Why go offshore?

IN THE SECOND OF TWO ARTICLES, **JONATHAN RIGBY**, **DANIEL LE BLANCQ** AND **DEAN GODWIN** SET OUT TO DEMYSTIFY THE OFFSHORE WORLD AND HIGHLIGHT HOW OFFSHORE FINANCIAL CENTRES MIGHT BENEFIT YOUR COMPANY.

Trading businesses often want to access the capital markets in an onshore finance centre but without necessarily becoming tax-resident there. This can be achieved by using an offshore holding company which can be managed and controlled offshore or in another jurisdiction.

Offshore financial centres (OFCs) provide tax-neutrality at the holding company level. Jersey, for example, offers a simple and favourable tax regime with no capital gains, capital transfer or corporation taxes. A listed Jersey company pays no tax in Jersey on income arising outside the island and is not required to make any withholdings in Jersey from interest or dividend payments to shareholders. And in many OFCs no stamp duty is payable on the transfer of shares in an offshore company.

It is important to choose a holding company structure that is familiar to investors. Many leading OFCs have a corporate legal framework based on English company law, so the two regimes will share very similar constitutional structures.

In certain important areas, company law in the OFCs provides more flexibility. For example, in Jersey the duties imposed on the directors of a company are in line with the older UK Companies Acts rather than the 2006 Act.

These factors also make Jersey holding companies popular for businesses seeking a listing on other international exchanges.

THE CASH BOX For corporates seeking to raise cash for an acquisition without depleting their cash reserves or borrowing, the equity markets can be attractive but the pre-emption rights regime restricts the amount that UK-listed companies can raise through a straightforward issue of securities for cash that is not made pro rata to their existing shareholders. Shareholder approval is required to exceed these limits and obtaining it can be expensive and time-consuming. Time can be of the essence in these transactions and often the way in which the cash is to be applied will be highly confidential. Shares issued for a non-cash consideration are not, however, subject to the same restrictions.

Guidelines published by the Pre-emption Group (a committee of representatives from the Association of British Insurers, the National Association of Pension Funds and others) set out acceptable limits on the disapplication of pre-emption rights. This is where a cash box company (the cashbox) is useful. It allows the company to raise cash within the framework of these limits from the equity markets through its subsidiary without shareholder approval, by enabling it to issue shares for a non-cash consideration, and to do so quickly.

The plc incorporates a new subsidiary which acts as the cashbox. The cashbox is usually incorporated in an OFC which does not have statutory pre-emption rights, but is managed and controlled in the UK for tax purposes. The cashbox, the plc and dealers or managers enter into a series of agreements, the effect of which is that the placing agents subscribe for redeemable preference shares (for cash) in the cashbox and then agree to transfer these shares to the plc in exchange for ordinary shares of the plc that have been placed with investors. The cash ends up in the cashbox – hence the name – and is either loaned to the plc or paid to it on redemption of the preference shares.

The advantages of using an offshore cashbox include fast-track incorporation, tax-neutrality in the OFC, and a quick and simple procedure for solvent winding up at the end of the life of the structure. Some OFCs also permit the issue of no par value shares which are easier to redeem.

EFFECTS OF THE UK REIT Long before the boom in offshore property investment structures created by seeding relief for stamp duty land tax, Jersey and Guernsey property unit trusts, often referred to as JPUTs or GPUTs, had been in steady use as tax-efficient property investment vehicles. And, although the unit trust has recently been the vehicle of choice, offshore property investment companies have also been used and continue to attract the interest of investors.

Although the seeding relief exemption was abolished by the Chancellor in the 2006 Budget, the JPUT and GPUT continue to be the preferred property investment vehicle for many investors because they bring other tax benefits. JPUTs and GPUTs are now so commonplace that units in these trusts could be described as an asset class in their own right.

