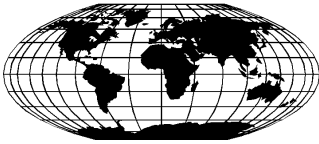


EAST ASIA TRANSNATIONAL

INTERNATIONAL COMMERCIAL LAWYERS

HONG KONG AND AUCKLAND, NZ



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IN THIS ISSUE:

- 1 *Change of office address*
- 1 *Web site*
- 1 *Two years back in New Zealand - a personal view of the commercial business scene*
- 2 *Ownership of NZ and overseas assets with an offshore trust*
- 3 *Tax havens under attack*
- 3 *Tax and the internet*
- 4 *Patents in the USA for business methods*
- 4 *Hong Kong and China economies*

CHANGE OF ADDRESS

Note our new address and change of telephone and facsimile numbers. A new card is attached.

The address of our Hong Kong office is unchanged. The writer remains a practising member of the local legal firm in Hong Kong, Joseph Chu Lo & Lau, and we continue to offer services locally in Hong Kong. For those wishing to contact the writer in Hong Kong, please call Kitty Wong, who undertakes secretarial services in Hong Kong.

There may be occasions when it is necessary or desirable that the writer be instructed direct as a Hong Kong lawyer in Hong Kong, and if so, please call Kitty Wong at Phone 852-25262077, Facsimile 852-28450354 or E-Mail jcll@asiaonline.net, who will pass any message or instructions to the writer.

WEB SITE

Our Web Site, much delayed due to pressure of work, will be up and running in the next month. On it will be a comprehensive summary of our services and a fee scale for most commercial work we undertake. We will advise details in due course.

TWO YEARS BACK IN NEW ZEALAND - A PERSONAL VIEW OF THE COMMERCIAL BUSINESS SCENE

Although the bulk of our commercial legal work is in Hong Kong and China, the writer as a long time expatriate in Hong Kong has some impressions of the New Zealand business scene in contrast to Hong Kong and Asia generally.

Points we have noted:

- The absence of a comprehensive take-over code and the almost total "hands off" attitude to some blatant dealings by major shareholders in New Zealand listed companies;
- The domination of the property market as the only investment that most New Zealanders know. Given the absence of immigration and the control the Reserve Bank has on interest rates, that seems now to be a risky strategy. Asia has discovered how much real estate markets can crash - in Hong Kong prices are now back at 1993 levels - a drop of some 50% from 1997 levels in some cases;
- The absence of a coherent and long term immigration policy. The latest business policy is a disaster, and proves that it is a waste of time trying to force foreigners to set up business here. New Zealand is too small. Rather try and attract individuals and companies to use New Zealand as a base to do business; the latest initiatives although positive, will probably not achieve much;
- A complex tax system which deters inwards investment;
- A reluctance to spend any money on advice or market research;
- A draconian tax system with regard to overseas investment. The CFC rules requiring disclosure of interests in "grey countries" are an affront to the intelligence of any investor who wishes for example to set up a company in Hong Kong to do business in Asia. New Zealand does not appear to favour overseas investment;

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- The complete decimation of rural New Zealand and its small country towns. Even places such as UK have a regional incentive investment scheme for different regions, and that type of policy appears urgent. Mr. Delamere's investment scheme for Chinese investors might not have been wrong.
- The tax on interest. Removal would probably attract large sums from offshore. Hong Kong is an example of an Asia country that has no interest tax and vast sums are parked there by international investors.

Some years ago NZ was rated a good place to do business. Now, in a recent OECD comparison in the Economist, NZ has slipped far below other major trading partners.

It is vital for the Government and business leaders to work hand in hand to formulate a vision for the future and that may involve incentives in certain sectors.

