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Preface

This quarter's newsletter comprises extracts from my lecture given this month at Oxford University in the United Kingdom under the auspices of Offshore Investment.com for which I am a contributing editor. The symposium addressed the ever-changing climate of international financial planning and considered where to venture in the new business and fiscal environment which is emerging as the second decade of this century approaches. As I always attempt to do, I hope that the text which follows will either give you pause for thought or be informative. If it does both, so much the better.

The Road Less Travelled

The last time I stayed at Oxford University was in 1991 at Christ Church College when, as an offshore financial services regulator, I attended a conference on international and white collar crime. Sadly, there are many more dirty collars to be found today and crime, with globalisation, has become more international as well. Added to the mix has been the economic turmoil which has done for the world what BP's oil spill has done for America's gulf coastline: widespread contamination and pollution. So in these uncertain economic times we should perhaps all heed the comforting words of that sage of the cinema, Woody Allen: "More than any other time in history, mankind faces a crossroads. One path leads to despair and utter hopelessness, the other to total extinction. Let us pray we have the wisdom to choose correctly".

Plato wrote about the lost continent of Atlantis whereas South America has been described as the forgotten continent. Although South America never sank beneath the waves it is true to say that for most of its history it has been on the periphery of world affairs and a young Donald Rumsfeld was told by Richard Dixon in 1981 that, and I quote, "Latin America doesn't matter… People don't give a damn about Latin America now". Well in 2010 they do.

It is true to say that in many contexts Latin America has been the road less travelled but when looking at the future, who could have imagined Robert Zoellick, the World Bank president, would apply the 1980s Latin American term La Década Perdida (Lost Decade) as a future scenario for some of today's developed economies which are swamped by debts and living beyond their means? The bulls for now have left Wall Street as well as the European bourses and the only noticeable bull run this year is likely to have been in Pamplona in Spain. Probably the Shakespearean direction "exit pursued by a bear" is more apt on Wall Street. A Winter's Tale indeed.

Some ten years ago it was all so different: Europe was confident, buoyant and expanding whereas Latin America was in the doldrums. Now the world's emerging markets are experiencing never-before growth; their consumers have outspent Americans since 2007; in 2009 their share of global consumption was 35 per cent whereas America's was 27 per cent. Economic growth between 2010 and 2015 for several Latin American countries will be healthy, according to figures released by the International Monetary Fund, with Panama perhaps having the highest growth in 2011 (6.3%) and 2015 (6.5%). This year's projected leaders include Brazil, Uruguay, Paraguay and Peru. Mr. Zoellick thinks that growth in developing economies will average around 6 per cent this year and next, which will probably be twice that of high-income countries. I believe that the familiar boom-and-bust cycles in Latin America are giving way to long-term investment opportunities.

Putting in the Hours

The previous century belonged to America. What about this one? Much is spoken about the BRICS – Brazil, Russia, India and China, a term created by Jim O'Neill at Goldman Sachs back in 2001. Brazil is a BRIC with a boundless supply of commodities (and now potentially huge offshore oil reserves). The whole of South America is destined to fall within its influence and Brazil has made it clear that it will be very comfortable in the role. It sees the rim of a wheel encircling the continent whose hub is Brazil. Certainly, its economic ties with the US have weakened and last year China replaced the US as Brazil's biggest trading partner. Some ten years ago the IMF loaned $42 billion to Brazil – one of its biggest–ever rescue packages – with stringent conditions attached. Today the Brazilian government has loaned $14 billion to the IMF.

I intend to restrict my comments to general remarks concerning taxes in Latin America but suffice it to say that in many cases they are high for individuals and corporations, the regimes are complex for taxpayers to comply with and there are insufficient tax collectors with the necessary expertise to enforce them. Those Latins lax with their taxes feel no real pressure because of the creaking tax systems most of which still need a complete overhaul. This, however, is changing as governments start shifting more towards direct, rather than indirect, taxes. As economic progress is made, more sophisticated tax regimes are being created which will encourage sensible tax planning. It will include international structuring to mitigate taxes for sophisticated businessmen.

Tax rates, excise taxes and contributions have increased and whilst a few countries in the Americas have territorial tax regimes, the majority now have a worldwide taxation policy. The quality of the tax departments across Latin America today is like the curate's egg: good in parts. Argentina, Brazil, Bolivia, Chile, Colombia, Guatemala and Panama stand out as having officials with a reasonable level of tax competency and technical knowledge. Collecting the taxes is another matter.

Let me mention some of the problems the tax systems face. The level of tax evasion in Latin America is high. Evasion is part of the business culture; sadly, in addition to this many citizens simply don't trust their governments to use the taxes for the common good. It must, however, be understood that evasion can be part of a survival strategy for those firms that would fail because of onerous and cumbersome regulations. Complexity compounds the problem and it seems to be a vicious circle that can only be broken if governments start to simplify the tax regulations. Until this is addressed tax revenues in Latin America will remain low by international standards. The last figures I saw show that tax revenues, excluding social contributions, represented about 17 per cent of GDP compared to 36 per cent in most industrialised countries. And while firms in high-income countries spend an average of 177 hours a year in tax-related transactions (such as preparing, filing and paying taxes) Latin American businessmen on average spend 320 hours doing the same thing. In Bolivia that figure is 1,080 hours and in Brazil, the region's economic powerhouse, an incredible 2,600 hours.

