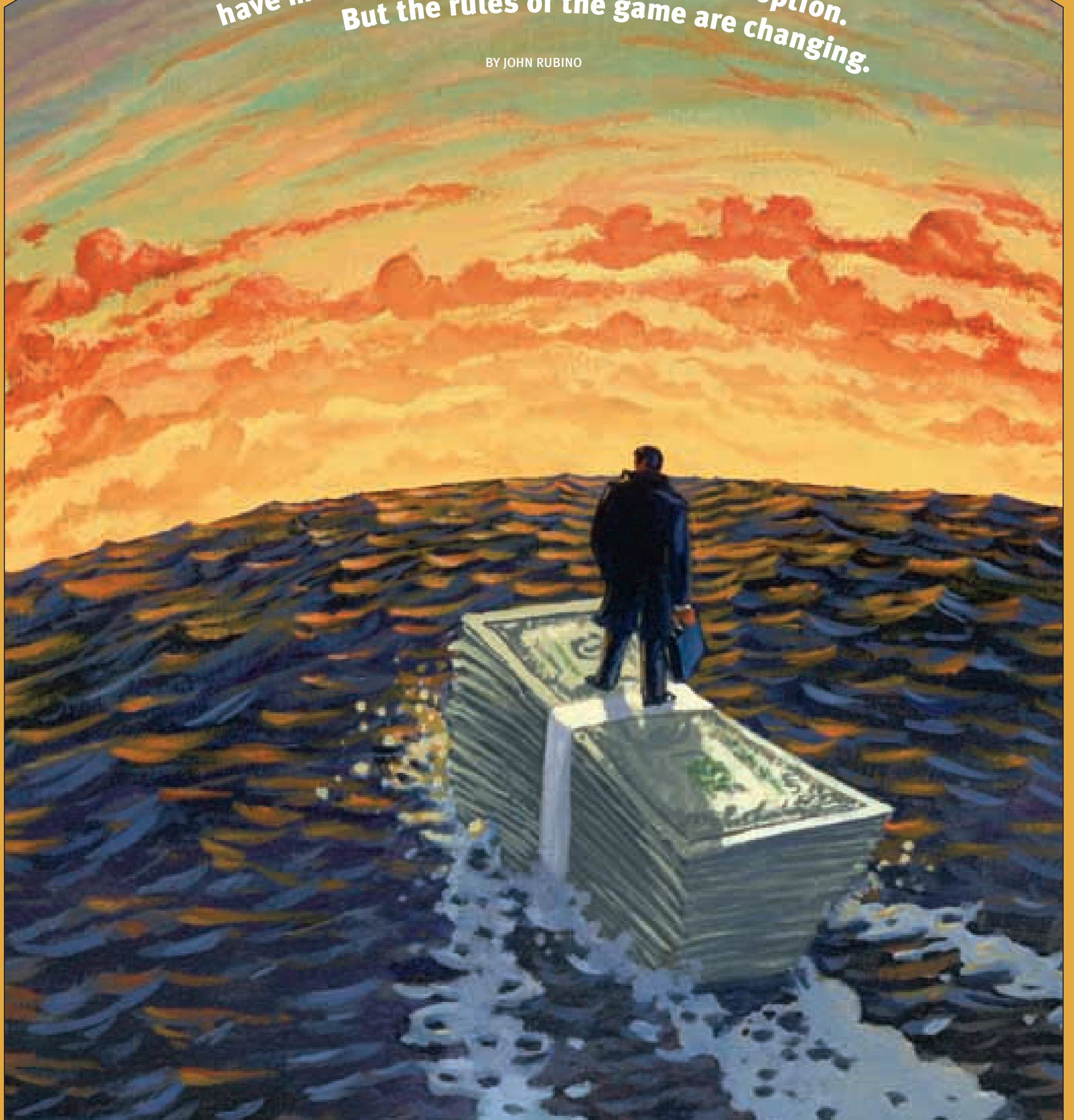
OUTWARD BOUND

Fears about capital preservation have made offshore investing a popular option. But the rules of the game are changing.

BY JOHN RUBINO



James Turk has been helping clients move money overseas for three decades, first as a banker in Southeast Asia and currently as managing director of GoldMoney, a precious metals storage service based in the British Channel Islands. So his July 2008 newsletter article describing a "last plane account"—an offshore stash that would allow its owner to catch the last plane out of an imploding country and still be able to live well in exile—was nothing unusual.

