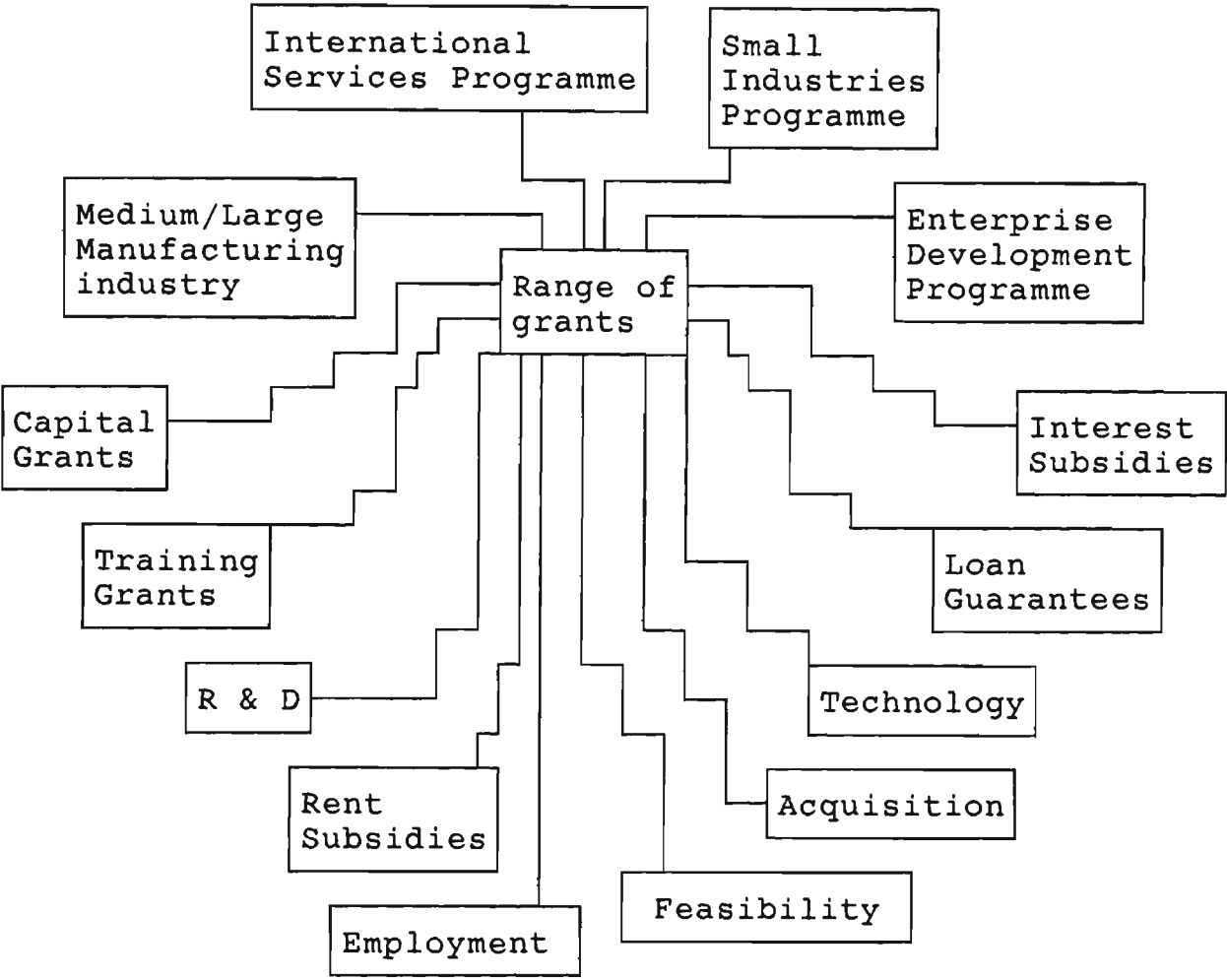
The IDA is an industrial development agency which promotes industrial development in Ireland by providing services to investors which start from preparing the initial contacts up to the finalisation of overseas investment in Ireland. Any project must satisfy the following special standards to be able to be eligible for assistance:

- a) Project should be engaged in the production of goods to be sold in international markets or
- b) Products may be of an advanced technological nature for both world wide and domestic markets or
- c) Products subject to world wide competition may be produced for parts of the Irish market or
- d) Goods may be services provided.

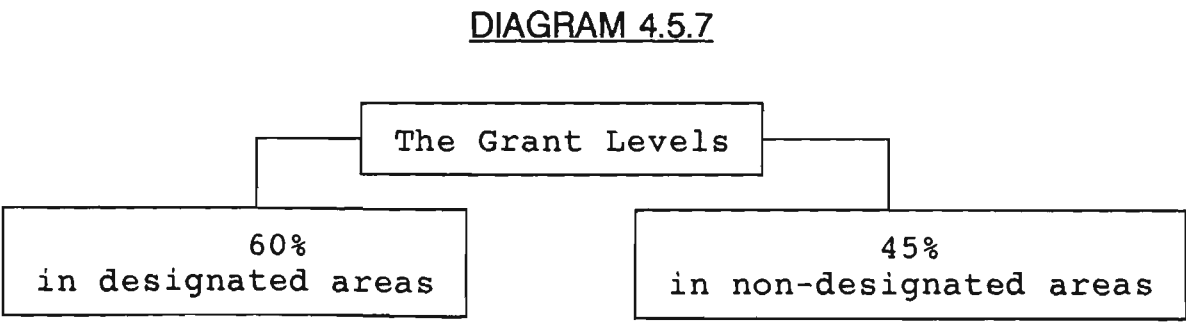
Further special information is required to show that financial assistance is needed and the proposal is commercially viable. In addition, the investor must show that the proposed investment will add to the development of the economy and will leave a positive return on investment and has its main functions (design, development, marketing and finance) located in Ireland.



DIAGRAM 4.5.6  
IDA PROGRAMMES



Other organisations are also established to provide grants to domestic industries and deals with the Irish speaking area. Those grants are given as follows:



The strengths of the economy, are fundamental to increase confidence in the use of Ireland for financial transactions backed up by several organisations, including the Shannon development, the Irish Goods Council, European Community, Bond Iascaigh Mhara and the Coras Trachtála.

Other incentives are provided to foreign companies which are carrying on the business of manufacturing and other specified operations. ie export oriented activities and international financial services provided within specified zones. The maximum applied rate on the above situations is 10%. Special relief is provided to both residents and non-residents. Also many other tax incentives are offered. Those are discussed below.

An important part of the overall design of the Irish International economy and its OBC is the arrangements for the Shannon Airport and the Custom house Dock International Area. This extends to the general level of activities and the associated need for international funding developments. Financial institutions exist because there are customers.

The manufacturing relief is charged on trading income derived by a company which carries out the business of manufacturing or other specified activities. These activities may be: the manufacture of goods for sale, research and development projects, repairs to ships, fish farming, operations on the Shannon Airport free zone and others.

The following are the most offshore areas set aside to attract business:

- (i) The Shannon Airport customs free zone (Shannon) is adjacent to the Airport where any person resident or non-resident may carry on trading operations as long as those operations are used to develop the Airport (not to run it). This exemption does not apply from 5/4/90 (for the new companies)
  
- (ii) The Custom House Dock area, adjacent to the centre of Dublin aims to stimulate international activities by providing the following tax incentives. For example there is a discount of 10% on corporation profits, exemption from rates, rent expense double deductions, 100% write-off of new building costs, 54% write-off in the first year of new building costs for lessors, and furthermore a write-off of the balance at 4% p.a..

The exemption (10% only tax) would be given from the Minister of Finance when the trading operations are carried on within the relief area, and when the above operations would develop the area as an international financial centre. Trading operations (provided to non-residents) may be banking services in foreign currencies, global money management, financial dealings in foreign currencies, insurance and related activities, and any related service to financial services.

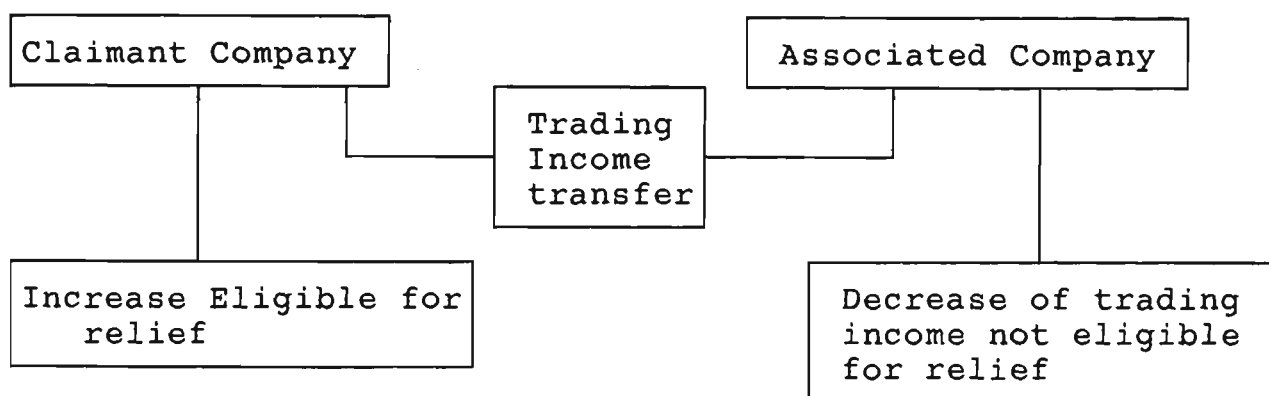
Further, companies operating at the specified Centre of Dublin and at Shannon Airport can pay interest to non-residents without deducting IWT and there are no property costs on businesses operating in designating area.

Inter-company pricing also applies. This must be of an arm's length transaction as they may be used for improper increase in the company's trading income which is eligible for relief and decrease of the associated person.

The following diagram shows the possibility of entering in an arm's length transaction and increasing the eligibility for relief.

DIAGRAM 4.5.8

Arm's length transactions



The above apply if the Associated person is a person who has control over the claimant company and if both claimant person and associated person are controlled by the same third person.

In addition, shipping relief of 10% applies on certain shipping activities from 1/1/87. This relief attracts more investment in certain activities related to shipping and more trade and banking activities which increase the promotion of Ireland as an offshore centre.

PATENT ROYALTIES EXEMPTION:

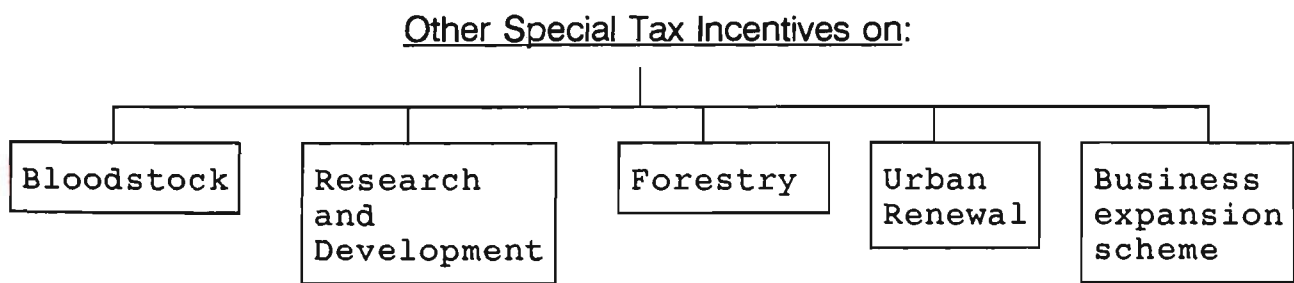
Further, there is an exemption from Irish Tax for qualifying patents. Those patents are issued for invention resulted from research carried out in Ireland. Dividends from above are free in the hands of the recipient. Foreign registration of patents recognised by Ireland tax authorities and companies register overseas which may be quicker to register.

TAX FREE GOVERNMENT SECURITIES

Government securities are also tax free. The objective of providing tax free Government Securities is to retain in Ireland surplus funds derived by foreign controlled companies from Irish trading operations.

Other tax incentives are shown in the following diagram:

DIAGRAM 4.5.9



Ireland has over 1,000 offshore investment firms which consider Ireland an ideal investment location because of its offered combined taxation and financial incentives.

For tax purposes new equipment may be written off in the first year. If a taxpayer does not pay tax then the deduction is useless. Therefore to gain the benefit from this allowable deduction an arrangement is made under a financial lease transaction to transfer those deductions to the lessor, who will then reduce the finance cost and the lessee will pay less. There are various special features of this type of financial lease.

## 2! TAXATION FACTORS

### TAXATION CHARACTERISTICS

The taxation system is favourable for productive investment as it provides a range of taxation reliefs and incentives to industrialists who want to set up an industry in Ireland, especially a manufacturing industry.

Taxes are divided into two main categories: Direct and Indirect Taxes.

These are illustrated below in the form of a table.

TAXES

<u>Direct</u> <u>Taxes</u>	<u>Indirect</u> <u>Taxes</u>
Income tax	Value added tax
Corporation tax	Customs & excise duties
CGT	Capital duty
Residential and property tax	Transfer
Gift and inheritance tax	Stamp duty
Social insurance contributions	
Health contribution	
Youth employment levy	

Banks are excepted from IWT. Normal 35% on interest on long-term facilities when payment is made to a non - resident by any person, and to a resident by non-banking company. Interest paid to a bank has no IWT (if it is carrying on business as a bank) to non - resident or resident. However if interest (paid or received was because of any other transaction) except banking then IWT will be imposed. IWT may also apply on gains on land disposal or shares deriving value from land at a rate of 35% or depending on a double tax treaty.

The imposing of withholding taxes is unusual for a successful centre. However, this is compensated by tax treaties with many countries under which dividends may be repatriated to a foreign parent tax free.

There are Tax treaties with many countries including three of the countries that are analysed in this thesis.

Ireland has Tax treaties with:

- a) United Kingdom
- b) Australia
- c) Cyprus

There are no tax treaties with Singapore and Philippines. The absence of a tax treaty makes certain jurisdictions non-comparable and double tax may be possible between the countries. Further, the absence of comparisons may have as a result the laundering of funds between countries and tax avoidance schemes may exist an international level. Non-resident offshore companies may pay interest on foreign loans without any restrictions imposed.

Under the Irish OBC model, the centre may deal not only with transactions between the second country and third countries (eg. Swiss - Cayman) but also with host country (Ireland) and second country transactions.

However, in the case of a resident Company, permission must be obtained by the Central Bank and withholding taxes must be paid. The tax rate will depend on the existence of a tax treaty.

Interest payment to a foreign parent may be considered to be deemed distribution of profits and therefore will not be allowed as a deduction.



Trading companies and financial service companies can be financed by means of low-cost loans (relieved from tax) and through leasing transactions.

Dividend withholding taxes are not paid in Ireland. After obtaining exchange control permission dividends may be paid to non-residents, or, profits may be accumulated to shareholders. In the case of an Irish resident, accumulation of profits will trigger accumulated profits tax. However, this does not apply to non-resident offshore companies.

### Taxation of Companies

Further, companies are divided into resident and non-resident companies. Resident companies are liable to tax on their worldwide income. Further, non-resident companies are non-labile to tax, unless the company derives income from an Irish source.

A company is a resident company of Ireland when its central management and control are located in Ireland. Place of incorporation is not a material factor to determine residence under Ireland residency rules.

