Keep clients from bolting offshore

MERRICK WEALTH

By Peter Merrick

We have heard that the best way for the wealthy in this country to reduce taxes and protect assets from creditors is to move their money offshore. This was popularized in Alex Doulis' 1994 bestselling Canadian business book, *Take Your Money and Run*.

However, the offshore option often has assumptions which are left unquestioned by the client and their advisors. I would like to share a story that makes the case for questioning underlying assumptions.

Early in my career, my best client called to tell me that he had just been pitched by one of the in-house chartered accountants at a large bank-owned brokerage firm on a structure that would move the account he held offshore. He was seriously considering this because he was presented with the possibility of saving on taxes and protecting his assets from creditors.

As I got off the phone I knew that there was a very real possibility that I would lose my influence with him or lose him as a client, or worse both.

The following morning as I was working out in Toronto, I noticed that Bob was on the next machine. Bob was a successful tax lawyer with over 30 years of experience. I had talked to Bob several times and had read his book on tax, cross-border and benefit planning for the successful business owner.

I decided to ask him about the benefits of offshore investing and the downside of it. I did this hoping that Bob would tell me something I could bring back to my client, to save the account and restore our relationship.

In our conversation Bob told me the following follies of offshore investing, which most people are unaware of until it is too late:

- When taking money offshore legally the individual receives no tax relief, the money must be removed after taxation.
- If you take money offshore legally you have to give up ownership of it for a moment in time, meaning you have to trust someone to be the settler of your account.
- For the money to grow tax-free offshore it has to stay out of the country. Your money could be brought back, but it would be very difficult and costly, generally speaking.
- To go offshore you have to pay large set-up fees and annual fees to maintain whatever structure you settle on.
- There is no offshore structure that allows you to invest pre-tax dollars.

As Bob finished explaining the pros and cons of offshore investing, he smiled. He began describing an alternate solution that was superior in a number of ways.

He believed that this should be the alternative presented to all financially successful individuals considering offshore investing. Bob then shared that it would result in the following outcomes:

- Your money would stay in Canada, where you can see it, touch it, feel it and smell it.
- Corporate deposits can be structured to be deductible.
- All personal deposits can be structured to be deductible over time.
- Large annual deductions are provided each year against income for the rest of your life.
- Money would be invested on a deductible basis, so the money grows tax-free. The individual retires tax-free, dies tax-free, and all the while having savings protected from creditors.
- The corporate or personal deduction creates a cash-on-cash return every year, year in and year out, in a plan where tax will never be paid as you use the funds for either retirement or investing.

I knew that I had just been listening to the solution that would save the relationship with my client and put an end to the possibility of his account moving offshore.

I asked Bob if he could tell me more. Bob said that he had spent over 30 years understanding this solution, as it met all the tax and regulatory compliance requirements. He told me that I would need to engage his firm before he could go into more detail, especially of how this solution would specifically relate to my client's situation.

I knew that Bob's billing rate was over $1,100 per hour, much higher than I thought I could afford at the time. As Bob headed towards the shower, he turned to me and said these words that I will never forget: "I like you Peter, so I will tell you this, the solution sits in Section 148 of the *Income Tax Act*."

I did not take Bob up on his offer to implement the solution for this client. What resulted is something I am not proud of admitting, my best client took the advice of the chartered accountant and moved his money offshore. He said goodbye to me and I said goodbye to my largest account at the time.

It's an experience that I am glad I had, but I promised myself I would never repeat it. I have learned that if it happens once it is a fluke, if it happens twice we may be able to call it a coincidence, but if it happens a third time, it's me.

I also learned that it pays to bring in experts rather than being 'penny wise and pound foolish.' And that Section 148 of the *Income Tax Act* holds the solution to wealthy clients keeping their money here instead of moving it offshore. All of us who provide tax advice should know what is in this section of the act.

Ask yourself the following questions: Who are my best clients speaking to other than me? What advice are they getting? Do I know what my clients' true issues are? Do I have the expertise needed to solve my clients' problems, or am I prepared to bring in the experts to do so? Remember, if you are not meeting a client's needs, they will find another professional to bring them solutions.