OWNERSHIP OF NZ AND OVERSEAS ASSETS WITH AN OFFSHORE TRUST

Since establishing our firm in New Zealand, we have been surprised by the number of persons who have approached us with a view to setting up offshore entities to own New Zealand assets. This is a healthy sign that New Zealanders are realising that ultimate ownership in Asia of local assets by offshore is a viable and positive strategy, and indeed is very much the norm in Asia. It might be useful if we briefly summarise the advantages and disadvantages inherent in such a strategy:

1 Disadvantages

- (a) It is expensive. A two tier system with a trust in say Caymans, Bermuda, Channel Islands, Turks and Caicos, etc. or even the Cook Islands, with the trust holding shares in a BVI (British Virgin Islands) holding company, which in turn owned the assets, would cost a minimum of NZ\$4,000.00 to NZ\$6,000.00 to set up and cost at least NZ\$3,500.00 per annum to administer; a single tier system with no interposed Company would cost around NZ\$3,000.00 to set up and NZ\$1,000.00 per annum to run;
- (b) If the Settlor is a tax resident of New Zealand, there are few tax advantages in such a structure, save perhaps some deferment of tax on the trust's income, or beneficiaries income;
- (c) Ownership of say a New Zealand asset by a nominee offshore or local company owned by the offshore trust will not necessarily protect the asset if there are tracing claims against a Settlor or person adjudicated bankrupt in New Zealand. Courts overseas have been prepared to wind up a foreign company owning local assets, although it is true to say that it maybe a very complex and time consuming process to do so;
- (d) If the trust was classified under the Income Tax Act as a non qualifying trust (as it would be), it may be a disadvantage as capital gains etc. would be taxed at rates as high as 45% on distributions, unless the Settlor wishes to declare the trust for NZ tax purposes and pay tax at 33%; some planning however can alleviate the higher tax rate;

- (e) Holding an interest in a simple IBC (International Business Company) in say BVI or other tax haven, would trigger disclosure requirements under the CFC rules, and may also trigger deemed returns if also an investment under the FIF (Foreign Investment Fund) rules;
- (f) Debts back from the Trust remain assets in NZ and subject to attack, unless the Trust itself can wealth create so that the debt is of little significance, or the Settlor is, or becomes later, non tax resident in NZ;
- (g) As will be seen below, tax havens are under attack from the OECD, and care is needed in using particular tax havens that may have fallen foul of possible OECD compliance and protective measures already announced.

Notwithstanding the limited tax advantages, there are some other commercial and asset protection advantages if an offshore trust is established:

2 Advantages

- (a) While some jurisdictions such as places in the Channel Islands (Jersey etc.) and Bermuda have laws similar to NZ so far as fraudulent transfers of assets to a Trust is concerned, other jurisdictions have set up laws and systems which prevent (save in very special circumstances and within short periods after transfer of the assets to the Trust) enforcement of judgements obtained in other countries against a Settlor who established the Trust. There is no choice but for a creditor to then enter the courts of the country where the Trust is established and seek a local court order. That may be very difficult to do;
- (b) The laws of most tax havens allow the Settlor to be a beneficiary by law;
- (c) The Settlor is able to control the Trust in most tax havens.
- (d) Even if there has been a fraudulent transfer, laws of most tax havens specialising in asset protection trusts allow the Trust itself, to remain a valid legal entity;
- (e) Confidentiality is assured, and in cases where the offshore Trust/Company wishes to deal in the NZ market Directors can be assured that no offshore search can establish who owns the Company or Trust. Ownership of a large shareholding in a listed Company in New Zealand or elsewhere should be owned by an offshore entity. Invariably in HK and other parts of Asia this is how such holdings are held;
- (f) No one knows whether governments in NZ will interfere in the freedom of New Zealanders to make bequests as they see fit, but the Family Protection Act is an example where claims can be made, and the re-introduction of Death Duty, a wealth tax or a capital gains tax are all examples of legislative interference. Given the erosion of the NZ tax base, we think such legislation is inevitable, and assets owned by a Trust outside New Zealand's borders gives protection from most New Zealand based claims;
- (g) Greater powers for the IRD and claimants under the Matrimonial Property Act to attack Trusts also seem inevitable under the present climate and it may be that offshore Trusts become much more popular in the future to

prevent Settlers with large amounts of capital being subject to major business disruptions in the event of a large claim in New Zealand. Certainly there are arguments in favour of a holding company offshore owned by a Trust where major business interests are owned in NZ;