Tax return requirements are on self assessment basis and the financial year is from 1 January to 31 December. The normal tax rate for Companies is 43%. However, from 1/4/91 it will be decreased by 3%. Taxes on capital are between 30% - 50%. Also stamp duty on transfers 1% - 6% on certain property and 1% capital duty chargeable on the issue of share capital.

Other taxation incentives are provided to increase economic activity and therefore boost business in the OBC.

An Irish resident company which carries on the business of manufacturing offshore may shift profits from a high-tax area to Ireland. (Manufacturing business is taxed only at 10%). However transfer pricing provisions apply to most countries which may prohibit the accumulation of low-tax profits in Ireland. Anti-avoidance provisions could apply to transactions which are not arms length, and in a case there is a loss in Irish tax. Conversely where there is no loss in Irish tax, there is no possibility of the above to happen. As a result of the above a non-resident (tax resident in another financial centre) Irish incorporated company can be used as a trading company with all previously mentioned advantages.

If imports to Ireland come from countries outside the European Community then customs duty will apply.

Administrative type services provided by those companies to non-Irish members of the multinational groups located on the two specified areas at Shannon Airport and the Centre of Dublin.

Those services which qualify for the 10% concessional tax rate may be services based on fees and back office operations, treasury management operations (ie accounting, information and others).

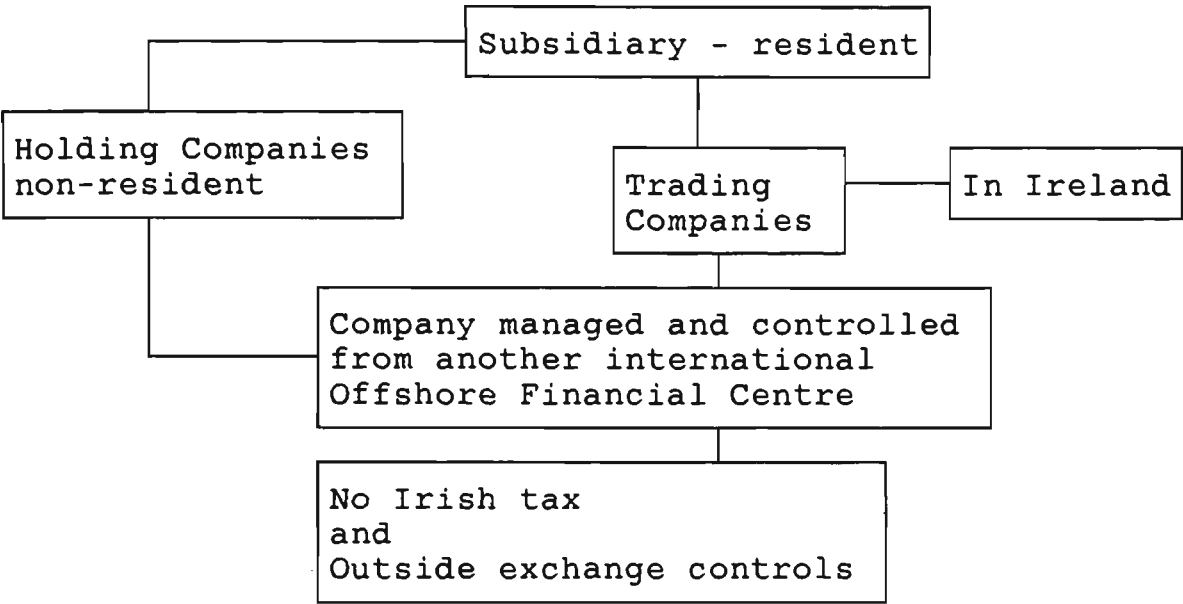
These activities require physical presence and are of high quality although costs are very low compared with international prices. As a result profit shifting to Ireland may be commercially justified.

The concessional rate of 10% tax on profits is available to shipping companies which are registered in Ireland and are Irish-owned.

Offshore companies, incorporated in Ireland but owned by non-residents, can derive income from sources inside or outside of Ireland. Such companies leave the benefit of a 10% tax rate and have the ability to use tax treaties to their advantage. An Irish trade is carried on by a branch of a non-resident company and therefore a 10% tax rate applies on trading profits. In addition, if those profits are invested then those profits may be earned by the non-resident company. As a result no Irish tax is paid on the above investment income.

The following diagram shows the operation of offshore companies in ireland in a form of a diagram.

DIAGRAM 4.5.10



Offshore companies payments to shareholders are not subject to Irish taxes unless the company is managed in Ireland. If it is managed in Ireland it has an Irish residence, and then withholding taxes may apply when the payments are interest royalties or dividends.

There are general tax law provisions on taxation of income and other gains that makes Ireland advantageous as a location for offshore companies carrying on business as holding, licensing, trading, financing, administration or shipping companies.

A resident offshore company may repatriate share capital or loans to the home country after obtaining permission from the central Bank. A holding company should not be located in Ireland as repatriation of profits will attract full tax. Furthermore

establishing appreciating foreign subsidiaries through an Irish company is not wise as Ireland has high rates of capital gains tax.

Anti-avoidance legislation prevents abuse of system by companies. However, legislation does not apply to non-residents.

### Other Taxation Characteristics

Income tax rate on trustee's income is 30% and that income is taxed separately (ie not added on other income). Parents are prohibited to divert income to children. A surcharge of 20% is imposed on that income that is not distributed to the beneficiaries.

### Capital acquisitions tax (gift and inheritance taxes).

Irish trusts are not used for international tax planning because of high tax rates and exchange control requirements.

(i) CONCLUSION

To conclude, the financial sector of Ireland has grown due to several factors listed below:

- 1! Time zone advantage,
- 2! Rapid economic growth,
- 3! Advanced infrastructure,
- 4! Availability of support services,
- 5! Skilled personnel,
- 6! Availability of special incentives including taxation, to promote foreign investments, increase business and therefore economic activity and consequently being made comparable to other Asian centres such as Hong King.

Ireland has implemented fiscal and legislative measures in an efficient way to emerge as a successful centre in north-west Europe.

## 4.6 CYPRUS

### INTRODUCTION

Cyprus is the third largest island in the Mediterranean Sea. Cyprus has suffered many foreign attacks through the ages because of its strategic position. The latest was in July 1974 by the Turkish army which resulted in the island, which has an area of only 9,251 square kilometres, being divided into two parts. The northern part, which is still occupied by the Turkish army, and the southern part, which is the free part of Cyprus governed by democratic rules. This part has emerged to steadily become a successful primary offshore business and shipping centre because of the genuine commercial considerations and the tax and other advantages offered to entities which use Cyprus as their base for offshore activities. In addition, Cyprus has a high standard of living, excellent climate, sandy beaches, snow resorts, quality services and banking facilities, and low cost of labour that attracts foreign investment in Cyprus.

#### (a) LOCATION / TIME ZONE

Cyprus is located in the north-eastern basin of the Mediterranean Sea and at the crossroads of Europe, Asia and Africa. Its strategic location has played a very important role in its development as an offshore financial centre.

Cyprus is situated four hours from U.K., and 3 1/2 hours from Frankfurt.

## b) POLITICAL AND ECONOMIC SITUATION

The strategic location of the island made Cyprus a target of the great powers starting from as far back as thousands of years BC. All those races left their influence on the islanders who were 77% Greek Cypriots, 18% Turkish Cypriots, 5% other nationalities. However, the British who were last to occupy Cyprus left their mark on the major areas of the country, i.e. on commerce, law, communications and others. After the July 20, 1974 Turkish invasion the island was divided into two parts. Despite the fact that the northern part is still occupied by the Turkish army and the death and destruction created by this the Cypriots have improved the southern part so well that it is now the tourist centre of the north-eastern Mediterranean Sea.

Cyprus has been transformed the last twenty-five years from a basically agricultural country to an export-oriented light industrial sector with a modernised agricultural sector.

## c) COMMUNICATIONS

Cyprus has a sophisticated telecommunication system which connects the island with 201 countries all over the world. Sea services (provided by the two major ports) are excellent. Both container traffic for the Middle East which comprises a major segment is the services provided by the two ports and the growing role of Cyprus as regional business centre with increased tourist traffic has led to the creation of a comprehensive network of air and sea communications between Cyprus and the Middle East, Gulf, Africa and Europe.



d. SKILLED PERSONNEL

In general, the workforce in Cyprus is highly educated. All types of professional services are readily available and of a very high standard. Many of the professionals are trained in the U.K. and belong to British professional bodies because of the traditional British connection. The labour force has a drive for learning which is promoted by the government. As a result, the Cyprus workforce is educated, well trained and versatile.

e. LEGAL SYSTEM

The Cypriot legal system has been based on its English counterpart. Consequently English case law is closely followed and English laws are the basis of all statutes that regulate the country.

f. BANKING SYSTEM, SECRECY AND FOREIGN EXCHANGE CONTROLS

The banking system in Cyprus is based on U.K. banking practices. The supervision of banks is carried out by the Central Bank of Cyprus. The Commercial Banks in Cyprus are the major source of funds. There are four local and three foreign. There are also other specialised Banks and Institutions offering a broad variety of services. In addition, a number of hire purchase finance companies and the Cyprus Investment and Securities Corporation Limited carries out activities combining elements of European type merchant banks, U.S. type securities and investment banks.

International banks may establish in Cyprus Offshore Banking Units (OBU's) under the Companies Law. These OBU's are locally incorporated companies or as subsidiaries or branches of overseas companies which are established banks in countries where

there is adequate banking supervision, lender of last resort facilities and they enjoy a good reputation internationally. The Central Bank of Cyprus grants permits for OBU's under the following conditions:

- (i) Where an OBU is a subsidiary of a foreign bank, then the parent bank should provide a letter of comfort.
- (ii) OBU's should operate as a unit with adequate personnel.
- (iii) Unless otherwise allowed by the Central Bank, OBU's will operate wholly offshore and all activities will be with non-residents and in foreign currencies.
- (iv) OBU's do not accept deposits from people of Cypriot origin irrespective of their residential status.

The above conditions are only guidelines and the Central Bank of Cyprus has the power to disapprove any transactions which may seem as a scheme to avoid the payment of any taxes or other duties.

OBU's have as their primary objective to attract new banking business from overseas and offshore companies and their employees.

There is a list of permissible transactions. However when a transaction involves a resident then permission from the Central Bank should be sought. Foreign currency loans to residents allows residents to obtain funds. Most of these transactions should be channelled through a domestic commercial bank which is an Authorised dealer.

OBU's and foreign employees have the same advantages offered to offshore companies. There is no tax liability where an OBU is a branch of a foreign company. However, when the OBU is controlled and managed in Cyprus it will be taxed at one tenth of the company corporate tax, i.e. 4.25% and their foreign employees at half the rate for Cypriot wage earners. If these employees are taxed at a tenth of the standard rate, and are exempt from import duty.

There is no withholding tax on dividends and interest at source. In addition there are exemptions provided from foreign exchange controls, no trade-union compulsory enrolment is required, simplified, low to setting-up and operating procedures and costs, a simple regulatory framework no restrictions on profit repatriation, banking secrecy, numbered accounts, financing of local development projects and government foreign borrowing requirements.

Each of these individual features could, by removing a barrier or reducing a cost, tend to make Cyprus an attractive location for foreign investors and depositors, and for the contact of offshore banking business generally. All features put together as a whole they appear to form an attractive combination.

Foreign banks may establish a representative office in Cyprus provided that only recognised banks which enjoy a good reputation internationally and from countries with adequate banking supervision are eligible to apply. Representative offices of foreign banks may only work on an offshore basis and deal with non-residents. The main objective of such representative offices is to gather financial and commercial

information and act as an intermediary between the Head office or other offshore branches or non-residents. They also have to promote banking outside Cyprus and amongst non-residents. The representative office is not allowed to accept any deposits or book banking transactions in its name or in the name of its branches or the Head Office; it may only accept deposits or took transactions in the name of the actual customer. All advantages available to non-resident offshore companies are also available to Representative Offices.

The Central Bank of Cyprus has no control on accounts opened by the foreigners in Cypriot pounds or foreign currency. The Central Bank requires the names of beneficial owners of the shares in an offshore entity. However, this information is classified as secret by the Central Bank which is bound by legislation not to reveal the names to outsiders. Exchange control is exercised by the Central Bank of Cyprus and "residents of Cyprus" are subject to Exchange control restrictions.

Non-residents are treated differently. A non-resident is a natural person or company who are overseas residents and offshore companies and their employees also regarded as non-residents. Non-residents may have external accounts with any Commercial Bank in Cyprus in either Cyprus pound or in foreign currencies. There is no control what so ever on those accounts by the Central Bank.

Investment by foreigners for housing purposes used a permission by the Council of Ministers. This permit will be granted normally very easily.

There are restrictions for investment offshore, and exchange control approval is required for transactions between residents and non-residents in foreign currencies. Therefore, foreign currency dealings should be authorised by the Central Bank. Residents are not allowed to export currency unless for private or business purposes travelling or any financial assistance to a non-residency by way of gift or for education or health purposes. However, payments for imports can be freely made through a commercial bank, even as commission payments up to the maximum of 5% of export value.

Foreign Investment in Cyprus, especially investments which may involve a new technology, that may increase exports and/or decrease imports are allowed by the Central Bank even if it is 100% foreign. It is however desirable by the Government authorities that foreign investments are controlled by residents.

Capital and profits may be repatriated after the issue of a tax clearance certificate as long as the investment was an approved one. Where, the investment was a non-approved investment then the proceeds are blocked and release at a fixed amount per annum. Only interest on blocked funds is freely transferable.

Finally, the foreign investor has the same rights and obligations of the resident investors.

(g) SPECIAL INCENTIVES

Special incentives are offered to promote trade and industry. The offering of them is very important as it consequently promotes the economy by creating more business for the OBC. These special incentives are the following:

Conditional reliefs are available for the payment of import duties and are provided to the industry, to the consumers and various organisations.

These are reliefs for the promotion of industry which waive import duties on specified raw materials, packing materials and plant and machinery. On the other hand, there are reliefs provided to promote various areas such as tourism where various merchandise imported by hotels and other tourist entities are waived. Also import duty is waived on goods to be used by charitable and education organisations.

Secondly, there available refunds of custom and excise duties collected on raw materials used in the manufacture of goods for exports. These refunds are offered to manufacturers to increase the competitiveness of Cyprus products overseas.

Thirdly, the ministry makes regulations related to temporary importation of goods without any import duties on goods for process or repair before re-exportation, sporting goods, goods for exhibition and samples. This relief may be allowed for three months in order to promote international trade and tourism.