At first, the introduction of UK real estate investment trusts (REITs) appeared to threaten to bring an end to the offshore property market by offering an onshore investment vehicle with free marketability, tax treatment in the UK equivalent to direct investment, and availability to retail as well as institutional investors. However, there are many

32-33 corfin mourant may08.qxd 16/4/08 7:04 pm Page 33

Executive summary

■ Offshore financial centres provide risk management and financial planning opportunities for the world's leading businesses. OFCs include offshore holding companies, cash box structures, property investment vehicles and securities listings. In recent years, the London Stock Exchange – and AIM in particular – has attracted large numbers of foreign trading groups seeking access to London's capital markets. Why do these organisations often choose to list through a holding company incorporated in an OFC?

situations where a REIT does not seem to work for certain investors and investing through offshore structures continues to be attractive. For example, for joint ventures or clubs of institutional investors who do not have an interest in a listing, and for those for whom enhanced liquidity from a listing is not a key factor, the requirement for a REIT to be a listed UK resident company will make it less attractive than the offshore alternatives. There is no requirement for offshore vehicles in Jersey and Guernsey to be listed.

For companies with large controlling stakes, the REIT will be of limited appeal given the tax charge levied on the REIT if it makes a distribution to a shareholder holding an interest of 10% or more. Offshore structures offer a number of savings over the REIT, with no equivalent to the entry or conversion charges and lower expected establishment costs.

The flexibility of the regulatory infrastructure in Jersey and Guernsey should also continue to attract property investment vehicles.

JOINT VENTURE VEHICLES The jurisdiction in which the joint venture operates will often lack sufficiently sophisticated corporate and commercial laws. In these circumstances, the joint venture parties will look to establish their vehicle in a jurisdiction which provides a sophisticated flexible company law regime with which they are familiar. The top-tier OFCs are able to provide this.

On other occasions the joint venture parties are simply looking for a compromise jurisdiction. In most cases, OFCs provide this neutrality as neither of the parties will be incorporated or resident in the OFC and the vehicle will not be operating there.

In both instances, the parties will also be seeking tax-neutrality for the joint venture vehicle. In the majority of OFCs the joint venture vehicle will either be zero-rated or not subject to taxation in the OFC in respect of income derived from its international activities.

CAPTIVE INSURANCE Captive insurance companies are limited purpose insurance companies established to finance risks emanating from their parent group. The administration of a captive is usually outsourced to a specialised captive manager, often located in an OFC which provides a favourable tax regime, actuarial reserve requirements and capital standards.

Some of the leading OFCs – notably Guernsey, Bermuda and the Isle of Man – have been recognised captive domiciles for many years. A number of offshore insurance markets also offer protected or segregated cell company structures which permit the assets and liabilities of a company to be segregated. These vehicles are extremely attractive to the captive insurance industry, providing additional flexibility in ringfencing and managing risk.

In Bermuda the insurance and re-insurance market has grown so large and sophisticated that it is now the third largest in the world. There are also signs the primary insurance market is becoming increasingly focused upon Bermuda. In September 2006 Hiscox, the FTSE 250 insurance company, announced that it planned to relocate to Bermuda, citing tax and regulatory advantages.

LISTING ON OFC-BASED STOCK EXCHANGES The leading offshore exchanges have been formally recognised or approved by a number of key onshore tax and regulatory authorities. For example, the Channel Islands Stock Exchange (CISX) and the Cayman Stock Exchange are formally approved by HMRC, the UK Financial Services Authority and the US Securities and Exchange Commission. As a result, offshore exchanges are now an attractive option for listing a range of securities including debt instruments, shares, structured products and Eurobonds.

The level of trading activity on offshore exchanges is relatively low so they tend not to be particularly attractive for issuers seeking to create a market in their securities. But for transactions where a listing is a requirement and where a developed trading platform is less important, advantages include lower listing costs and sponsor fees, fast approval processes and international standards of issuer regulation coupled with a commercial and pragmatic approach to disclosure requirements.

The past 18 months has seen a surge in the demand for the listing of quoted Eurobonds on the CISX. Quoted Eurobonds are attractive because interest can be paid gross without deduction of UK income tax. One of the conditions to qualify as a quoted Eurobond is that the securities are listed on a designated stock exchange, such as the CISX.

Jonathan Rigby is Partner at Mourant du Feu & Jeune.
jonathan.rigby@mourant.com

Daniel Le Blancq and Dean Godwin are Co-heads of Corporate at Mourant International Finance Administration.
daniel.leblancq@mourant.com
dean.godwin@mourant.com
www.mourant.com