



Mergers and expansion

Offshore update: riding the wave

Offshore legal leader Appleby has opened in four new jurisdictions over the past year, including through a merger with the largest law firm in the Isle of Man. It comes as the dramatic downturn in the economy has hit its heavily transaction-based market especially hard.

By Peter Bubenzer, global managing partner, Appleby

Since the commencement of the international financial crisis, attention has regularly been turned to the 'offshore financial centres' or 'tax havens', which have either directly or implicitly, but wrongly, been accused of some part in the origins of the crisis.

Most of the commentary suggesting some sort of participation by offshore centres in the creation of the crisis has retreated in the face of the facts. This crisis clearly originated in central bank and government policies in the major economies of the world, particularly those of the G20.

What is interesting, however, is that the crisis has provoked a renewed focus on precisely what is represented by the offshore financial centres and how the G20 should deal with them. The result of that exercise to date appears to be that the G20, following the Organization for Economic Co-operation and Development (OECD), has determined that the major economies of the world wish to set certain standards before they allow offshore financial centres to access their economies. If those standards are met, their continued participation is accepted and their continued existence, therefore,

is permitted. The initial focus has been on the creation of a standard of accessibility of information required by G20 and OECD countries to maintain the efficiency of their tax network by closing off opportunities for tax evasion. This has led to the development of a network of international tax information exchange agreements, which allow for disclosure of information relating to tax matters between the countries party to such agreements. All the seven offshore financial centres in which Appleby is represented (Bermuda, the British Virgin Islands, Cayman, the Isle of Man, Jersey, Mauritius and the Seychelles) are on

the 'white list' produced by the OECD, which recognises countries that have not only committed to implementing the OECD standards, but have actually taken steps to enter into the requisite minimum number of treaties mandated by the OECD.

Most of these offshore financial centres are continuing to negotiate and enter into these agreements, so as to remove forever the complaint that the offshore financial centres are uncooperative – in relation to tax matters – with the major OECD countries from which they obtain much of their business. Additionally, this openness is intended to make clear that the business in those centres is in no way suspect or tainted.

However, a good deal of the tax evasion about which complaint is made is carried out by individuals who fail to make disclosure of the offshore accounts or offshore investments they hold. Most of the major OECD countries are adopting stricter reporting requirements and raising penalties for failure to disclose, as they are now able to take advantage of the tax information exchange agreements in order to improve the efficiency of tax collection, based on their current tax laws.

Having said that, the significant business Appleby sees across the major offshore financial centres is either institutional in nature or is won from high-net-worth individuals or private businesses. It is derived from the major financial centres and economies of the world and in no way founded on tax evasion. Such business is usually structured through one of the offshore centres on the basis of very careful tax and regulatory planning, involving a great deal of consultation and advice, taken both onshore and offshore, to ensure that the structures comply with the appropriate tax and regulatory requirements. One also needs to bear in mind the obligation such businesses or persons have to report for tax or regulatory purposes, the significance

for them of avoiding any hint of illegality and their full exposure to all the powers of domestic regulators and agencies to require information on their onshore, and usually offshore, activities. As a result, the current OECD initiatives have not had any significant effect on the level of institutional or significant private client business being derived in the offshore financial centres. The hostile pronouncements on tax havens, the entry into multiple tax information exchange agreements and the general scramble to ensure offshore centres continue to comply with G20 and the OECD's requirements have had no discernable effect on the business that the vast majority of the firms such as Appleby are winning.

What is affecting the flow of business offshore at present is, not surprisingly, the drastic downturn in the world economy. This has led to a marked decrease in the number of transactions, and most offshore work relates to the creation of companies or offshore structures for the purposes of transactions. As an example, structured finance has virtually ceased to exist as an activity at the present, although it is ultimately expected to revive, possibly with new loci, rather than the traditional centres of Dublin and Cayman. The funds industry has faced considerable contraction, and has shown no sign of a return to its old vigour as yet. Financing activities are still infrequent, and capital markets, while reviving, are not yet encouraging of any significant improvement in the levels of work on capital-market transactions such as public offerings or mergers and takeovers. As a result, in the offshore world the financial crisis has had a dramatic effect on the level of business that is flowing.

Priorities in progress

While considerable progress is being made on the tax information aspect of the concerns of the G20 and OECD, there is

an indication that attention is now being turned to two other areas.

The first is the question of restricting opportunities for lawful tax avoidance. I note many commentators on offshore centres glibly, and wrongly, use the terms 'tax evasion' and 'tax avoidance' as if they were interchangeable. Tax avoidance is lawful. Tax evasion is not. A number of countries in the European Union and the US are looking at adopting legislation that will restrict the potential use of offshore financial centres, for example by removing tax reduction opportunities that exist under present law. This is not a new development, and certainly is perfectly understood in light of the current economic situation in many G20 countries. This has been the goal of tax reform for many years, and will no doubt continue as, alas, one opportunity closed seems invariably to lead to another opened.