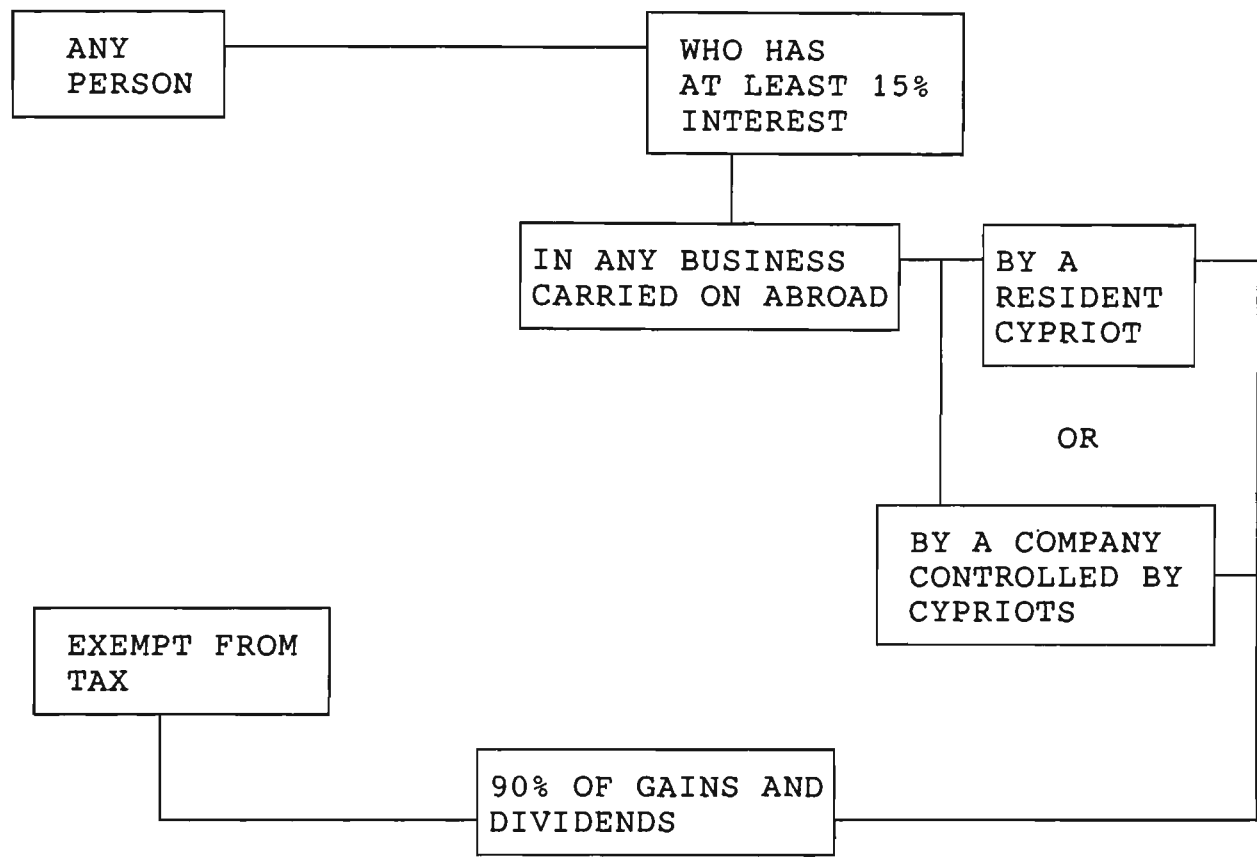
Fourthly, the importer may store imported goods liable to customs duty or local goods liable to excise duty in public warehouses without the payment of the duties that they would attract. This relief defers the payment of duties to allow the benefit of a better cash flow to the importer/exporter who may pay the duty only when he needs to use the goods.

Fifthly, there are factories that operate only for exports. Those factories will pay no custom duties for any equipment used when manufacturing and packing goods for exporting.

Finally, there is an industrial free zone on a site adjacent to the Larnaca Airport. This area operates under the Ministry of Commerce and Industry. Factory units, which operate on this zone pay no duties whatsoever on any equipment used or any raw material used to manufacture goods for exports, or under a special licence they may sell to the domestic market. Further, foreign employees working there are liable to tax at 50% of the normal rates. Also, the income derived by foreign investors from shares in companies situated on the free zone, has no further tax in addition to the tax paid by the Company on the profit out of which dividends were paid out. Also, the recipient shareholder has the right to on any excess of tax paid on the dividends. Therefore, the shareholder may offset the tax credit against any other personal tax liability.

BUSINESS PROFITS AND DIVIDENDS ABROAD

DIAGRAM 4.6.1



The above exemption provided to any person who imports into Cyprus 90% of gains or dividends of carrying on business offshore who has at least 15% interest, or the business is controlled by Cypriots is tax exempt.

Foreign Capital may freely be imported into Cyprus and deposited in a bank which operates in Cyprus. Where interest arises from such capital, this interest will be free of tax. Further interest on foreign capital which is borrowed and invested in Cyprus on a project that may contribute to the development of Cyprus is also exempt from tax.

In addition, foreign investment income of a non-resident which is remitted to Cyprus it is taxed at 5% on the excess of C£2,000.



Also, salaries of non-residents employees of offshore entities, from the rendering of services to offshore companies although received in Cyprus are taxed exempt. Further, pension from services rendered overseas which are received in Cyprus are taxed at 10% of the normal individual rates. Professional services rendered overseas are 60% exempt when profits are imported in Cyprus. Also 100% exemption is provided when rendering salaried services for business overseas.

There are also exemptions available to exporting of Cyprus manufactured or produced goods and which is equal to 6% of foreign exchange received from exports.

Mining operations have several reliefs such as, investment allowance on plant and machinery on exploration and development, 130% of the abortive exploration expenses, annual allowance on the balance of exploration and development expenditure, and depletion allowance in lieu of the investment and annual allowances. Also, mergers are eligible to 25% investment allowance on used plant.

One of the dominant business activities conducted by and through Cyprus is international shipping. Foreigners may establish a local company in order to apply for a registration of a vessel under the Cyprus flag. All shipping companies registered in Cyprus belonging to non-residents are regarded as non-residents provided that they are engaged only in shipping activities. Because of the large international customers

derived through Cypriot shipping, economic activity is increased. Consequently, the business of the Cypriot offshore banking business has increased.

Cyprus, which provides low registration fees, together with exemption to all profits and dividends from international shipping operations has become increasingly attractive for registering large and newly built vessels. Furthermore, there are exemptions on estate duty on the inheritance of shipping company shares, no capital gains on the sale or transfer of the vessel or sale or transfer of the shares of a shipping company under the Cypriot flag. No income tax is also payable on the wages of the Cyprus ships crews and shipping companies have the same tax treatment as offshore companies.

In the registration of a ship under the Cyprus flag a mortgage can be created, without the need for exchange control, as a shipping company is regarded as a non-resident. Many advantages may arise because of a Cyprus ship mortgage. i.e. most international banks recognise mortgages on Cyprus ships and lend money on the security of such mortgages, no stamp duty is payable, simple to lend, documents are delivered to the Cyprus consul where they executed. He then informs the Registrar of Cyprus by telex and all the records are also kept with the Cyprus High Commission in London for security purposes.

Finally, Cyprus double tax treaty may give other advantages to Cyprus shipping companies whose management and control is situated in Cyprus. Ship management companies which are owned by non-residents and whose ships are operating worldwide pay income tax 4.25% on their profits.

## 2! TAXATION FACTORS

### k TAXATION CHARACTERISTICS

Offshore entities in Cyprus can take the form of a company, a partnership or a branch of a foreign company and should satisfy mainly two basic conditions:

- (a) The entity must directly or indirectly belong to non-residents.
- (b) The income of the entity must be derived from sources outside Cyprus.

The application for registration of those companies must be submitted to the Central Bank of Cyprus, which after examining the details required, issues the respective permit.

As non-residents these offshore entities have the following advantages:

- there is no exchange control restrictions on their foreign currency accounts.
- they are free to do any type of offshore transactions without any exchange control interference.
- provided they maintain the required external funds they can make the use of all financial facilities available for their offshore transactions.
- may use bonded warehousing facilities.
- pay no import duty on store materials and goods in transit.
- can maintain administrative offices for the purpose of looking after their offshore activities.

Taxation advantages of offshore companies in Cyprus and Cyprus offshore branches of foreign companies.

There is no withholding tax imposed on dividends and royalties paid out by these companies.

These companies which are incorporated in Cyprus (irrespective of where the management and control is exercised) are subject to 10% of the normal company tax which is 42.5%. If such profit is derived from dividends which have been received from shares in a Cyprus offshore holding company, then no additional tax is paid.

Offshore branches of companies which have their management and control overseas and derive profits outside Cyprus are exempt from Cyprus tax.

Tax rates for foreign employees working in Cyprus are equal to half the rate of the Cyprus tax rates. Allowable deductions include annual allowances on fixed assets.

Company foreign employees receiving their wages in Cyprus but working overseas are taxed at 1/10th of the normal rate. In the absence of a tax treaty, tax paid by offshore companies in another country is deducted as an expense from their profits without the allowance of a tax credit relief.

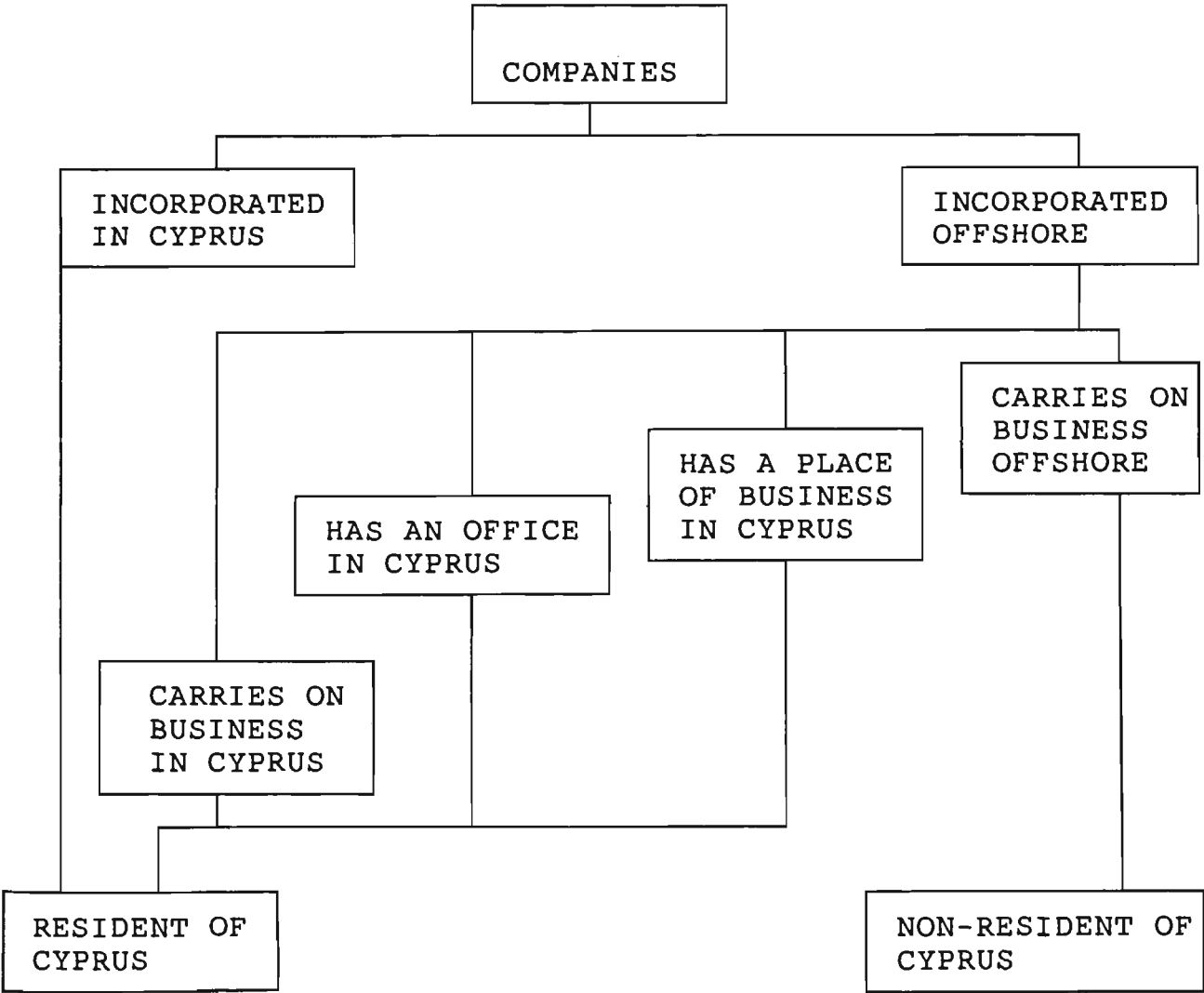
Under the Customs and Excise Law, offshore entities and their staff are eligible to import free relief on certain imported goods. i.e. Office equipment, motor vehicles and others. They are also exempt from payment of social insurance contributions, from contribution on refugees or defence, estate duty, capital gains and stamp duty on transactions.

Offshore entities are not to carry out trading with residents in Cyprus. Any trading with non-residents should be carried out offshore. There are borderline activities offshore. There are borderline activities which may be carried out in Cyprus after permission is granted by the Central Bank. ie. transit trade, repacking goods for re-export, printing foreign language books for offshore consumption, store, break bulk and repair or maintain goods for offshore consumption, private bonded warehouse for exhibition of foreign goods whose sale is on a wholesale basis for offshore customers.

CYPRUS COMPANY RESIDENCY RULES

Diagram 4.6.2 illustrates the company residency rules.

DIAGRAM 4.6.2



As shown in the above diagram a company which is incorporated in Cyprus is a resident of Cyprus. Conversely a company which is incorporated offshore and carries on business offshore is a non-resident. However, if the company which is incorporated offshore carries on business in Cyprus, or has an office in Cyprus or has a place of business in Cyprus, is considered to be a resident of Cyprus.

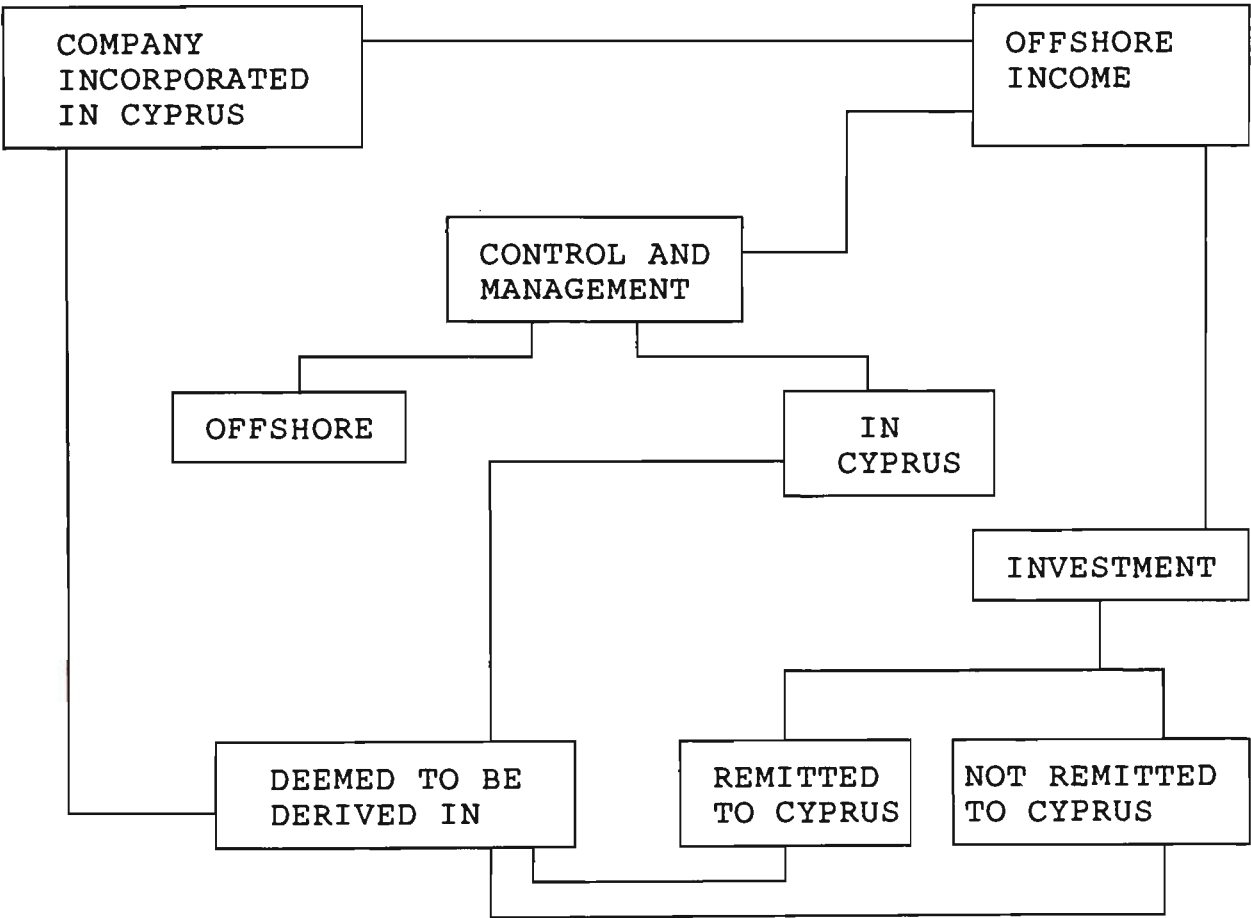
All companies are liable to Cyprus income tax on income accruing in, derived from or received in Cyprus in respect of profits from trading, dividends, rentals, royalties or any other income. Investment income other than earned income is also deemed to be derived where remitted to Cyprus or not.