Dr. Johnson's Dog

But let's not overlook the fact that simplifying taxes is not just a Latin American problem. Remember that William the Conqueror tried to simplify matters by creating his Domesday Book which, in 888 pages, compiled the English nation's wealth for purposes of taxation. Britain's tax law today runs to 11,000 pages and now the government has had to create the Office for Tax Simplification. We must all surely have some sympathy for Latin America's problem.

In Latin America the largest percentage of tax revenues come from corporations so corporate tax income is crucial to the region's tax collection system. That said, the majority of the firms are small enterprises and perhaps over 80 per cent of manufacturing establishments employ fewer than 10 workers (often referred to as micro-enterprises). In the services sector this percentage is even higher and in Mexico, for example, 97 per cent of retail establishments fall into the category. Collecting taxes is a nightmare, even before addressing evasion, and I am reminded of Dr. Johnson's dog that walks on its hind legs rather badly, but even so one is surprised that it can do so at all. And introducing special tax regimes for such micro-enterprises has not really eased the problem. In one study of 17 countries, 13 of them have at least one special tax regime for smaller companies. But if the regime is simple, applying to qualify for it, by going through bureaucratic hoops, is not.

There are so many small firms in Latin America and it is very difficult for the tax authorities to track them down; because of this, efforts are concentrated on the easy prey. This means that the main targets are the largest and most productive firms in Latin America. But if large firms are targets they are also sometimes guilty of tax evasion too. What is for sure is that tax authorities need to spread the burden more evenly and ratchet up the efforts to increase the amount of taxes paid by individuals.

Even so, low levels of personal income limit the scope for income taxes in Latin America and the region continues to lead the world in income inequality according to the OECD. This inversion of the personal tax pyramid with the pinnacle supporting the system (including social security contributions) with too few contributing to it remains a key issue. In Japan and much of Europe, unlike Latin America, this is unavoidable due to ageing populations.

Figures from 2008 revealed that in OECD countries individual tax payers represented 27 per cent of the total of tax revenues whereas in Latin America the figure was 4 per cent. Approximately 90 per cent of working people in Brazil, Chile, Colombia and Costa Rica had earnings below the minimum threshold at which tax becomes payable. Even if taxes were properly paid, the fact remains that the size of the tax base will still be small.

It seems, therefore, that most revenues in Latin America are derived from imports and state-owned enterprises. In some countries the large, small and micro-enterprises under- report as much as 40 per cent of sales. Take Mexico, for example, where McKinsey and Company say nearly 70 per cent of micro-enterprises are not registered and so pay no taxes. 63 per cent of registered small and medium size firms report not paying taxes at all and 48 per cent of large firms don't pay any taxes either. Just a couple of years ago the Mexican government received 40 per cent of its revenues from petroleum.

A study by the Inter-American Development Bank on the various tax regimes says, and I quote, "At the end, these regimes create incentives for firms not to grow beyond a certain point. If they invest and grow, they will not be entitled for such special treatment and their taxes will increase dramatically. The additional taxes they will have to pay will, many times, not pay for the investments they make. So they simply don't invest". As I say, governments need to streamline and simplify their systems. Two years ago it was estimated that only one in three Latin Americans was subject to income taxation and more than half of all Latin American workers were not entitled to pension rights through their jobs.

Bending with the Wind

Those wishing to capture some of Latin America's lucrative investment market and who conquer the conundrum of the confidant versus the professional, might still have to consider replacing the trust with a foundation, and yet still retain the company as a common denominator as the operating arm for investment planning.

Panama is the ideal platform for co-ordinating much of the financial services business in Latin America. It's political stability, as well as its infrastructure (the most developed in Central America), suggests that its regional banking centre with some 90 banks and nearly 60 trust companies will continue to develop and although its government is reluctant to dilute the country's prized banking secrecy, it will not choose isolation to become the North Korea of offshore banking.

Panama has caught the economic wave that is passing across the region that I have written about in my supplementary notes and in doing so, it has, so far, like the Chinese, adopted the bamboo policy: bending with the wind rather than standing straight and eventually snapping. Recent developments in firming-up Double Taxation Agreements with several countries has illustrated this.

Afterword

As I said at Oxford University, there is no question that Latin America, as a whole, with Brazil in the vanguard, is an emerging economy that is going to complement the other new economic powers, namely, China, India and Russia. Uniquely, however, Brazil has a combination of key attributes: it is a democracy; there is a respect for human rights; it has renounced nuclear arms; there is racial harmony; there are no border conflicts.

Panama, Central America's most vibrant economy, stands in the shadow of South America's potential but is well-placed to reap the benefits from being the region's banking centre. The track record of Panamanian banks during the recession (one that still lingers) has been exemplary and will doubtless contribute towards a growing confidence in the country and an increase in business.

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