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In Full Bloom

If what the 17th-century playwright, William Congreve, said is true: "Uncertainty and expectation are the joys of life", then Latin America promises bountiful happiness for years to come.

The rapid developments taking place in Latin America have caught many by surprise and increasingly there are surveys, reports and articles providing historical, political and economic detail. Our sister publication, Latin Letter, addresses these subjects specifically and the June column (The Magical History Tour) should be read in conjunction with this issue of the Quarterly. All Latin Letters, dating back to the first one in October, 2002, can be found on our website (click the LOCAL NEWS icon) for those who do not already receive them.

I hope that this issue of the Quarterly will provide, if not joy, then at least some guidance. Oscar Wilde said: "The only thing to do with good advice is to pass it on. It is never of any use to oneself". In pointing the compass towards Latin America, therefore, I hope I can go some way towards offering a little of it through commentary laced with history and humour. Some of the advice has been given before, but I think 2013 is a propitious moment to repeat it.

Just because today Europe and, to a lesser extent, the United States of America, have lost their confident, buoyant stance of a decade ago, it does not mean Latin America is home and dry; as for the euphoria experienced by some, as I write this, over the American stock market rise, I lean towards the Menckonian view that the flowers one smells suggest a funeral and not a wedding. Latin America may be in full bloom, with not a hearse in sight, but it must

temper its growing confidence and avoid the fate of Icarus, ecstatic with the ability to fly, who flew too near the sun on wings of feathers and wax.

The focus on commodities has carried inherent risks and enticed some countries closer to the sun; but prices can never be constant and declines follow surges. A cautious smelling of flowers – as events this year have shown – is recommended. Commodity prices rose strongly due to the industrialisation and urbanisation of China that created a supercycle of high demand compared with low prices in the 1990s. Whatever re-balancing may be going on in China today, the weather and Mammon are key for commodities. Look at Japan's earthquake and tsunami as well as the Arab Spring which caused spikes in prices from oil to wheat and gold. In sum, geopolitical and environmental uncertainties could see an era of volatility in prices that might last through this decade and so Latin Americans, in similar fashion, should re-balance their economies too.

The important point here is that Latin American nations have to continue to wean themselves off too great a dependency on commodity exports and concentrate on finding ways to develop viable, long-term alternatives, such as services industries – the key to Panama's success – while at the same time tackling crime rates, corruption, shaky tax systems, and political divisions. This they have started to do, although internal divisions tend to flare up as they did in January at a biennial summit with the European Union in Chile's capital, Santiago. Perhaps in anticipation of this, most of Europe's important leaders did not attend (astutely, Germany's Angela Merkel and Spain's Mariano Rajoy did).

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It is the Pacific Alliance, however, that has taken centre stage and which is a newly-formed group of countries comprising Colombia, Chile, México and Perú; Paraguay, Panamá and Uruguay are also interested in taking part. Even although the region has a growing number of self-confident and independent democracies now, the differences in temperament displayed in January at the EU summit highlight not just the Latin culture, but the variances in it across the many Central and South American countries.

Green Shoots

But for me one of the most important issues has been raised by México's former Economic Secretary, Bruno Ferrari García, who says that economies need to be integrated to bolster the future economic well-being of the region. Importantly, intra-trade could lead to closer integration of tax systems, promoting more uniformity and clarity. Green shoots are appearing everywhere.

The region needs to continue to look inward, and not just outward, to a Latin American market of over 550 million people; the level of growth is only second to Asia's. While the region's natural resources have fuelled expansion in China and India, meeting domestic demands (as China and India are doing) will be a powerful back-up in the future.

Where can investors feel that their money can be put to work for a reasonable return in what are dismal economic days for many countries? Not just in Asia; with Latin America (in particular Brazil) experiencing growing domestic demand – in itself, as I say, a buffer against outside calamities – and by already trading less with the rest of the world than Asia does, investment prospects are promising. At least by being more self-reliant it stands a better chance of lasting 10 rounds in the global ring, even if bloody and bruised. And let's not forget that beyond the rivalries of China and the US, vying with each other in their bid to capture market share (not to mention influence) in Latin America, the EU is a player too. It is a fact that the EU has provided the main source of direct foreign investment in the region during the last decade. The EU has enthusiastically pursued trade deals with Colombia and Perú, for example, which

should not only open up markets but reduce considerably tariff barriers. It is worth noting that as long ago as 2010 trade between the EU, Colombia and Perú alone was worth 16 billion euros.

Trade ties between regional countries are strengthening. Just consider the case of Brazil and México which are the largest economies in Latin America and make up the lion's share of the region's gross domestic product; their combined population is not far off the number of people living in the US. After a series of successful business negotiations more Mexican goods are heading south to Brazil rather than remaining in the local market. Besides Brazil, exports to South America in general are gaining traction, according to México's economy ministry.

Although the EU is the biggest investor in Latin America, in 2010 for the first time in more than a decade, South America overtook the EU as a destination for Mexican exports. But to get this in perspective, that same year it was reckoned that 80% of Mexican exports went to the US, so the importance of the US market remains; unfortunately, it follows that México's economy is, to a great extent, a hostage to the one north of the border – although I expect the Pacific Alliance will change things.

When we talk of intra-trade in Latin America we are not talking just fruit and vegetables; quite the contrary: the items available today are often, I quote, "truly globally competitive products that are diversified", says Chris Sabatini, senior director of policy at the New York-based Council of the Americas. Important products in Latin America include medium or high-tech goods such as passenger vehicles, tractors, medicines and telecommunications equipment.