Further, when control and management is located in Cyprus then any income from offshore sources is deemed to be derived in Cyprus irrespective whether it is remitted in Cyprus or not. Where a company is incorporated in Cyprus and the shareholders are non-residents, control and management location is not important. In this situation the whole of income is deemed to be derived in Cyprus.

The following diagram illustrates the derivation of income of an offshore company.

DIAGRAM 4.6.3

DERIVATION OF INCOME OF AN OFFSHORE COMPANY



TAXATION RATES OF RESIDENT COMPANIES

Generally companies are taxed at the rate of 42.5% on their taxable income.

DIAGRAM 4.6.4

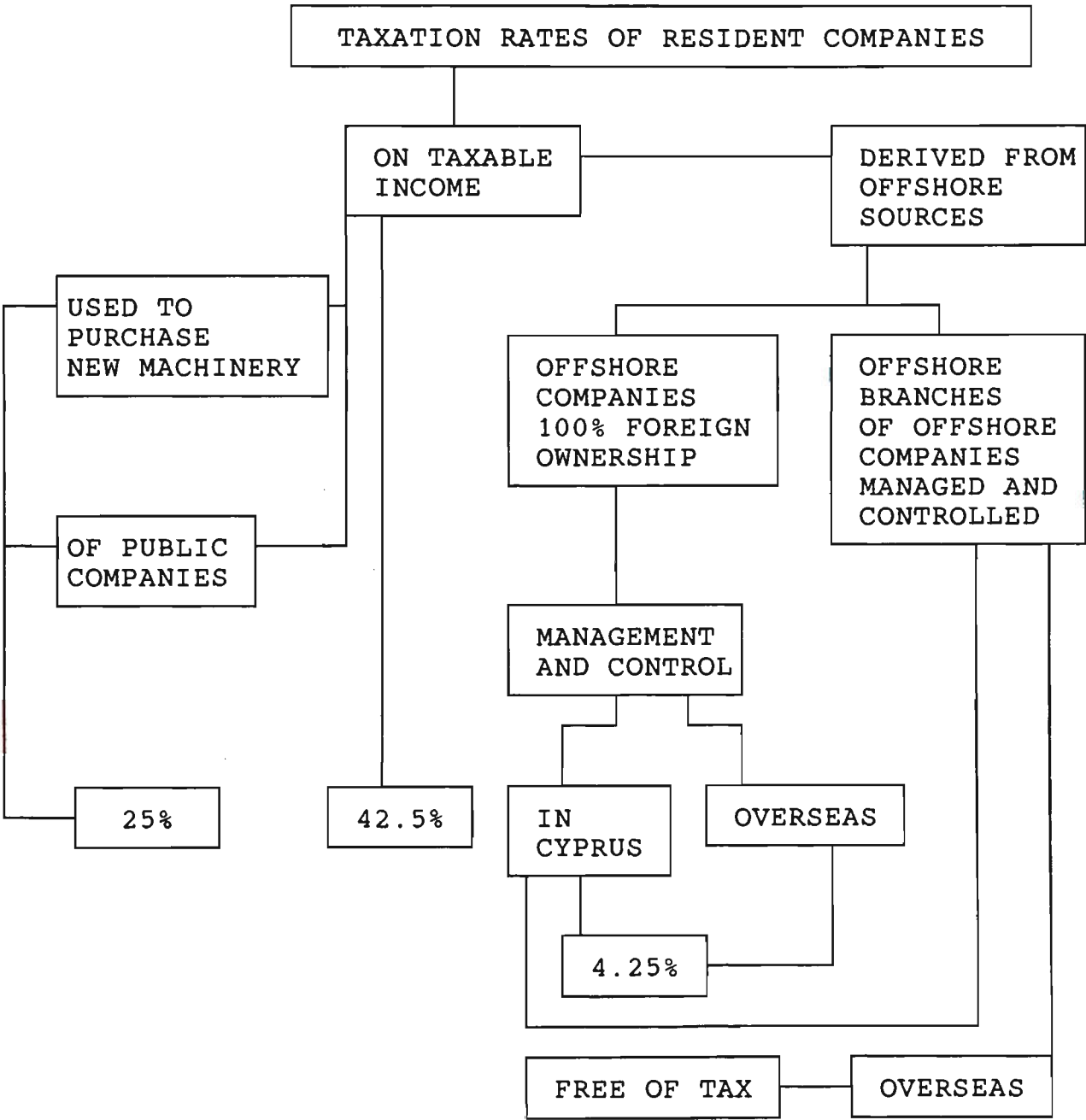




Diagram 4.6.4 indicates that the rate of 42.5% is not universal because there are exemptions from tax available to companies in order to promote certain areas. These are: Offshore branches of offshore companies which are registered in Cyprus and are managed and controlled from Cyprus but derive their income outside Cyprus are taxed at the rate of 10%. Those branches are free from tax if their management and control is exercised outside Cyprus. Offshore companies which derive their income from sources outside Cyprus irrespective where management and control is exercised are also taxed at 10%.

Private companies converted into public or public companies are taxed at the rate of 25% for their first 10 years of trading.

Company income used to purchase new machinery (excluding motor vehicles) is also taxed at the rate of 25%. In addition, there are wear and tear allowances but motor vehicles are not deemed to be depreciable assets for income tax purposes. Furthermore, manufacturing and agricultural businesses are eligible for 100% accelerated depreciation on the cost of new machinery used in the carrying on of their business.

Investment allowances may be calculated on the cost of new plant and machinery (second hand imported plant are also included). The investment allowance rates vary between 15% - 55% depending both on the type of the plant and the business structure.

Cyprus has tax treaties with many countries including U.K. and Ireland. In most treaties there are provisions which attract foreign investors. These provisions include tax "sparing", that is tax that is excepted in Cyprus, may be credited against the investor's taxation liability in its home country. These taxes may include: tax on interest which is been charged on a loan used to promote investment in Cyprus, tax paid in Cyprus for capital expenditure in hotel business, manufacturing, construction, shipbuilding or the supply of energy in order to promote the development of Cyprus, Cyprus tax equal to 15% on dividends and Cyprus tax on profits or interest which has been given a tax incentive exemption or relief in Cyprus.

There are also restrictive measures which are aimed to stop certain types of foreign-source income from being channelled through Cyprus or even from being accumulated there via the offshore entity vehicle.

(i) CONCLUSION

To conclude, the financial sector of Cyprus has grown due to several factors listed below:

- 1! Location/Time zone advantage
- 2! Rapid economic growth
- 3! Advanced communication facilities
- 4! Skilled personnel
- 5! Increased foreign investment
- 6! Relaxed foreign exchange controls for non-residents
- 7! Special incentives to promote offshore business and which consequently increased economic activity
- 8! Concessional rates of taxation for non-residents.

Cyprus has implemented fiscal and legislative measures to achieve a rapid growth in availability and efficiency of services. This has broadened the range of domestic and offshore financial activities in Cyprus. As a result Cyprus has emerged as a successful financial centre in the north-eastern basin of the Mediterranean Sea.

## AUSTRALIA

### INTRODUCTION

Australia's location in the South East Pacific and area, which is expected to be the major area of growth in the 1990's, offers certain advantages. Australia is the only centre that can open each day before the other Asian centres start their trading day. Australia also has the potential to become the major Pacific Basin Offshore Banking Centre, especially in the case of a future shift of political balances in Asia i.e. Hong Kong. However, the extent to which offshore banking transactions will be attracted to Australia, will depend mainly on whether Australia would offer the same taxation and other incentives as the other centres in Asia because Singapore and Hong Kong, Australia's major competitors, do offer certain incentives in order to attract foreign investors.

The only area which is considered to be seen as limiting further growth of the Australian offshore financial centre concerns taxation, especially interest withholding tax and company taxes. Interest withholding tax exemptions under section 128F of the Income Tax Assessment Act creates inequities and potential for erosion of the Income Tax Base.

In the recent past, the Australian Government has established many committees which have looked into the possibility of the abolition of interest withholding tax and changes to corporate taxation. Corporate taxation imposed on banks creates inequity between Australia and other offshore centres i.e. Singapore. As a result, Australia's role as a major capital importer would be jeopardised and there would be implications for

Australian borrowers and the economy in general if taxes continued to be levied in their existing form.

## 1! GENERAL FACTORS

### (a) LOCATION / TIME ZONE

Australia is located in South East Asia. It is situated 2-3 hours ahead of the other Asian centres.

### (b) POLITICAL AND ECONOMIC STABILITY

Although it has traded traditionally with the United Kingdom, Europe and the United States, Australia has recently moved towards establishing relationships with countries which are located in the Asia-Pacific basin. However, Australia has many economic problems and a high rate of unemployment.

### (c) COMMUNICATION FACILITIES

Telecommunication facilities are adequate. However, there is potential for improvement in order to compete with the other successful financial centres. Australia is faced with problems. There is an adequate intrastate and interstate communication net which is efficient for the business and private needs of the Australian community. However the Offshore Banking Centres need advanced communications which have possibilities of improvement.

(d) SKILLED PERSONNEL

Australia has personnel who are educated and skilled in banking.

(e) LEGAL SYSTEM

The central Federal Government has its powers defined by the written constitution of the Commonwealth of Australia.

The British business system is the base from which Australian business operated for years. However, American influences are evident, especially in the area of business management. This relates to Offshore Banking Centres.

(f) BANKING SYSTEM, SECRECY AND FOREIGN EXCHANGE CONTROLS

The Banking Industry in Australia is going through crisis due to the changing climate in the corporate section and the downwards trend of the economy.

The financial institutions in Australia are divided into the following categories: banks, merchant banks, finance companies, building societies, credit unions, authorised dealers, and other financial institutions.

There are also specific purpose institutions which have specific roles when established in order to promote financing requirements in certain categories of entities in the community. i.e. Australian Industry Development Corporation which its main object is to promote Australian ownership of industry. This organisation gives priority of finance to manufacturing industries, tourism and other industries using new technology.

### Non-Bank Financial Institutions

Non-bank financial institutions operate mainly in order to facilitate the financial requirements of large corporations, are connected with sharebroking firms and most of them have the authority to deal with foreign exchange. Other activities of merchant banks may include not only banking facilities but also leasing, investment, corporate advice and money market.

Authorised money markets are part of the wholesale money market and have dealing privileges in the open market due to their close relationship with the Reserve Bank.

Finance companies provide short to medium term finance to small organisations where there is a problem obtaining a loan with a bank due to lack of security. The major Australian Banks and some foreign banks own some of the finance companies.

Building Societies provide mainly housing finance. They also provide other banking services to customers.

Credit Unions are created to facilitate the financial needs of the credit union members at competitive prices.

## Foreign Banks in Australia

Foreign Banks in Australia provide large loans to the commercial sector. They do not deal with retail banking. Most foreign banks are now engaged mostly in investment bank business which is fee based. Also foreign banks in Australia have performed poorly in the past because of certain restrictions on their operations and because domestic banks have large retail operations with comparatively cheaper funding.

## Offshore Banking Units

Thirty nine Offshore Banking Units are now operating in Australia. They are under the following eligible entities:

- (i) authorised banks subject to the Banking Act 1959.
- (ii) State Banks
- (iii) Other financial Institutions.

They are authorised to deal in foreign exchange. However, they should keep proper separate accounts kept by a separate department which deals with offshore transactions. Section 128AE of the Income Tax Assessment Act provide the interpretation provisions relating to Offshore Banking Units.



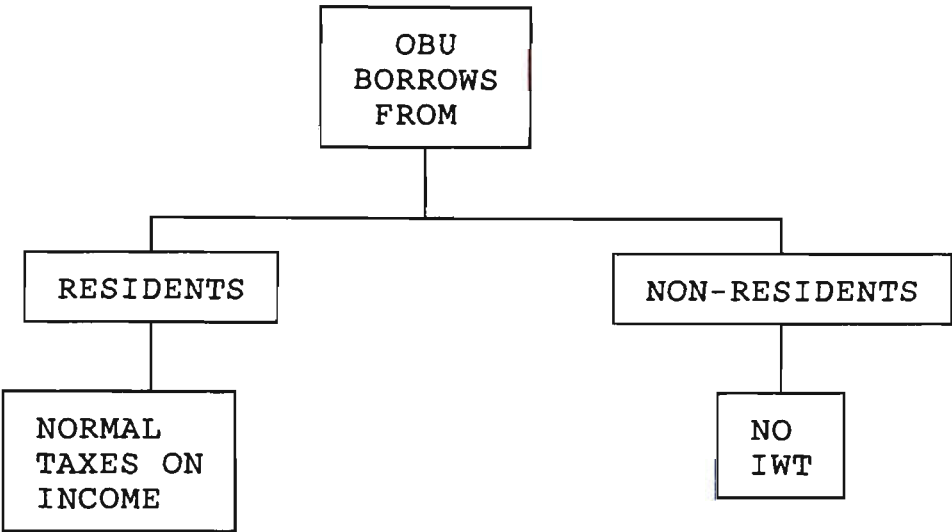
S128AE (2) defines that an offshore banking unit may be a saving bank or trading bank as defined in the Banking Act: it may also be a public authority that carries on a business of state banking or a person whom is proper to carry on a business as a dealer in foreign exchange.

However, S128AE (4) exempts from tax offshore loan money of a person who is an OBU and the lender is liable to pay IWT on income consisting of interest on the offshore borrowing, exempt under S128GB. The same exemption for the amount borrowed applies under S128AE (6). Further, this amount ceases to be exempt if the OBU transfers tax exempt loan money to another person and in return of the same equivalent amount in a different currency.

S128GB(2) of the ITAA exempts OBU's from interest withholding tax. This exemption is an attempt made in order to encourage offshore transactions. An offshore Banking Unit in order to maintain this exemption should not lend or deposit amounts with Australian residents other than another OBU. The exemption from IWT is provided only when an OBU borrows or accepts deposits from non-residents in any currency or borrows or accepts deposits from Australian residents in foreign currencies. The OBU accepts deposits from Australian residents in foreign currencies. The OBU must convert foreign currency into Australian dollars or any other currency before on-lending them. When lending from offshore which is free from IWT is directed to Australian residents then lending may be taxed at a penal rate. S128NB(2) provides the formula of calculating "lost withholding tax" and penalties may be up to 300%.