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Salole says SEC has right idea

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accept it, could effectively undermine the power of the International Accounting Standards Board in its standard-setting activities.

According to Salole, "the ultimate objective is to have a single set of high-quality, globally accepted standards for financial reporting worldwide." He does not believe that this objective would be achieved if every jurisdiction were allowed to carve out one or more IFRS requirements. "To my thinking, this would run counter to achieving the objective."

Not according to the EALC letter, signed by corporate heads from 11 European countries. It said that "having a critical mass of IFRS reporting companies in the United States will enhance the familiarity of investors (and the commission) with IFRS. The more companies that publish IFRS financial statements in the United States, the more likely that IFRS will become a truly global standard."

But it noted that, for European companies, the crucial issue is to ensure proper co-ordination of the new rule with IFRS as adopted in the European Union. "While European companies would prefer that there be only one IFRS (and not an IASB version plus jurisdictional variants), they are faced with the reality that they are legally bound to publish financial statements in accordance with IFRS as adopted by the European Union."

For a European company to produce a single set of financial statements worldwide, those financial statements would have to comply with IFRS both as published by the European Union (to meet home country legal requirements) and as published by the IASB (to meet the requirements of the SEC new rule).

Today, said the EALC letter, this is substantively achievable for most European companies as IFRS under the aegis of the IASB and the European Commission are substantially the same. "There is no guarantee, however, that it will always be true. If a conflict were to arise in the future, the SEC's current proposal would effectively require European companies to publish two sets of IFRS financial statements to remain in the United States market. This could result in confusion for investors."

The EALC, therefore, "strongly" recommend that the SEC eliminate the U.S. GAAP reconciliation requirement for companies that publish financial statements in accordance with IFRS as adopted by the European Union. "This would be the best way of making the U.S. market attractive to European issuers. It is also perfectly consistent with the protection of U.S. investors for the SEC to recognize a high-quality jurisdictional variant of IFRS, based on IASB standards and supported by strong auditing and regulatory infrastructure. This is particularly true given that today there is no material difference between IFRS as adopted by the European Union and IFRS as published by the IASB."

For its part, the Investors Technical Advisory Committee (ITAC), which advises the U.S. Financial Accounting Standards Board on behalf of investors, liked the direction of the proposed rule, especially the fact that it asks for the elimination of the reconciliation requirement only for financial statements prepared according to international standards issued by the IASB, excluding statements prepared using "country versions" of the standards.

But the proposal comes too soon, said its letter, sent last August 31, and signed by ITAC member Jack Ciesielski. "We do not believe there is sufficient current symmetry between the IFRS literature and U.S. GAAP to warrant the elimination of the required reconciliation. There remain many highly material differences in the results produced by the two systems. In the absence of the required reconciliation, those important differences generally could not be quantified or even reasonably estimated."

The ITAC would prefer to see concrete evidence that the two sets of standards are substantially equivalent before reconciliation is eliminated, the letter said, noting that "having a process in place to achieve convergence is not the same as having achieved convergence."

The committee was highly critical of the possibility of permitting U.S. issuers to prepare their financial statements using IFRS in their SEC filings. "If the goal of convergence is a single set of high-quality accounting standards, would permitting U.S. companies the options to use IFRS or U.S. GAAP further the attainment of that goal?"

In its view, concluded ITAC, "the reconciliation remains a critical repository, providing visibility to investors of the material variations between the accounting systems that are otherwise generally not determinable . . . . We believe it is clearly premature to consider its removal because the data in the reconciliation has even greater significance to investors during a period of frequent underlying changes to the respective GAAPs."

The difficulty Salole has with ITAC's view is in "understanding whether they are suggesting that IFRS's should be sufficiently 'similar' to U.S. GAAP before the reconciliation is dropped. I would question any contention that claimed U.S. GAAP does not need to change to adopt IFRS's that many consider an improvement. On the other hand, the reconciliation does have information value, and phasing it out over two years might be useful. This was the approach taken in Canada with respect to the reconciliation between U.S. and Canadian GAAP."