- (h) Sale of a major NZ business to offshore buyers would be better facilitated if the holding company itself could be sold offshore, as an international investor is not likely to require an onshore structure ultimately owned in New Zealand by a tax resident entity;
- (i) Many reliable and respectable small Trust companies exist offshore who can provide trustee services at a fraction of the cost of a large Bank. For example, HSBC International Trustee, with whom we have dealings, commonly charge up to \$HK50,000.00 (\$NZ13,500.00) as a set up fee, plus another HK\$50,000.00 per annum to administer the Trust. By contrast smaller Trust companies can charge a fee 60% cheaper;
- (j) Although NZ tax issues must be considered, some large international companies with many subsidiaries (Richard Branson of Virgin Airlines is an example) routinely use BVI and other companies with bearer shares to own subsidiaries. Transfer of the bearer shares to another subsidiary offshore can therefore shift ownership of the subsidiary on delivery of the shares, which means that losses or profits are shifted from one subsidiary to another, which may have significant reporting advantages domestically;
- (k) For those investing in shares and securities held on overseas registries, and who wish to control the investments they have in a single entity, ownership via an IBC/Trust is an advantage in that expensive and lengthy probate applications on the death of the investor are avoided, as the shares in the IBC can simply be transferred to a beneficiary at little or no cost;
- (l) Structuring of what would otherwise be a mutual fund vehicle can be set up in many offshore jurisdictions such as BVI and the Isle of Man through an IBC or to take advantage of local legislation which imposes few requirements for regulatory consent save for a simple offer document containing details of the investment being promoted. As an example, BVI has a total of 1506 open-ended private of professional funds duly approved by local authorities proving that such jurisdictions will continue to be attractive for groups wishing to market funds to investors internationally.

A word of warning

We have seen some clients in NZ purchase IBC's from somewhat dubious "trust companies" who also offer "Protector" services within the same group. This is to be avoided, particularly as the services often go hand in hand with leveraged investments offering huge and speculative returns.

We offer individual advice on establishment of structures offshore both in NZ through our office in Auckland and through our Hong Kong office.

TAX HAVENS UNDER ATTACK

In 1989 Britain and other "western nations" established the Financial Action Task Force (FATF) based on the Organisation of Economic Development and Cooperation in Paris to combat money laundering and required most tax havens to pass legislation setting up checking procedures to deter offshore banks and individuals being knowingly, or unwittingly, involved in such activities.

This action is seen to be fair and reasonable, save that with pressure from the USA and Europe Britain has had to extend the scope of FATF to cover "fiscal offences" (breach of its and other nations tax laws) which may be committed through utilisation of such jurisdictions as BVI, Caymans, Bahamas, Cook Islands etc. And the OECD has on the 25/5/2000 produced a list of countries which it says are known tax havens, and which it says are distorting the financial system on a large scale. While it was probably thought that "fiscal offences" was not intended to be lumped in with money laundering, it now appears clear that the OECD expects that tax havens will in the future have to co-operate with the tax authorities of various OECD countries to track down known tax evaders. In addition, "fiscal offences" are meant to be treated as crimes by all tax haven countries.

While some tax havens may refuse to co-operate, the sanctions that can be indirectly applied by the international banking sector alone are a powerful incentive to conform, as otherwise banks, under pressure from Governmental authorities, will simply refuse to send funds there.

The effects of the FATF are far reaching and it will now be advisable to study in detail how confidentiality will be affected in each country. For instance, Bermuda, regarded as a well behaved tax haven, requires disclosure of all beneficial owners of Companies, while BVI will now require that the names of Directors appear on a public register. It seems however that Directors can still be nominees, and no disclosure of the real directors is required.

As an illustration of how determined the OECD is over the whole issue, the Bahamas, considered a mainstream financial centre, is classed as "non co-operative" on one list of the OECD, and eight other countries top all three OECD lists, including St Kitts- Nevis, and Niue, Nauru and the Cook Islands. Jersey, Guernsey and the Isle of Man are also on the list in the category of tax havens. The USA is also considering sanctions against a country, a bank or even a type of transaction where a tax haven is involved.

While the issues are serious for clients owning/controlling tax haven entities, and require careful monitoring, we do not expect that there will be anything to fear if IBC's and other tax haven entities are used for trusts, asset protection, or simply as useful tools in structuring within legitimate group activity.

TAX AND THE INTERNET

Today's tax system is based on knowing where a particular economic activity is based, but the Internet allows a global company to operate in many different countries while operating from the one base, and the hitherto traditional approach of taxing business activities solely on activities carried on at a physical location is under challenge.

For instance, under traditional tax rules a company was deemed to have a taxable presence in a country if it had "a permanent establishment" there, or sometimes if the company concerned was subject to director control at local level. It is however by no means clear that the existence of a server or a Web Site constitutes such a presence, and it is also virtually impossible to prove where a Board meeting took place, given that meetings can be set up by E-Mail and deemed to be held in any jurisdiction that the company may wish.