The following diagram illustrates the fact that when OBU borrows from non-residents and pays interest, this interest is exempt from IWT.

DIAGRAM 4.7.1



S160AF(7) deals with foreign tax credits that arise from Offshore Banking Income. These credits may be offset against Australian Tax on such income. However S160AFE(8)(b) precludes the transfer of companies with excess of foreign tax credits.

S160AFD states that losses made by an OBU are quarantined and may only be offset against Offshore Banking profits of an OBU for subsequent years. This is to prevent on OBU from transferring excess foreign tax credits within a company group (S160AFE(8)).

Further, certain dividends are deemed to be offshore banking income. This deeming provision (S160AFAA) purpose was to stop the altering of the character of offshore banking income. This might have been achieved by interposing a foreign company

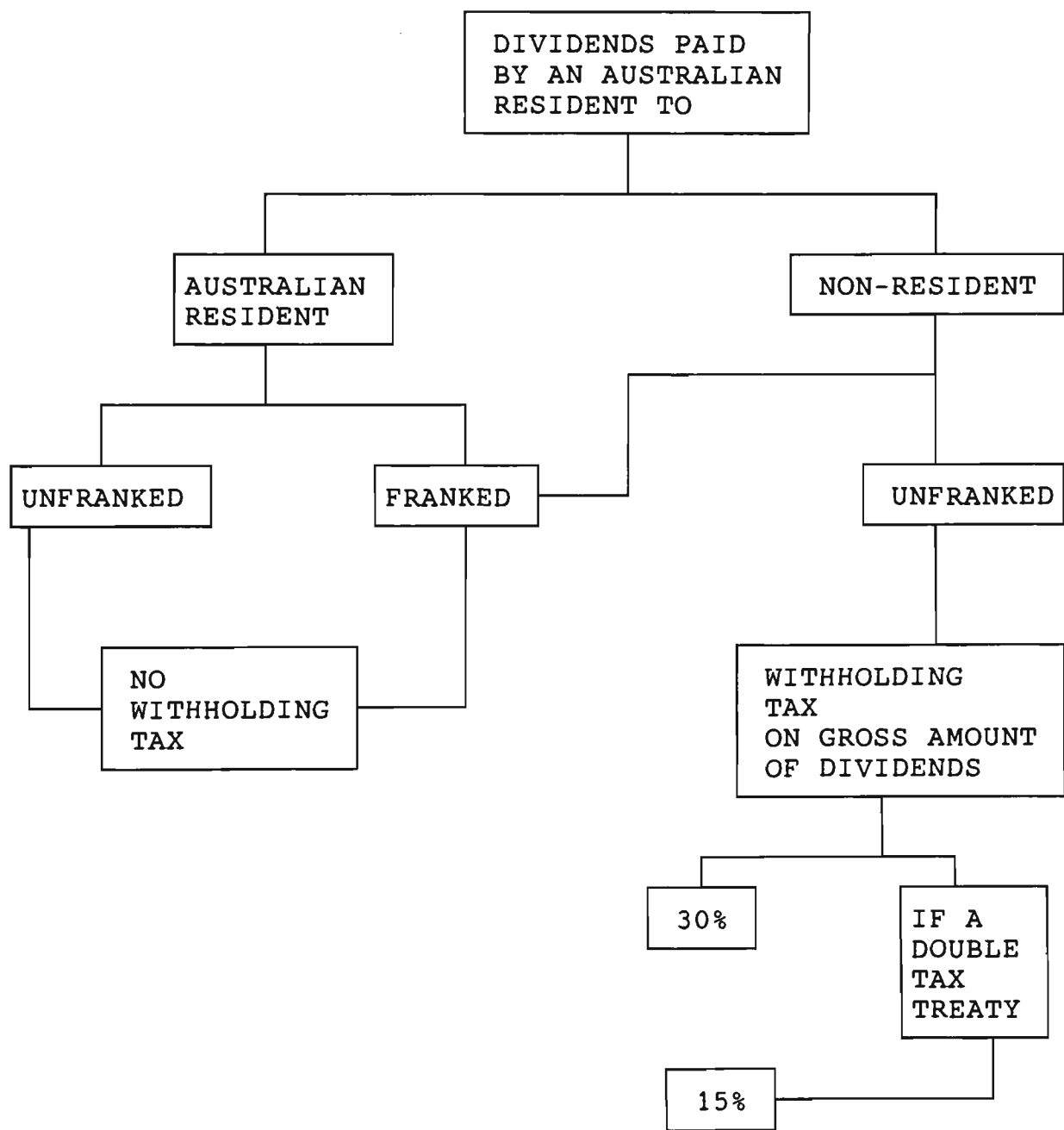
which may receive that income and changed its nature by paying it as a dividend to an Australian resident.

Both Australian company tax and interest withholding tax apply to offshore banking. 10% I.W.T. is imposed on Australian source interest income derived by a non-resident lender unless an exemption applies. The person paying the interest will withhold the 10% of the gross interest to pay it to the Australian Tax Office and the rest will be paid to the lender who might be able to apply for a credit of Australian I.W.T. to be offset against his other income in the home country (where there is a double tax treaty in existence). This may be only up to the amount of the tax levied in that country and this credit may be delayed to be deducted. Because of these reasons overseas lenders in order to recoup the interest withholding tax which is levied on them impose a loading on the interest rate to be able to recover it.

This diagram illustrates rules on withholding tax.

DIAGRAM 4.7.2

1!



This above diagram has shown the absence of IWT on dividends when they are paid to an Australian resident or to a non-resident when they are fully franked. If dividends (unfranked or partly franked) are paid to a non-resident then 30% withholding tax is deducted at source. However, if there is a double tax treaty then withholding tax may be reduced to 15%. In addition, where there is a double tax treaty in existence

dividends paid to residents of the double tax treaty country will have a credit for the Australian withholding tax which could be offset against tax payable in that country. Withholding tax is paid where a non-resident company pays dividends overseas from profits which arose out of an Australian branch. However, withholding tax is not payable when there are payments to overseas companies from Australian branch taxed profits.

Withholding tax is deducted at source from:

- (i) Interest at the rate of 10%
- (ii) Royalties at the rate of 10% -25%
- (iii) Dividend withholding tax at a rate of 30% on unfranked dividends.

There is no dividend withholding tax levied on franked dividends which were declared after June 1987.

However, Australia has attempted to eliminate the disadvantage from IWT to the Australian borrower and has allowed certain exemptions:

(i) SECTION 128F

IWT is not withheld at source when interest is paid on debentures which are issued offshore by an Australian resident provided that the loan and the interest payments are in a foreign currency, issued by a wide distribution among investors and the funds raised are to be used in an Australian business.

(ii) SECTION 128GA

I.W.T. is not withheld at source when interest is derived from an offshore loan which will not be used to compete directly with a non-government entity and the borrower is a State or an authority of the Commonwealth or state.

(iii) SECTION 128B(3)(a)

I.W.T. will also not be withheld at source when interest is received by a foreign superannuation fund which is income tax exempt in its country of origin.

(iv) THE PRINCIPLE OF SOVEREIGN IMMUNITY

Where the lender is an arm of a foreign government, any interest derived is exempt under the principle of sovereign immunity.

(v) TAXATION TREATMENT OF INCOME FROM OFFSHORE BANKING  
TRANSACTIONS

Company tax is levied on any income that is received by an offshore banking institution. This income may be interest received from a non-resident or resident borrower which after deducting any allowable deductions is taxed at a company tax rate of 39%.

In addition, dividends paid to non-residents by a company incorporated in Australia are subject to dividend withholding tax. If the banking institution is a non-resident then additional branch profits tax at 5% on its Australian taxable income will increase the total company tax paid.

Finally, any interest paid to foreign lenders or depositors by the institution is subject to IWT, unless an exemption applies as previously stated.

Australian banks have no secrecy regulations. On the contrary, taxpayers in Australia are required to submit their taxation file number to banks. Failure to do so, triggers taxation payments in the high marginal rates deducted at source by the banks. In addition the Commissioner has the right to obtain any information regarding the banking affairs of a taxpayer when this is required in the cases of auditing of taxpayers taxation affairs.

However, Australia has attempted to eliminate this disadvantage to the Australian borrower and has allowed certain exemptions:

S15 of the Cash Transaction Reports Act 1988 reports in relation to the transfer of funds into and out of Australia. Therefore all transfers of currency are subject to the Act which specifies a duty to report transfers of currency greater than \$5,000. Transfer, has the meaning of physical transfer. Furthermore, a cash dealer is obliged to report a suspicious cash transaction especially when this transaction involves suspicious transactions (drug trafficking) transit countries or countries listed as tax haven countries which have been known to facilitate laundering of money or due to bank secrecy legislation facilitate tax evasion.

However, common law duty of confidentiality has to be reconciled with the obligations that are imposed by Section 16 of the CTRA 1988. S16 modifies common law bankers' obligations of confidentiality to their customers in order to disclose information regarding their clients' affairs.

Financial institutions have the discretion to decide whether a transaction is eligible for exemption from reporting and therefore could be entered in the institution's exemption register.

g. SPECIAL INCENTIVES

Australia's special incentives only exist in relation to capital which is invested in:

- (i) Scientific research operations and
- (ii) Local manufacturing.

These incentives include:

- a) decreased taxes rates of payroll
- b) decreased cost of industrial land
- c) low interest finance
- d) Government guarantees
- e) various grants and tax rebates in order to promote export markets i.e. investors in Australian feature films where capital or "qualifying" investments in eligible Australian films will be deductible.



Foreign Takeovers Act regulates the purchases of Australian real estate. This Act is administered by the Foreign Investment Review Board. In addition, the Foreign Takeover Amendment Act and Regulations will look into foreign investment proposals and in the case of breach of the Foreign Investment Laws penalties will be imposed. This will apply specifically to acquisition of urban real estate which may be opposite to the interests of Australia as a nation.

Non-residents like to operate an administrative or liaison office in Australia due to its strategic location in the South Pacific. Provided that no important decisions are made in Australia, and they are not trading or doing business in Australia, they will be considered to be non-residents. The Australian office may only buy merchandise, collect information or advertise products.

## h! TAXATION FACTORS

### TAXATION CHARACTERISTICS

There is a need for compatibility between the tax systems of various countries. If this is not achieved, then there is a possibility of the occurrence of double taxation on company profits. When banks operate as subsidiaries in a foreign jurisdiction, they are often taxed on their profits in that foreign country. When those profits are later paid to the parent company in Australia as dividends, they are taxed again. The foreign tax credit system is a mechanism that allows a credit of tax paid by the foreign subsidiary and thus avoid the payment of double taxation.

In Australia, the Foreign Tax Credit System applies to income derived from foreign jurisdictions. For this purpose there are three classes of income: passive income, offshore banking income and other foreign income. Each class of income has its own foreign tax credit limits and is separately assessed. Foreign source income derived by an Australian resident is included in his taxable income and is assessed accordingly. However, credit for foreign tax paid on foreign income is only allowed to a resident taxpayer.

In general, S6 (1) defines that an individual, to be a resident must have his domicile in Australia or must satisfy the 183 day rule which specifies that he must be a resident of Australia more than half the income year.

In undecided cases, where there is a doubt, then the taxpayer has to satisfy the following three tests:-

1. where is his usual place of abode?
2. does he intend to take up residence in Australia or
3. if he is an eligible employee for the purposes of the Superannuation Act 1976, or is the spouse or a child under 16 years of age of such a person.

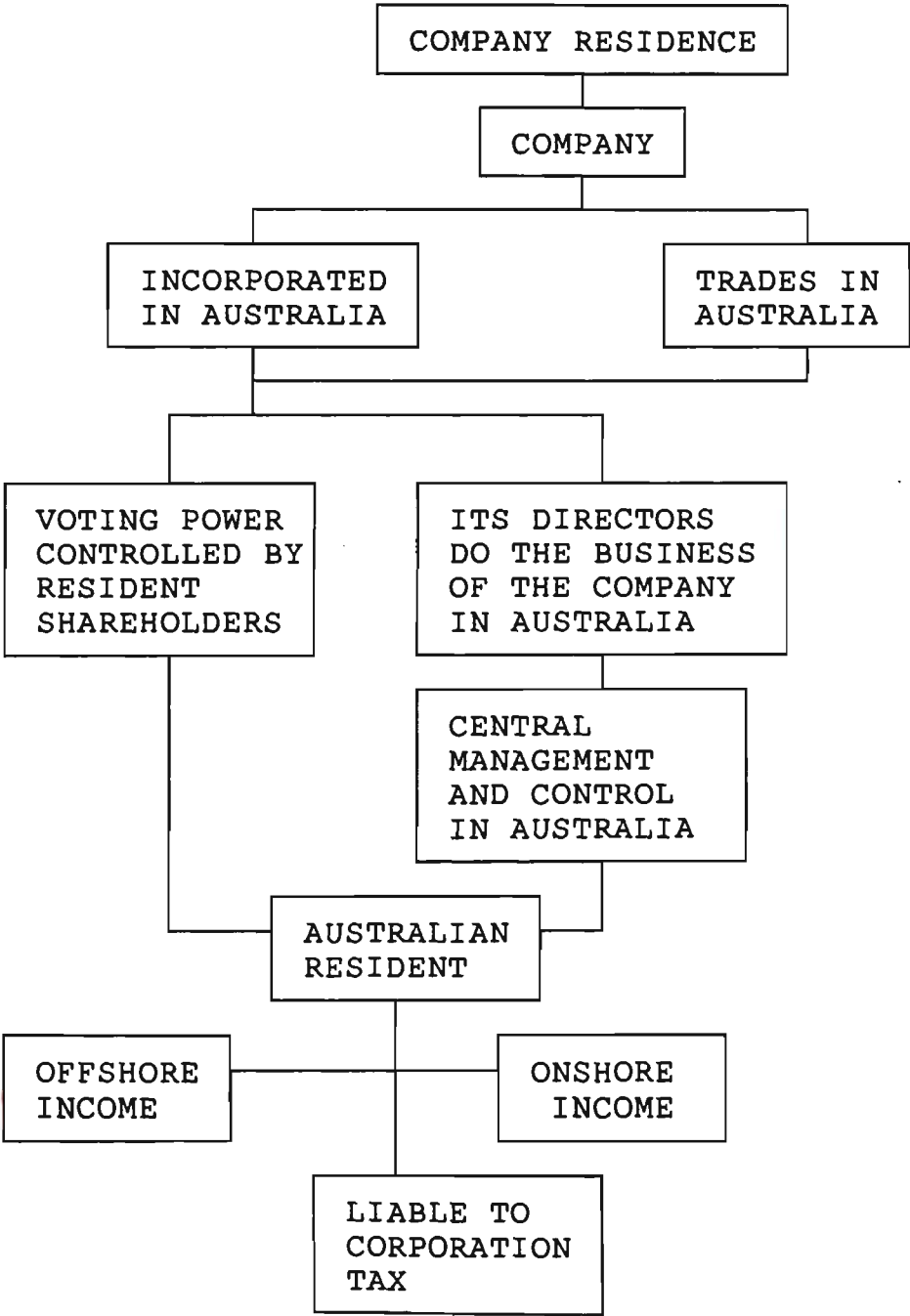
A resident company is defined to be a company that is incorporated in Australia. If it is not incorporated in Australia, it must carry on business in Australia and must have its central management and control in Australia, or its voting power controlled by resident shareholders. Foreign income is defined as income derived in a foreign

country with exemptions of S6 (c) of royalty income and interest on money given as a security for mortgage of property in Australia. The source of income is also important as well as the individual tax treaties that Australia has with other countries.