But the response caught even Turk off guard. E-mails and calls poured in from Americans and Europeans worried about everything from rising taxes to hyperinflation to capital controls. "Of all the articles I've published over the years," says Turk, "this one ranks near the top based on reader feedback."

Many readers cited the experiences of their ancestors who fled 20th century chaos, such as this from an Atlanta attorney: "My family knows all about 'The Last Plane Out.' In 1938, my grandparents fled from Germany to Switzerland. … My grandmother was subjected to a FULL body search when she crossed the border into Switzerland. She knew that this would happen, so she and my grandfather threw their gold into the Rhine River (near Basel) before they crossed the border. There really is some Rheingold in that river!"

Most then followed up with pleas for advice on how to protect their money from what they fear is another approaching storm. "People sense that their country is headed in the wrong direction, that the financial and monetary policies being followed are unsustainable," says Turk. "My article helped crystallize the thinking necessary to see geographic diversification of one's assets as a prudent financial step."

A glance at the headlines is all one needs to understand the growing angst: The U.S. projects federal deficits totaling US$9 trillion in the coming decade. Spain's unemployment rate now exceeds 17 percent. The latest U.K. budget calls for a deficit of 12 percent of GDP. Japan's exports plunged 49 percent in the first quarter of 2009, and its sovereign debt is projected to reach 200 percent of GDP in 2010. And virtually every major government is printing new currency at unprecedented rates.

These are the kinds of imbalances that in the past have led to inflation, civil unrest, martial law, and various forms of capital controls and confiscation. (See the sidebar on page 37 for some of history's more colorful examples.) And while the current crisis might be resolved without further suffering—in early May, the financial markets did appear to be stabilizing—the general direction won't be certain for months, if not years. In the meantime, a growing number of investors are moving their money overseas, according to Erika Nolan, executive director of the Sovereign Society, a Florida-based offshore investing consultancy. And the type of client is changing. "Historically, offshore solutions have been reserved for very high-net-worth individuals. But starting in about 2001, we started to see people in the 'mid-tier millionaire' stream—$1 million to $30 million in net worth—saying 'I've worked really hard. I don't want to have my assets at risk.' Most recently we've been seeing a big demand from Americans saying 'I just want to put $100,000 or $500,000 offshore. I'm reporting it; it has nothing to do with taxes.' It's just asset safety at this point."

In short, offshore investing looks to be one of the financial sector's bright spots going forward.

A CAT-AND-MOUSE GAME

Once upon a time, moving money offshore was no big deal for a person of means. Simply wire funds to a Swiss bank or Cayman trust and watch your money disappear into the black hole of state-sanctioned bank confidentiality. But those days are over.

Offshore banking centers and bank privacy laws, while offering a range of legitimate benefits to honest investors, have been exploited by dictators, drug lords, and terrorists, along with run-of-the-mill super-rich tax evaders. According to the World Bank, more than half of the world's personal wealth—over $40 trillion—currently resides in about 60 "tax havens" worldwide. More than a third of that is thought to be in Switzerland, with the rest in such places as Hong Kong, the Cayman Islands, Panama, Bermuda, and the Isle of Man.

Much of this wealth is allegedly unreported and untaxed. The U.K. claims to lose out on £18.5 billion annually in taxes on profits earned in tax havens. Germany's DSTG tax union estimates that €300 billion has been transferred illegally from that country over the past decade. The U.S. claims that its citizens use offshore accounts to evade $100 billion in taxes annually.

Not surprisingly, high-tax governments hate tax havens with a vengeance and have been trying for decades to get at these hidden accounts. "It's been a cat-and-mouse game for the past 30 years in which U.S. or European citizens find some loophole, and as soon as word gets out, the authorities change

the rules. So these laws are constantly changing every time there's a chink in the wall," says John Pugsley, former executive director at the Sovereign Society.

Lately, the game has become far more serious. To discover who has what where, the U.S. government has transformed its Internal Revenue Service into an *External* Revenue Service, taxing its citizens on their worldwide income and requiring them to report all offshore financial accounts to the IRS. As a result, investors who use offshore entities to avoid U.S. federal income taxes—or who simply fail to report accounts—can be prosecuted for tax evasion.