Flood Conditions

I thought back to a comment made by Winston Churchill during the Second World War, when the pace and uncertainty of momentous events was unprecedented. He said that the receptive capacity of a man's mind was like a three-inch pipe running under a culvert. When a flood comes the surplus water flows over the culvert whilst the pipe goes on handling its 3 inches and no more. Well today the



changes (and the speed of them) taking place across Latin America can flood the human mind.

Brazil, of course, is Latin America's Goliath, but big changes can be found throughout the region which means that Brazil is not the only horse pulling the cart. In the case of tax innovation, however, it does seem to be the lead horse and from which many regional countries could learn.

It's hard to keep abreast of things, which brings me to the tax men in Argentina who were on the trail of tax-evading plastic surgeons apparently not declaring income from breast implant surgery. It has been estimated that the value of imports of implants from Brazil, France and the US was US\$15 million in 2008-9, for example, which should have generated US\$50 million revenue for doctors and clinics but according to income declared there was a tax shortfall of US\$10 million. But there was no fear of them going bust, if not literally, because the tax authorities reckon that up to 80% of the income earned from all plastic surgery performed is undeclared.

Taxes will test the patience of those doing business in Latin America and here's how one president described his tax system. It is "complicated, unfair, cluttered with gobbledygook and loopholes designed for those with the power and influence to hire high-priced legal and tax advisers". Any country in the region fits the bill except that in this case the country was the US and the president was Ronald Reagan making a televised speech in 1985.

But that's not to say that things aren't changing; like a fully-laden oil tanker, turning the ship around takes time. As in many things, it is Brazil that leads the way, if not a little clumsily. Jean Baptiste Colbert asserted that the art of taxation means plucking the goose in such a way that the maximum of feathers, with the minimum of hissing, is achieved; Latins have been heavy-handed and the number of geese in the region hissing from rough treatment is growing.

Regular readers of *Offshore Investment*, the British financial services journal, will know that back in October 2010 (and since) I wrote about the changes to Brazilian tax law under the title "The Hissing Goose" which put Delaware and other US states offering Limited Liability Companies in the spotlight, but suffice it to say that in the case of Brazil new

reporting rules and regulations have impacted on the ease with which foreigners can use foreign entities to, euphemistically speaking, lighten their tax burden.

Animal Instincts

Now that the term "tax favourable jurisdiction" in Brazilian tax law has been extended to countries beyond the usual suspects, (the tax havens), the rules of the game have changed. Back in 2003 Brazil introduced legislation which increased the withholding tax rate from 15% to 25% on capital gains incurred by non-resident beneficiaries doing business in Brazil who met the criteria. Originally the tax code only covered payments to non-residents located in a "country that does not tax income, or that taxes it at a minimum rate lower than 20%" whereas now it states that, and I quote: "It is also considered a tax haven the country or dependency where the law does not allow the access to information regarding the shareholding composition of the company, its ownership, or the effective beneficiary of income earned by non-residents". The reference to "or dependency" in this context includes states within the US, whether the country itself has been blessed by the OECD and placed on its tax white list.

The glare was not just on Delaware, a favourite with foreigners, because countries that have been classified with having privileged fiscal regimes include Luxembourg, Denmark, the Netherlands and Spain. But for Delaware to be singled out by Brazil is somewhat of an embarrassment, considering the United States' vocal condemnation of what it labels jurisdictions plying their trade with the benefits of secrecy.

While US taxes due from Delaware LLC operations will be paid, those with no such obligation can operate non-US business anonymously, like Argentinean plastic surgeons, for example, and elect not to declare earnings to their own government; when such disinterest in tax compliance is shown by International Financial Centres that prejudice the US, its government considers them hostile. In fact, the head of the Global Forum Secretariat called the LLC issue a "serious deficiency". Brazil's largest trading partner, China, no longer accepts treaty benefit applications from Delaware LLCs.



Unfortunately, in Animal Farm fashion, by which some are indeed more equal than others, Brazil's detrimental designation has been suspended in Delaware's case as diplomatic discussions with the US ensue; George Orwell would have understood and perhaps the G8 will also at their meeting this month in London when the British prime minister assumes the one-year presidency of the steering group of nations comprising Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the US. One of the main items on the agenda is how to tackle tax

evasion and encourage greater transparency and accountability.

From farce to other issues. Taxes can be but one of many tortuous trips that businessmen bound for Latin America may be required to experience, but my advice is not to be overwhelmed; be Churchillian about it and accept the 3-inch pipe's limitations; and remember, too, William Congreve's words. That way, the adventurous, with determination, will find the hidden treasure that Latin America has always promised to the bold.

Offshore Pilot Quarterly (independent writing for independent thinkers) has been published since 1997 by Trust Services, S. A. which is the British face of trust business in Panama where it is licensed under the fiduciary laws. It is written by Derek Sambrook, our Managing Director, who is Treasurer for the British Chamber of Commerce Panama and is a former member of the Latin America and Caribbean Banking Commission as well as a former offshore banking, trust company and insurance regulator. He has over 45 years private and public sector experience in the financial services industry about which he has written extensively and our website provides a broad range of related essays including his Latin Letter column which appears in every issue of Offshore Investment, a British professional journal published since 1986, and for which he is a contributing editor.

Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice in the appropriate jurisdiction before making offshore commitments.

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