The following diagram illustrates company residency rules.

DIAGRAM 4.7.3

Diagram that illustrates residency rules

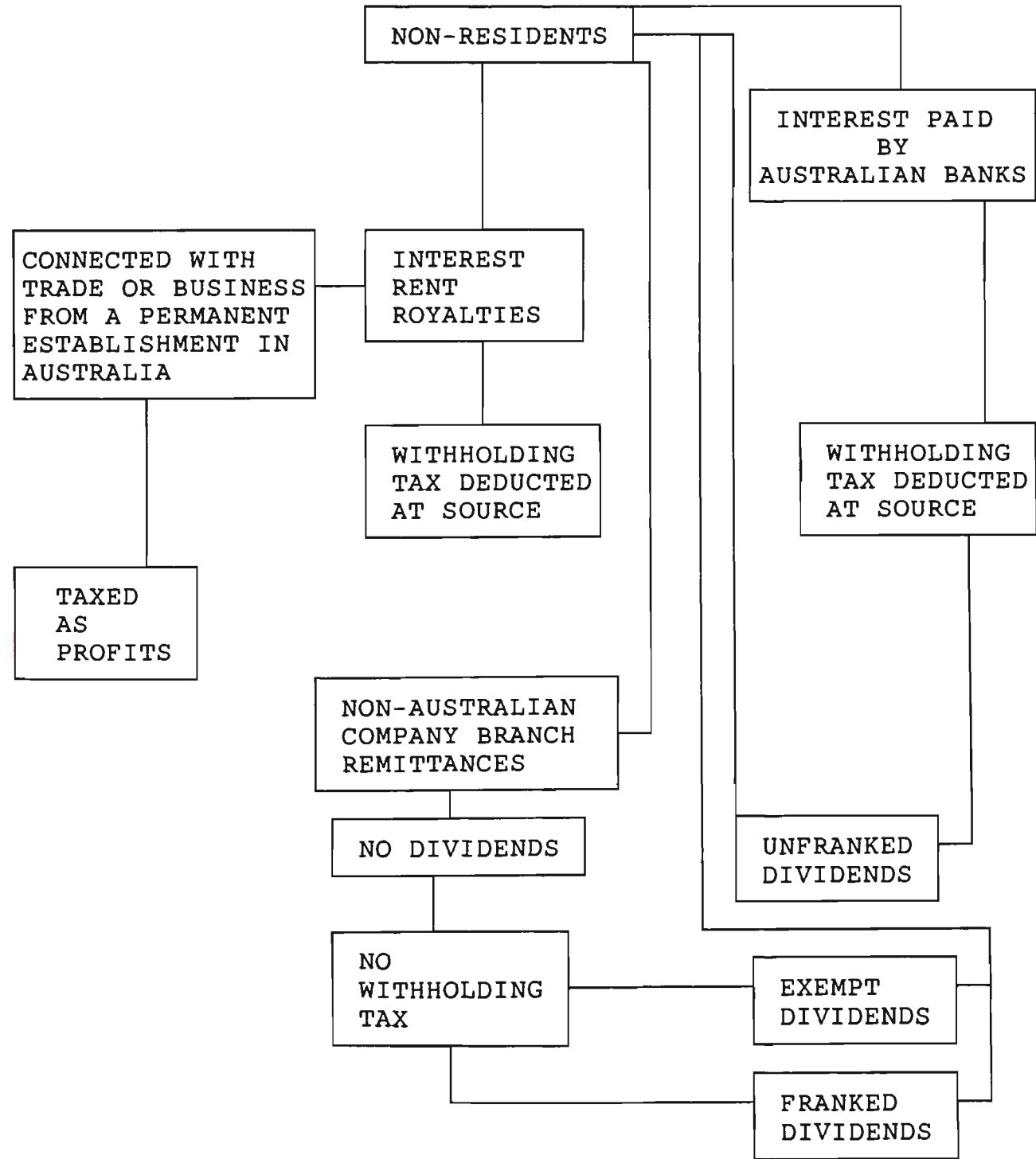


S6AC (1) requires that foreign income must be grossed up which means the gross amount of foreign income before any payments of foreign tax.

\$

i.e.	Company Net rent income received from a foreign investment	8,000
	Foreign Tax	<u>2,000</u>
	Gross amount to be included as foreign income	<u>\$10,000</u>

DIAGRAM 4.7.4  
AUSTRALIAN SOURCE INCOME OF



The above diagram summarises the taxation implications of a non-resident who has Australian source income.

However, Division 18 Part III of the Act, allows a credit for foreign tax paid on that income.

	\$
Australian tax on foreign assessable income	3,900
Less tax credit of foreign tax	<u>2,000</u>
Australian tax payable	<u>\$ 1,900</u>

This credit is only available where the taxpayer has paid the foreign tax and does not apply to tax payable. There are no provisions for any adjustments made by the foreign jurisdiction. Other difficulties would be timing differences. In order to be able to follow the "tax paid" credit it may be practically impossible. Strategies may be adopted to open routes for internationalising of banking foreign operations to minimise high tax costs by the use of the right form of operations. ie. Branch of subsidiary.

S 160 AF. A resident is entitled to a credit of the foreign tax paid but not if it is greater than the amount of Australian tax payable on the foreign income. In addition, losses incurred in deriving foreign income cannot be offset against Australian income.

S6AB (2) although defines foreign tax as tax imposed by law on income in a foreign jurisdiction it does not include unitary tax nor credit absorption tax (S6AB (6)). Unitary taxes are taxes on income, profits or company gains derived from worldwide sources outside the country and taking into consideration the level of activity in the particular state that imposes the tax. Unitary taxes are not creditable when calculating Australian tax.

A credit absorption tax is usually imposed when the taxpayer would otherwise be entitled to a tax credit for tax paid on income earned in a foreign jurisdiction.

i.e. instead of a 25%, he pays 30% as he is entitled to an Australian credit on tax paid on his income from the foreign country.

All forms of sales taxes, wealth taxes, inheritance taxes are excluded from foreign tax credit system and only those taxes which are similar to the Australian income tax will be eligible for credit. There are lists of taxes on which foreign tax credit is allowed. Foreign income is required to be converted into Australian currency when remitted and at the exchange rate of that period. Foreign taxes are required to be converted into Australian currency when paid and at the exchange rate of that period.

S23AG deals with the situation where a taxpayer is entitled to an exemption on Australian tax, on income from wages taxed in a foreign country. This only applies where the foreign service was more than 90 days. However if the taxpayer has also Australian source income this income will be taxed at the average tax rate applicable to a nominal taxable income that includes the exempt foreign service income.

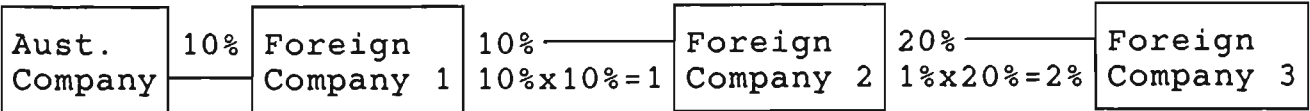
Foreign Underlying Tax

An Australian resident who receives dividend from a related company would normally have a credit for foreign withholding taxes on those dividends. In addition, S160 AE(1) credit will only be granted for the foreign underlying company taxes on dividends paid out of company profits.

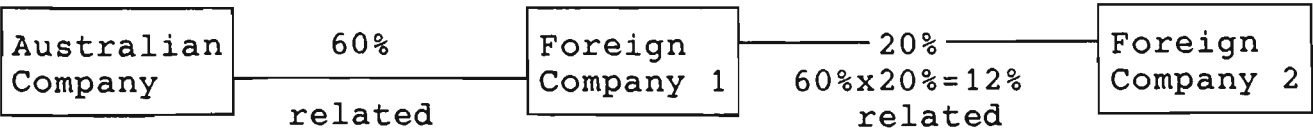
Companies are related when they belong to the same company group and have 10% of controlling interest in the foreign company. An extension to tiers may be achieved if each company in the chain has 10% voting interest in the company in the tier below it. The Australian resident should have a direct or indirect interest of at least 5% in the voting power of the company for which is claiming a foreign underlying tax credit.

Related Companies

S160 AFB (2) provides that a company to be a member of the group of companies has to leave at least 5% of the voting power of the foreign company which is a member of the group.



Therefore the Australian Company is only related to Foreign Company 1.



The Australian Company is related to both Foreign Companies.

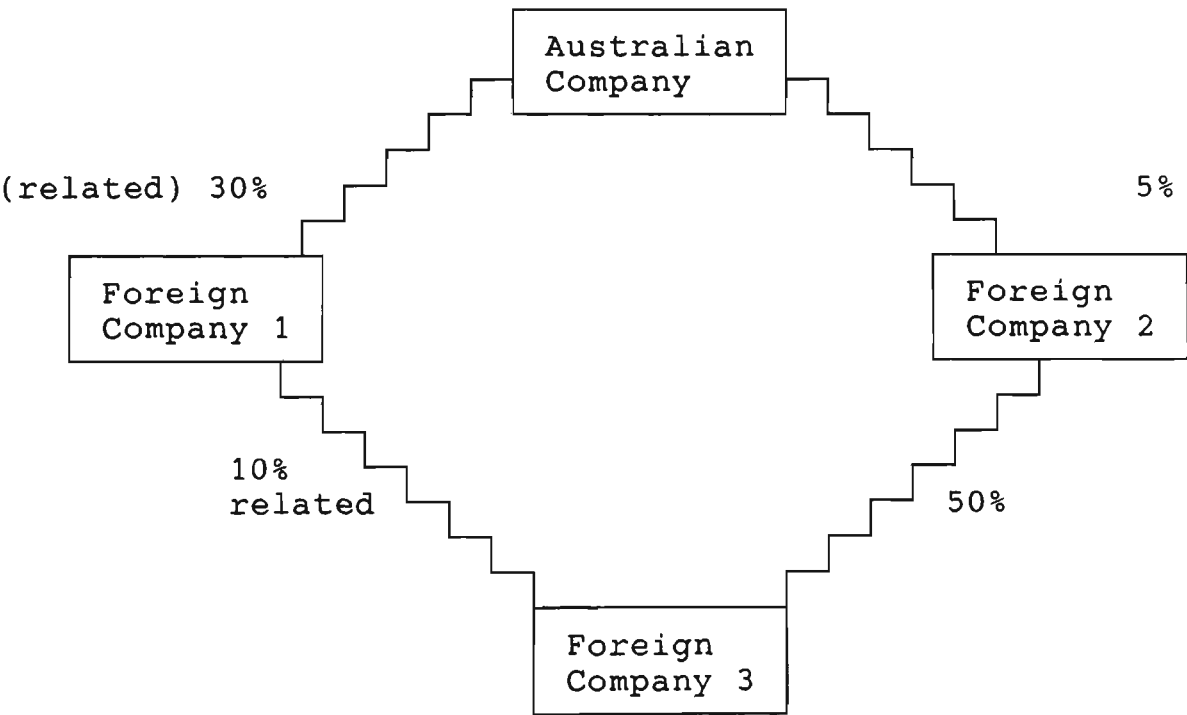
The formula to find the above may be as follows:

$$\frac{\text{Voting Interest in Foreign Company 1}}{\text{Voting Interest in Foreign Company 2}} \times \text{Voting Interest in Foreign Company 2}$$

Claim of voting companies

In case of a chain of foreign companies the aggregate voting interest should be greater than 5% even if the test to have at least 10% of the voting power in the tier of companies is not satisfied. As a result the tax credit is available only where a dividend is received by an Australian Company from a related foreign company i.e. Foreign Company 1 and 3 not Foreign Company 2.

DIAGRAM 4.7.5



Although this constitutes a TIER the companies are not related. They are not a group company. Therefore the Australian Company is not entitled to the underlying tax credit where the dividend is paid through Foreign Company 2.



$$\frac{30\% \times 10\%}{100} = 3\% \quad 5\% \times 5\% = 2.5 \quad 3 + 2.5 = 5.5$$

The Australian company is entitled to a credit for the underlying tax paid by Foreign Company 1. The above example of Australian tier may easily be related to an Australian bank, deriving offshore income. (eg. ANZ or NAB)

#### Transfer of excess credits within company groups.

This is only allowed firstly when Companies are 100% owner, and owners are at all times during a year or secondly it is only against other foreign sourced income. The excess credit is equivalent to Foreign Tax Credit which is greater than Australian Tax. Excess credit applies to both class of income and when foreign tax is greater than Australian Tax in respect to that income.

#### Ancillary provisions.

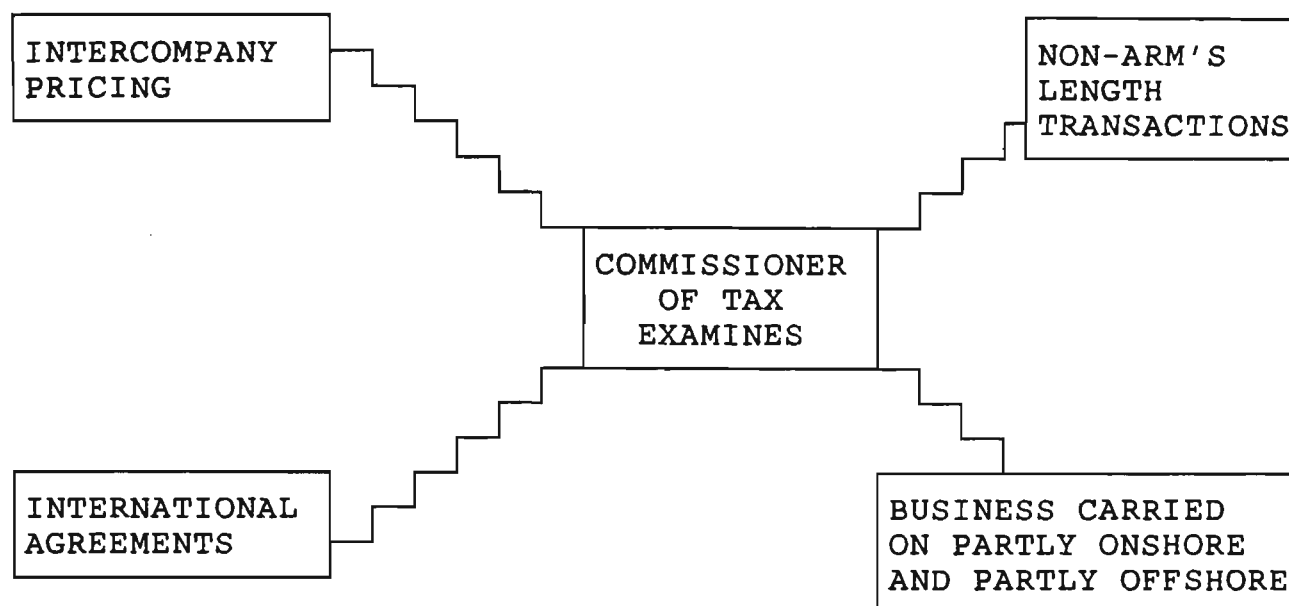
S20(1) Provides that income and expenses should be stated in Australian dollars. Further, S20(3) states that translation of dividend income should be made at the exchange rate of the day when is wholly or partly remitted. However, the translation of dividend income that has not been remitted, although it has been derived, should be made at the exchange rate at which is current, at the end of the year.