The second new area is the suggestion that countries (including offshore financial centres) should now be assessed on the basis of their regulatory environment. No detailed discussion appears to have taken place on this concept yet and it would appear to have a number of challenges before this could be meaningfully realised – given, for example, the regulatory differences existing between all of the G20 countries. A number of these effectively compete on the basis of regulation to attract business.

Merger movement

Against this background, the past five years have seen the continued growth (in the offshore world) of six larger offshore law firms, competing internationally, although not all of them across common jurisdictions or with a common footprint. There has been no significant consolidation among the larger firms, although some of them, such as Appleby in the Isle of Man, are continuing with mergers

for the purposes of expansion into a new jurisdiction. Some of these firms are also establishing new greenfield sites to expand into new jurisdictions, as Appleby has done in Mauritius and the Seychelles. While the current world economic environment would appear to suggest that the time may have come for a large law firm merger, I still think that unlikely. There remain distinct cultural and financial differences between the larger offshore firms, which make mergers challenging. Many have similar locations where synergies and efficiencies may be hard to find. There is also a small selection of potential large firm partners from which to choose. Nothing at present suggests that any of those firms has a need to merge in order to survive, and therefore I would expect most of the current six still to be here, and independent, for the next five years.

The current downturn in work, particularly as it has not been evenly felt across all offshore centres, has inhibited expansion for most firms, as they focus on internal restructuring, redundancies and expense cutting. Most have tended to limit any expansion to enhancing their existing presences, rather than expanding their offering into new markets. At Appleby we have sought to do both, in terms of recruiting good talent that is now more readily available (for example in our offices in London and Cayman), investing in the growth of our legal practices and fiduciary businesses, as well as expanding our jurisdictional offering to clients (in Zurich, Bahrain, the Isle of Man and Seychelles in the past year).

In developing their global business, all the major offshore law firms operating in multiple offshore jurisdictions, for example Appleby in seven offshore centres, also focus on the development of the business for each specific offshore centre in which they are located.

Accordingly, such firms have been well received by the governments in those jurisdictions, as they provide a

further opportunity for the development of the international business aspect of their economies. In some cases it is the substantial foreign currency earner for those jurisdictions. These firms have therefore taken on an even more interesting role in assisting in the development of the offshore centres for the benefit of their governments and people. This creates the opportunity to work with those governments to help design effective structures and opportunities for foreign investment, which will thereby strengthen their economies and provide opportunities for their people. This is something that is well understood at Appleby and we, for example, will cooperate enthusiastically in law reform initiatives and studies undertaken by those governments, where our knowledge can be of real assistance. When establishing an office in a greenfield site, it is important to do so with a view to being there for the long term and becoming part of the business community, as is the case in our other locations. In Appleby's case we do this, for example, by offering scholarships and giving back to these communities in a variety of ways.

Looking ahead

One might ask about the future for the offshore financial centres and for the firms such as ours that thrive in them? The real question, in some ways, is rather why it is that major countries, such as members of the G20, continue to accept the existence of offshore financial centres. The answer is partly simple reality. There is a recognition that these centres provide a means for the efficient investment (in tax and regulatory terms) of significant capital into or out of their economies. Thus, significant investors into countries such as China and the US include offshore financial centres such as the British Virgin Islands or the Cayman Islands. Mauritius and the Seychelles provide the means for efficient and secure

investment from North America, China and Europe into Africa.

Additionally, there is the recognition that these offshore centres do not exist because they are promoting some sort of financial drug which, when consumed onshore, leads to a trance-induced state of tax evasion. Rather, most of these offshore centres exist as the tax laws and regulations of the G20 member states provide, to varying degrees and efficiencies, perfectly legitimate and accepted means for companies and individuals to mitigate their tax burden or solve a regulatory issue, which will include both onshore and sometimes offshore solutions.

The result of this rather curious circumstance is that while vilified and attacked on the one hand (although then praised and rewarded for signing up to tax cooperation, for example) these offshore financial centres are effectively acknowledged as a part of the efficient deployment of capital throughout the global financial system. While not equal, they are at some level a partner in the chain of links that constitute the global financial and economic network that is the world economy.

It would be my guess, and I would not rate it as a prediction, that the next five to 10 years will see the major offshore centres still thriving, and still conducting business with the major economies of the world. While specific tax, regulatory and other opportunities will come and go, the world economy is diverse and large, the shift of wealth to countries such as Brazil, China, India and Russia will continue and, against that background, stable, secure, reputable and accepted international offshore financial centres will continue to thrive. Managing PARTNER

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