The problems become more complex with E-commerce and the sale of services over the Internet.

Collection of sales taxes

With E-commerce, it is almost impossible to collect sales taxes. As an example, if a retailer bases his warehouse where he stores goods in a location that does not impose sales tax (some states in the USA do not) then with a server situated in a tax haven or low tax jurisdiction, then the Web Site emanating from that server is immune from attack, as the retailer effectively has no taxable nexus with the country or state he may be selling into.

While with E-commerce and physical goods the tax authorities may well be able to check products coming into the state of a country to see if tax has been paid (within the EU, but not the USA, retailers are supposed to collect vat tax from individuals buying over the Internet) where the sale of intangibles are concerned, such as services, online music, education, particularly those downloaded from the Internet, the tax authorities cannot hope to catch a company which has been set up in a country or tax haven where sales or other taxes are not imposed.

Tax planning

Tax planning on the Internet is here now. To take a very simple example, if a retailer wishes to sell an education programme comprising physical books costing US\$10,000.00, then depending where his server and Web site is situated, it may be possible to separate the cost of the physical product to equal say US \$4,000.00, with an intangible goodwill, copyright, design price, customisation etc. costing say \$6,000.00 which is sold separately from another server or Web Site situated in a nil or low tax jurisdiction. Sales tax might well be payable on the physical component, but no tax can be levied on the intangible service. Obviously, other variations are possible.

Hong Kong as a Base

Hong Kong is a major centre for E-commerce in Asia, being substantially a free and unrestricted information centre, unlike places such as Singapore and Japan. The possession of a territorial tax system such as Hong Kong has, and its easy access and experience to and with other low tax jurisdictions, is also a major selling point for Hong Kong.

FIXED ODDS TRADING OVER THE INTERNET

We have been advising a Hong Kong and Isle of Man client on the structuring of an Internet. Possibilities exist to set up a site in the Cook Islands and Macao from which certain operations normally classed as gambling (but in this instance fixed odds betting - arguably a security under Hong Kong's Securities Ordinance) can be conducted on the Internet. We should be pleased to advise any local "ISP"s or investors in NZ on the subject.

PATENTS IN THE USA FOR BUSINESS METHODS

It is worth mentioning briefly that under US law patents for business methods, not necessarily technology based, has been allowed in recent times. Mostly this has applied to be sites where a novel method of business was being introduced, but the possibility remains that even ideas and business methodology can be patented. One client of ours has patented an investment method, and another is contemplating patenting of a business methodology.

Needless to say, a patent in the USA is worth a considerable sum and offers much greater protection than a trademark.

Any NZ business which can possibly qualify should consider doing so, although the time lag may be substantial; our agents in New York tell us that the registration process is clogged up with applications such is the desire of many investors and businesses to register and protect existing business methods.

HONG KONG AND CHINA ECONOMIES

Both domestic economies are subdued, and influenced by higher interest rates in the USA. China's proposed admittance to the WTO has given great impetus to various service sectors to gear up for anticipated business, but we find it difficult to see how China will handle certain regulatory and business changes which membership will force on to it. Nevertheless, the future for China looks positive, as economic changes must inevitably put pressure on for more democratic institutions.

Two clients of ours recently have established holding companies in HK to enter joint ventures in China, and the position of HK as the entry point to China is not seriously under threat from Shanghai or any other region in China.

A positive move recently was China's approval to establishment of Bank accounts in China by foreign investors. Notwithstanding this, pre-approvals may be required for the remittance of funds out of China, and unless a China bank account is required by reason of a local business in China, or a JV, a Bank account is best set up in Hong Kong, where there is no interest tax or exchange controls.

HONG KONG/CHINA NEWSLETTER

We also publish a separate Newsletter for clients based in Hong Kong and China. Anyone requiring a copy may obtain one from us by E-Mail. Topics covered include new securities legislation, trademark update, new electronic contracts legislation, and tax planning using an offshore company for investments in Europe.

DISCLAIMER

The information contained in this Newsletter is for general information only, and should not be relied on by any party as a specific or comprehensive statement of the law in relation to any issues reviewed herein. Specialist legal advice should be sought from us in relation to individual circumstances

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