S20(5) also considers income as remitted only when received. Withholding tax is payable on received dividend. In the case of underlying tax in foreign currency this should be translated to Australian currency on the day that the dividend is remitted. S20(2) deals with income from dividend derived from carrying on business in a foreign jurisdiction. This is translated at the average exchange rate. However, the amount of foreign tax paid for that income is translated at the current exchange rate, on the day tax is paid.

Losses incurred in deriving foreign income.

S160 AFD claim, within 7 years, is allowed, when the loss is from the same class of foreign income.

S51(6) specifies that a loss incurred from a foreign source income deriving from business or investment activities cannot be offset against domestic source income. To be able to do so the loss should be derived from foreign source dividend. Further, S160 AFA treats foreign interest income as a separate class of income.

DIAGRAM 4.7.6SPECIFIC OVERSEAS TRANSACTIONS

The Commissioner of Taxation has the right to investigate books and accounts which deal all the above overseas transactions. In addition, the Commissioner uses information contained in schedule 25A of the company tax return to discover any international tax avoidance schemes. Schedule 25A contains information on related entities.

There are certain exemptions from the notification requirements of real estate acquisitions : i.e. purchase by Australian citizens living overseas, acquisitions of off-plan residential areas or non-residential commercial areas which have a value not greater than \$5 million and others.

In general, the regulation policy of the Government is to find out whether a certain proposal is opposite to the interest of Australia as a nation whether that is a real estate proposal or a proposal for property other than real estate.

The accruals system of taxation is a new legislation introduced (from July 1991) to tax income earned in low tax jurisdictions in which Australian residents have an interest. The income is subject to tax as it is earned, rather than when it is remitted to the Australian shareholders. Income that accruals taxation applies is mainly passive (tainted) income from dividends, interest, royalties or other. There is a "white list" that contains comparable countries to which accruals taxation does not apply. U.K., Philippines and Singapore are on that list. Accruals taxation will apply to the remaining non-listed countries and on passive income and where foreign companies are controlled by five or fewer Australians. Further, income in a listed country which may be taxed at a lower rate of tax is also subject to accruals taxation.

There are quarantining provisions in respect of overseas losses on a country-by-country basis.

The accruals system of taxation equates the taxation of the income of a subsidiary and of a branch situated in listed countries. Both dividends paid by the subsidiary will be exempt from Australian tax and income will not be attributed. The same will apply to a branch. Branch profits remitted to Australia will not be subject to, unless the branch carries on business through a permanent establishment in the country and therefore taxed in that country. Where the income of the branch is not subject to tax concessions, there is equality between the taxation of a subsidiary and a branch. The branch cannot benefit from the active income exemption so it will be beneficial to operate as a subsidiary, especially where the expected income to be derived is concessional income.

Foreign source dividends are exempt from the accruals system. As a result, the Australian parent will not be able to apply for franking credits for tax already paid on that income. When the dividend is passed on to the shareholder of the Australian parent this will be the second time that tax will be imposed on the same income.

Firstly in the foreign jurisdiction and secondly in the hands of the Australian shareholder. This will also apply where exempt branch income in a listed country is derived by an Australian company. For example, when investing a foreign company may be interposed in a non-listed country to take advantage of the franking credits, not available where there is a direct investment into a listed country because dividends are exempt.

Australian financial institutions subsidiaries which carry on business as financial intermediaries benefit from the following exemption. Certain tainted income is excluded from the 5% test which specifies whether they qualify for the Active Income Exemption. If the Australian Financial Institutions subsidiaries operate in listed countries they will be benefited because of the tax concessions.

Furthermore, Taxation File Number (TFN) system introduced in Australia will have an impact on non-residents, investing into Australia. TFN must be quoted for various investments, otherwise the income from those investments will be taxed at the highest marginal rates unless the investment income of a non-resident is subject to withholding tax. Thus non-residents who receive fully franked dividends should quote their TFN otherwise pay the highest marginal rates.

The following are investments for which a TFN is required:

- 1! new and existing bank accounts,
- 2! company or government agent investments,
- 3! investment in shares in public companies, unit trust and cash management or property trusts or through solicitors' trust accounts.

A TFN will apply to all business structures who may apply for a TFN to the ATO.

Individuals however, may apply for a TFN to either ATO or Australian Post Office.

### OTHER TAXES

The proposed Value Add Tax will be imposed both on goods and services. Therefore, it is the writers opinion that the introduction of value added tax will have an affect on the banks' provision of services. They will be more expensive and this will decrease their competitiveness with foreign banks.

Sales Tax is a Commonwealth Tax and is levied on the last wholesale sale of new goods that are manufactured in Australia or second hand goods. This tax is paid by the wholesaler who includes the value of the sale tax on the price paid to him by the retailer. The retailer then passes this cost on to the consumer. There are 32 Acts dealing with Sales tax and there are different categories of goods and the sales tax rates are different depending on the class of the goods.

Bank accounts debit tax is levied on the debits of cheque accounts with banks. There are various rates depending on the amount of the debit with 10 cents for a debit more than a dollar to \$100 and a maximum of \$1.50 for a debit greater than \$10,000. There is also a bank account credits tax.

Further, fringe benefits tax applies to all non-cash benefits related to employment and which are received by employees are taxed to the employer at the higher marginal rate.

Also capital gains tax is levied to all capital gains made from the sale of property that is acquired after 19th September 1985. The gain is calculated after deducting from the disposal proceeds the indexed cost base of the asset. In the case of companies the capital gain is taxed at the company rate of 39%.

In order to assist local industries, customs duty is imposed on certain goods upon importation. Conversely, excise duties on certain goods are imposed by both Commonwealth and State Governments. Further, both Commonwealth and State Governments impose taxes on certain classes of minerals and petroleum products.

## STATE GOVERNMENTS TAXES

### k.15.1 PAYROLL TAX

Payroll tax is imposed on payroll when this exceeds a certain level which is adjusted yearly. Because payroll tax is paid by the employer, the foreign banks financial institutions consider this as an additional burden that increases their expenses and as a result international organisations may opt for a different location to save an approximate 7% payroll tax.

Financial institutions tax (FID) is imposed on receipts of specified financial institutions. FID may be passed onto the customers of the institutions. The rates of duty differ, depending on each State's legislation but ranges from .03% to 0.05%. However, duty ceilings may be applied to receipts.

Also, Land Tax is levied on the unimproved capital value of land. This tax is not imposed on domestic use of land. The amount of Land Taxes vary depending on the annual rental value of the land.



(i) CONCLUSION

To conclude, Australia has several advantages in order to grow as a successful financial centre.

- 1! The time zone advantage.
- 2! Its stable political situation, against the instability of the other countries in the Pacific Basin.
- 3! It has adequate communication facilities.
- 4! It has educated and skilled personnel.

However, Australia's financial sector has not grown due to the factors listed below:

- 1! there is a downwards trend in the economy.
- 2! foreign exchange controls.
- 3! the existence of withholding taxes and many other taxes and regulations that are a disincentive against foreign investment. In addition, taxation law changes frequently and tends to be complex.
- 4! the absence of any special incentives which may promote business and could make Australia comparable with other centres.

Although Australia had many advantages it has failed to implement fiscal and legislative measures to increase the availability and efficiency of services which could promote Australia as a successful financial centre.

4.8     SUMMARY

The following tables compare the various characteristics (general and taxation factors) that exist to make an offshore banking centre either successful or unsuccessful. It is evident from the following tables that those characteristics are common and pre-existed and assist in the success of the centres examined.

Further the tables that follow demonstrate that U.K., Ireland, Singapore and Cyprus have special characteristics, general and taxation, that increased their success as Offshore Banking Centres. Philippines and Australia have low ranking as they do not offer special incentives to attract business from other Offshore Banking Centres.

TABLE 4.8.1

NON-TAX COMPARATIVE INFORMATION

Non-Tax features as important as tax considerations for every person natural or not and play a significant role in one's choice of location of business operations.		Relative Position					
	Features Compared	U.K.	Irel.	Sing.	Cypr.	Phil.	Aust.
	Location/Time zone	5	5	5	3	3	3
	Economic & political stability	4	4	3	3	1	4
	Communications	5	4	3	3	2	3
	Currency	5	4	5	3	2	4
	Skilled Personnel	5	3	5	3	2	4
	Legal system	5	4	5	2	3	5
	Bank secrecy	4	4	4	5	1	0
	Exchange control	5	5	5	3	3	2
	Offshore companies	5	5	5	5	3	2
	Other incentives to promote investments	5	5	5	5	2	2

- 0 = Poor
- 1 = Unsatisfactory
- 2 = Average
- 3 = Satisfactory
- 4 = Very Good
- 5 = Excellent

TABLE 4.8.2  
COMPARATIVE TAX INFORMATION  
SIX SELECTED OFFSHORE CENTRES

The overall comparative assessment of the eight tax features is quite favourable. A consequence of the diversity of an offshore business has as a result the observation of all developments and adjustment of policies in order to compete with other offshore centres.		Relative Position					
	Features company	U.K.	Irel.	Sing.	Cypr.	Phil.	Aust.
	Personal Income Tax	3	4	4	4	3	1
	Company Tax	2	3	4	4	2	1
	Tax on foreign source income	3	3	4	3	1	0
	Capital Gains	4	4	3		2	3
	Withholding tax on dividends	5	5	5	2	1	1
	Withholding tax on interest	5	5	5	2	1	1
	Special incentives provided to investors	5	5	4	5	0	0
	Taxation on offshore banking	4	4	2	4	3	3

- 0 = Poor
- 1 = Unsatisfactory
- 2 = Average
- 3 = Satisfactory
- 4 = Very Good
- 5 = Excellent

CHAPTER 5

FINDINGS

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## 5I FINDINGS

### 5.1 INTRODUCTION

Many offshore financial centres claim that their success is due to the centres' advantageous geographic location, together with the tax incentives offered by their governments and the existence of a business oriented framework.

A survey was conducted with the objective of identifying the main areas that enhance the development of a country to an international offshore financial - banking centre and commercial centre. The basis of the survey was that policies followed by the authorities of an offshore centre should be compared with similar policies followed by other competing centres. In addition, certain possible areas of weaknesses in the legal and institutional framework may be identified as well as other factors which may affect offshore business operations and the attraction of foreign investors to the centre. The survey focused on certain points:

- a! the comparison of each selected centre with competing offshore financial centres.
- b! the operation of offshore companies and banks in each competing centre.
- c! the level of taxation to offshore entities.
- d! offshore banking conditions.

## 5.2 STUDY THROUGH PERSONAL INTERVIEWS

To gather additional material for this study the writer conducted a series of personal interviews. Interview techniques and questionnaire design is discussed in Chapter 3. The major objective of the interviews was to obtain an indication of the special characteristics that contribute to the success of certain offshore financial centres.

Three sub-objectives were:

- 1! To find whether taxation incentives provided to non-residents contribute to the development of an Offshore Banking Centre.
- 2! To discover whether banks in offshore centres do not promote offshore business unless taxation incentives are provided.
- 3! To find out if heavy regulation affects offshore banking business.

Of the twenty eight people approached, twenty agreed to be interviewed, a response rate of 71%. Those interviewed included ten bankers, seven regulators and six academics. The research was from a random selection of twenty-eight interviewees (ten bankers, seven regulators and eleven academics) from Cyprus, Singapore and Australia. Response rates were 80%, 86% and 55% respectively with an overall response of 71%.

The main question referred to the special characteristics that contribute to the success or failure of the selected offshore banking centres. Some 95% responded that the major characteristics that contribute to the development of an offshore centre are, in

general, the following: favourable taxation legislation, absence of exchange controls, deregulation and other incentives provided by governments in order to promote foreign investments.

However, 75% of them specified that unless there is a regulatory framework that favours offshore companies in a country, the offshore centre will be disadvantaged. Especially when taking into account that the level of taxation is the most important factor taken into consideration by offshore entities.

Ninety percent of respondents replied that some conditions applied by the authorities of various governments have contradictory objectives. This is because they enhance the respectability of the centre and its future development in the long run. However, they also facilitate the attraction of new offshore enterprises and the carrying out of the business of the existing enterprises in the short or the medium term.

Seventy percent referred to the location/time zone of the offshore centre and the various administrative procedures, controls and conditions which apply by the government or other regulators should also be considered. Eighty five percent responded that excellence in telecommunications and the existence and adequacy of the professional, financial and back-up services also have a significant bearing on the offshore centre.



Further, the level of operating costs should also be taken into consideration when permanent establishment is intended. On the other hand operating costs will be of no importance when an entity is interested only in paper operations in order to avoid taxation.

Eighty percent of the interviewees also suggested that relevant provisions of Company Law are another consideration to be taken into account.

Sixty five percent responded that the economic and political stability of an offshore centre is obviously a characteristic that is highly regarded by offshore entities.

Furthermore, 95% agreed that taxation incentives offered to non-residents attract offshore business and increase the inflow of funds.

Question b) requested information on whether banks in offshore centres do not promote offshore banking business when there are no taxation incentives offered. Sixty percent of bankers admitted that they prefer to book transactions between offshore centres without channelling the transaction through their home country centre which imposes high tax on income. Therefore, they do not promote offshore banking business in the country of their residence.

Question c) also requested information on whether heavy regulation affects offshore banking business. Question c) responses clearly showed that respondents believe that when income is earned; especially rents, dividends and commissions only a small

percentage is channelled back to the country of heavy regulation. As a result, savings may be kept to a minimum in such a country, in comparison to monies that are accumulated in foreign jurisdictions where regulations are not as strict. The above statement was a speculation and the personal opinion of respondents based on their experience which was not backed up by actual figures.

The following Tables represent a weighted average of the opinions of the 20 respondents. Table 5.1 and 5.2 represent the results from a number of rating scales on the comparative tax and non-tax factors respectively. A numerical value is attached to the categories. Table 5.3 represents a comparison of the level of taxation of the 6 selected centres.

Finally, Table 5.4 represents the opinions of the respondents in the conditions to license and operate offshore banking including bureaucracy levels, supervision and liquidity requirements.

TABLE 5.1

NON-TAX COMPARATIVE INFORMATION

Non-Tax features are as important as tax considerations for every person natural or not and play a significant role in one's choice of location of business operations.		Relative Position					
	Features Compared	London	Dublin	Singapore	Cyprus	Phillipines	Australia
	Location/Time zone	5	4	5	3	2	3
	Economic and Political Stability	4	2	3	2	0	4
	Telecommunications	5	4	4	3	0	2
	Currency	5	4	5	3	2	4
	Skilled Personnel	5	3	5	3	3	3
	Legal System	5	3	4	3	2	4
	Banking System	5	3	4	2	2	3
	Bank Secrecy	3	2	3	5	3	0
	Exchange Control	5	5	5	1	2	2
	Offshore Companies	5	5	5	4	3	1
	Other incentives to promote investments	5	4	5	5	2	1

0 = Poor

1 = Unsatisfactory

2 = Average

3 = Satisfactory

4 = Very good

5 = Excellent

**TABLE 5.2**  
**COMPARATIVE TAX INFORMATION**  
**SIX SELECTED OFFSHORE CENTRES**

The overall Comparative assessment for the eight tax features is quite favourable for the first four centres. A consequence of the diversity of an offshore business has as a result the observation of all developments and adjustment of policies in order to compete with other offshore centres.		<u>Relative position</u>					
	Features Compared	London	Dublin	Singapore	Cyprus	Phillipines	Australia
	Personal Income Tax	4	3	3	2	1	0
	Company Tax	3	3	4	3	2	2
	Tax on foreign source income	3	2	4	2	1	1
	Capital Gains	3	3	4	3	2	2
	Withholding Tax on Dividends	5	5	5	3	2	1
	Withholding Tax on interest	5	5	5	3	2	2
	Special incentives provided to investors	4	4	5	3	1	0
	Taxation on offshore banking	4	4	3	4	2	2

0 = Poor

1 = Unsatisfactory

2 = Average

3 = Satisfactory

4 = Very Good

5 = Excellent

TABLE 5.3

## OFFSHORE BANKING

Offshore Banks or OBU's assessed their terms and conditions under which they carry out their banking operations in the selected Offshore Banking Centres and the main problems they are faced with regarding those terms and conditions		RESPONSES					
	Terms and conditions	London	Dublin	Singapore	Cyprus	Phillipines	Australia
	A! Terms and conditions to OBU license	1a	2	1a	2	3a	3a
	Operations may be carried out onshore	1a	2	1a	2	3a	3a
	Submission of monthly foreign exposure returns	2	2	2	2	3a	3a
	B! Level of bureaucracy						
	- Central Bank	2	2	2	2	3	3
	- Other Government departments	2	2	2	2	2	3
	-Level of supervision in relation to other countries	1	2	3	3	3	2
	Liquidity requirements	1	1	2	2	2	3

1 Low

1a Liberal

2 Reasonable

3 Excessive

3a Unduly Onerous

### 5.3 COMPARISON OF THE FINDINGS FROM ANALYTICAL RESEARCH METHODS AND PERSONAL INTERVIEWS.

The process of testing the hypothesis has been based upon the evidence provided by both the analytical review and the survey. The evidence has supported the hypothesis as shown by the ranking of concepts in Tables 4.8.1, 4.8.2, and 5.1, 5.2, 5.3.

It appears evident, from both the analytical review and the survey, that successful centres have characteristics that attract offshore business away from other competing centres. It was interesting to note that there was little difference between the analytical review ranking and the survey results.

# CHAPTER 6

## CONCLUSIONS AND RECOMMENDATIONS

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## CHAPTER 6

### CONCLUSIONS AND RECOMMENDATIONS

This chapter sums up the answers to the research questions outlined in Chapter 2. The second section of this chapter includes recommendations and then in the final section, areas for further research are suggested.

#### 6.1 ANSWERS TO RESEARCH QUESTIONS

##### a) DO OFFSHORE BANKING CENTRES HAVE SPECIAL LEGAL (TAXATION) AND REGULATORY CHARACTERISTICS THAT CONTRIBUTE TO THEIR SUCCESS AS A FINANCIAL CENTRE?

The analyses in chapters 4 and 5 demonstrate that Offshore Banking Centres (OBC) do have special legal (taxation) and regulatory characteristics that contribute to their success as a financial centre. They are the following:

##### 1! TAXATION CHARACTERISTICS

Substantial tax concessions are granted to attract offshore business away from other competing centres. Their legal framework deals with all aspects of offshore business (i.e. banking) in a comprehensive, positive and unambiguous way.

Therefore Offshore Banking Centres often used as an interpose centre that facilitates tax planning. They are also used as a structure to improve economic activity. This



is achieved by the provision of their incentives. They create more business which results in the increased activities of successful Offshore Bank Centres.

Furthermore concessional rate of taxes and duties do attract more business which is the foundation of strong economic activity. Business activity is an important factor to the success of an Offshore Banking Centre.

Interest withholding tax is either abolished in the majority of the successful financial centres or is substantially decreased through double tax treaties with increasing numbers of countries. This has become evident from the examination of the selected centres. However, Australia's system which provides selective exemptions from interest withholding tax, decreases the efficiency in the financial market due to competition and reduction of choices. Therefore, not only are offshore borrowings not conducted in the most efficient way but Australian lenders or borrowers are disadvantaged. This is possible through the existing system of exemptions, which does not assist the above mentioned Australian lenders and borrowers. Thus offshore borrowings are inefficiently conducted, and the existing system of exemptions helps create the erosion of the tax system on withholding tax and assists in tax planning by many organisations.

Deregulation of financial markets may increase competition and economic efficiency but government intervention and involvement is necessary and should deal with a particular issue. Government intervention would gain public confidence as in the case of MAS in Singapore and it will result in the stability of the financial sector. The

Government may also influence certain groups and also investment proposals. The government may also choose to adopt a foreign investment policy which will deal with proposals by foreign investors.

Regulation is desirable in order to reduce attempts by companies to be involved in international taxation schemes that will create the image of a "tax haven". This, in turn will discredit an offshore centre in the eyes of the tax authorities in other countries.

Regulation is also a means for stopping the abuse of a market which has oligopolistic trends. Government intervention may ease down the unfairness of competition between groups who set barriers to free entry in certain areas. On the other hand, government intervention may lose efficiency and equity in many areas of trade and the ability of an industry to compete in the economy. Therefore the possibility of survival of such a firm may be handicapped by regulation. London's rise as the offshore financial centre of the world was due to the regulation of financial markets and the free trade of Eurobonds. Banks and other financial institutions in U.K. were free to compete in bidding for deposits and this decreased their incentive. Innovation and diversity helped them adapt to the rapidly changing circumstances. Therefore competition provided incentives to operate at minimum cost, increased their effectiveness, and allowed greater use of market-oriented policies.

High standards are created when foreign banks participate in banking and in financing activities that promote competition.

Financial intermediation should not be restricted to domestic entry. However, should non-resident participation in banking be made easy? It has become evident by the examination of the six selected offshore centres that controlled entry of foreign banks or foreign branches increases competition in the banking industry or arguably increases efficiency. Foreign banks offer more stimulating competition than domestic banks when they are not subject to restrictions on activities or imposition of discriminatory regulations.

Successful centres have a central bank (London, Singapore, Cyprus, Ireland) that implements the monetary and banking policy of the nation and has the ability to respond to market development and communicate between the Treasury and other economic policies in the public sector as well as to promote financial markets to the local and overseas communities.

Offshore banking also plays a significant role in the success of an offshore financial centre. Most major banks in those centres have branches offshore that provide international banking activities which may be unrelated to any transactions of home depositors. Most foreign currency loans are organised offshore by the representative offices.

The majority of centres have minimum regulations on offshore activities in order to promote the offshore market. This has been achieved by reducing or even abolishing taxation on corporate profits and interest withholding tax paid on interest derived by

non-residents. Offshore Banks may also be able to have access to domestic currency deposits and loans.

Furthermore exchange control liberalisation allows offshore and domestic banks to participate in the Euromarket, Asian dollar market and to a lesser extent the Yen market. The lifting of exchange controls is generally used to assist in exchange rate policy and it stops transactors seeking alternative channels for capital movements outside the exchange control. Successful centres have established ongoing monitoring and reporting systems which depend on the notification of transactions at the time they occur.

The majority of the centres also have regulations which permit non-resident accounts in local currency or foreign currency accounts.

Most centres ensure that as in-so-far as possible financial activities carried out in their country are booked onshore and the benefits accrue to all residents.

However, the role of foreign capital is significant and barriers that prevent the free flow of foreign capital in a country have been lifted in successful offshore centres. Even an unsuccessful centre such as the Philippines, has benefited from the flow of foreign funds. On the other hand, dependence on foreign capital may have destructive effects on an economy which relies on foreign funds in order to use them not for capital expenditure to improve productivity, but merely for consumption.

An establishment of a government body that applies foreign investment policies is another characteristic of successful centres as it facilitates not only big investors but also the participation of smaller investors in projects that benefit the nations interest as a whole. It became evident from London, Dublin, Singapore and Cyprus that a policy which promotes foreign investment and also enhances the opportunity of resident investors to increase their wealth by participating in many of those foreign investment projects, benefits the economy as a whole. However, an adoption of a more restrictive foreign investment policy places strains on the domestic financial system.

b) 1! DO OFFSHORE FINANCIAL CENTRES HAVE OTHER NON-TAX CHARACTERISTICS WHICH ARE SIGNIFICANT FACTORS TO THEIR SUCCESS?

(i) LOCATION/TIME ZONE

International banks prefer to trade foreign exchange around-the-clock. Therefore the country's time zone monopoly is relevant to its competitiveness as an offshore financial centre. This became evident from the selected offshore banking centres. They have a strategic location within a time zone which includes major financial centres to attract offshore trading. Location proximity to Asian (Singapore) or European (London, Dublin, Cyprus) centres is a competitive attraction.. However, since Australia appeared later in the offshore banking scene, it's time zone advantage is reduced as it has to compete with established successful centres such as Singapore and Hong Kong. Tokyo is also situated in the same time zone as Australia.

This reduces the likelihood of success of Australian OBCs. Recently Australia has increased foreign exchange and funding business from Singapore. On the other hand, Singapore is located very close to South East Asia and is the recognised centre of the Asian dollar market.

(ii) POLITICAL AND ECONOMIC STABILITY

Political and economic stability contribute to the development of a successful centre. A prime example is Singapore. Although a relatively short time has passed since it gained independent status, its political and economic stability rates very high. This is evident from the foreign investment in the country.

On the other hand, the Philippines, due to the country's political instability, suffers from capital flight which is a great financial problem.

Further, because of the uncertainties which are related to the future administration of Hong Kong, businesses are looking offshore. But instead of diverting offshore business to Australia, they have tended to divert business from Hong-Kong to Singapore and Malaysia.

(iii) THE AVAILABILITY OF SPECIAL INCENTIVES

Incentives are available through the provision of grants for export engaging business manufacturing new technological products and others. These grants encourage entry into a market of maybe undesirable participants as it does expose the investing public

to areas which are not preferred for investments. These grants foster investor confidence and increase involvement.

At the same time, relaxation from taxes imposed and other requirements in "free zones" established in London, Ireland, Singapore and Cyprus attract a particular clientele who is happily engaged in production in order to export on those free zones. On the other hand, it promotes exports and increases the foreign currency entry in the home country.

2! DUE TO THE ABSENCE OF TAXATION INCENTIVES, BANKS IN OFFSHORE BANKING CENTRES DO NOT PROMOTE OFFSHORE BANKING TRANSACTIONS.

This became particularly evident from interviews conducted. Many transactions (loans) are booked in other financial centres and are not transferred to the OBU's books of countries which do not offer taxation incentives. This is possible because of inconsistencies which exist in the treatment of offshore sourced income in different jurisdictions. Many domestic banks may not be taxed on their global profits except U.S., U.K. and German banks. As a result they may enjoy the concessional profit tax in offshore centres where they only pay eg. Singapore 10%, Cyprus 4.25% because they are not assessed on the difference between the offshore tax rate and the domestic corporate tax rate. As a result, no pure offshore transactions are booked in countries which provide no taxation incentives. Some countries like Australia, in order to promote the booking of pure offshore transactions, have exempted the 10% rate of interest withholding tax on loans booked to the OBU's.

3! THE DEVELOPMENT OF AN OFFSHORE BANKING CENTRE DEPENDS ON THE TAXATION INCENTIVES PROVIDED TO NON-RESIDENTS.

If non-residents are provided with taxation incentives, this makes an offshore centre compatible, as they prefer this centre to conduct their business. The more taxation incentives provided, the more attractive an OBC may be to conduct any form of business. This will increase the economic activity in a centre and consequently the activity of an Offshore Banking Centre

4! HEAVY REGULATION AFFECTS OFFSHORE BANKING BUSINESS

The experience of successful OBC's suggest that heavy regulation affects offshore banking business. As noted in Chapter 4.7 Australia has not developed its offshore banking business due to the heavy corporate taxation of non-residents and on foreign sourced income. This became evident when the amount of total overall profits on offshore banking, showed that very little had been achieved.

## 6.2 RECOMMENDATIONS

- 1! All matters relating to OBCs should be handled in a centralised manner by a central government body in the form of either the Bank of England or MAS or Reserve Bank. This authority should deal with approval, registration and operation of offshore entities and investment policies of foreigners. This body should also have an advisory committee on offshore entities that will advise the Government on all matters related to offshore business.



- 2! Offshore entities should be provided with an exemption certificate from taxation, valid for a specified period from the day of their registration, for example, 20 years.
- 3! An offshore financial centre should be very selective when promoting offshore business as a long term good reputation is significant. Otherwise, an offshore centre may be included by other countries in their list of tax havens. When there is such a case this will destroy the image of an offshore financial centre and it will discredit it in the eyes of the taxation authorities of other nations.
- 4! Substantial tax concessions should be granted to attract offshore business. In addition. There should be abolition or significant reduction of personal taxation i.e. on the personal income of the expatriate. Also, the abolition of withholding tax and the relaxed regulations on offshore activities will assist in promoting an offshore centre as an attractive centre to conduct business.
- 5! A policy of gradual liberalisation of the entire economic scene needs to be followed, because there is a degree of interaction between the offshore sector and the rest of the economy.
- 6! There should be an advertising and public relations campaign, that promotes the country internationally as an offshore business and financial centre which offers business and tax incentives to foreign companies.

- 7! Specialisation in the Euromarket or in the Asian dollar market, or the Japanese yen or in the case of Australia, co-operation with New Zealand as one market. This should facilitate the success of a centre and promote its internationalisation in the world arena and contribute to its development.

### 6.3 SUGGESTED FURTHER RESEARCH

This study analysed six selected offshore banking centres. An analysis of more centres may add further weight to support the findings of this thesis.

In addition, further research in the importance of Offshore Banking Centres in the area of international trade would be valuable.

Finally, further research is needed to find the economic impact of Offshore Banking Centres on the host economies, probably with specific reference to Australia.

## Appendix A

### GLOSSARY OF TERMS

Offshore Banking: Conduct of Banking Business in currencies other than the domestic currency of the country where the dealing takes place.

Offshore Banking Centre (OBC's): A location where there is a large volume of borrowing and lending of foreign currencies, between residents and non-residents, either for trading and capital needs or for speculation.

Collection Centres: From country's market to outside market areas. (Generating excess savings.)

Offshore Banking Units (OBU's): International Banks, domestic or foreign licensed to carry on offshore banking business.

Paper or Booking Centres: The actual deposit taking and lending take place in other countries, but the transaction is recorded in on to the "paper" centres in order to avoid the various taxes and levies which might otherwise be applicable.

Functional Centres: Centres where banks leave a physical presence and raise, invest and lend funds largely on their own initiative.

International Offshore Financial Centre: A country that offers advantages in international tax planning.

## APPENDIX B

The actual interview had the following standardised questions:

- a) Which are the special (legal) or other general characteristics that contribute to the success of the selected Offshore Financial Centres?
- b) Which are the taxation and other incentives provided to non-residents that promote the Offshore Banking Centre?
- c) Which are the incentives available to Banks to promote offshore transactions?
- d) Do heavy regulations affect offshore transactions?
- e) Is there any international capital accessibility?
- f) What are the methods (I) of separating transactions between resident and non-residents and, (II) of controlling and checking such separation?
- g) Is there any competition between local-offshore banks?
- h) Give suggestions/comments on steps required in establishing a successful Offshore Banking Centre in Australia.
- i) Discuss employment/training opportunities.

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