The United States now requires foreign banks to give their U.S. clients a choice of filling out and filing tax forms with the IRS or having 30 percent of the proceeds (not just the profit) from the sale of stocks or other securities withheld. Any bank taking deposits from U.S. clients must submit to an audit by a U.S.-based accountant. And under the Patriot Act, the government can seize money in the bank's U.S. branch (via a secret civil procedure in which the foreign bank does not participate). "Say a Hamas member has a million dollars in a foreign bank account and the bank has $10 million in New York," says Mark Nestmann, an Arizona-based offshore investing consultant. "If the U.S. government can convince a court in a secret proceeding that there's a link, they can seize a million dollars [from the foreign bank] in New York. They've not done this with European or Swiss banks but have done it with banks from Belize and Latvia. So this is a real threat."

In 2008, the United States charged Swiss banking giant UBS with helping U.S. citizens evade taxes, indicted a UBS executive, and fined the bank $789 million. This move was a direct challenge to Switzerland's banking industry. Because UBS is, in effect, a global bank that does considerable business in the United States, it caved, closing the accounts in question, disclosing the names of 300 clients, and paying the fine. The United States upped the ante, demanding access to 52,000 more accounts belonging to U.S. clients. In May 2009, that discussion was ongoing.

One effect of Washington's aggressiveness—perhaps intentional—is that many foreign banks have simply stopped accepting accounts from U.S. customers. Bermuda-based LOM Asset Management typifies the new attitude. "As a company that's 100 percent non-U.S. revenue generating, we didn't feel that we wanted U.S. clients if it meant the IRS had the ability to come in and look at our client manifest," says LOM general manager Jon Heckscher. "It's a big world; we just gave up our U.S. clients and moved on."

HIGH-TAX NATIONS, UNITE

The United States, while the most extreme case, is far from the only country going after tax havens. In early May 2009, Germany was debating a new law that would raise reporting requirements and impose tougher penalties on tax evaders. British Prime Minister Gordon Brown promised in a recent speech "no hiding place for special investment vehicles, for hedge funds or tax havens." And India's opposition Bharatiya Janata Party (BJP) has made tax evasion a key campaign plank, promising to force Indians to repatriate an estimated US$500 billion now held in offshore accounts.

At the April 2009 G-20 meeting, attendees threatened to unveil a "blacklist" of tax havens that refused to share account information. This set off a scramble among those about to be named to address the OECD's demands. Such tax havens as Andorra, Liechtenstein, and Singapore are now signing information-sharing agreements with the world's major economies.

THE END OF BANK SECRECY?

With bank privacy laws being watered down on a daily basis, how open will offshore banking systems become, and how will such openness affect offshore investing—both practically and conceptually? For example, if an offshore bank account is no longer private, will it still offer a tangible advantage over a domestic account? Will Switzerland become just another banking center like London or Manhattan, with high-level financial services run in relative openness and reporting to the relevant tax authorities? Will the concept of financial privacy join time and distance on the list of quaint ideas made obsolete by technology and globalization? And (more ominously) will offshore investing become pointless in a world where a government can find its citizens' assets with chilling efficiency?

Kees Stoute, managing director of Swiss bank EFG's Singapore branch, cautions against reading too much into recent events. "The main change is that an increasing number of governments insist on the cooperation by offshore centers when it comes to sharing information on individuals who are being investigated for tax evasion," he says. "Most of the offshore jurisdictions, including Switzerland and Singapore, have already announced that they are willing to endorse the OECD standard for the exchange of information. But calling

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> JOHN PUGSLEY

this the end of banking secrecy is going too far. Banking secrecy as such is not at stake; the fact that offshore jurisdictions will cooperate—under certain specific, bilaterally agreed, and strict conditions—to share information with foreign authorities does not represent the end of banking secrecy nor the end of offshore banking. Banking secrecy will continue to protect the legitimate right for confidentiality, and offshore banking will continue to serve its purposes."

OFFSHORE OPTIONS

Which brings us back to those worried "last plane account" readers. For them, there is bad news and good news. The bad news is that the archetypical numbered Swiss bank account, impervious to all prying eyes, no longer exists. "Tax evasion through offshore personal bank accounts really is a thing of the past," says Peter McFarlane, editor with London's *Q Wealth Report*. "It's been passé for years. It's not a particularly attractive business for any tax-haven bank because it has the potential to cause lots of problems for relatively little reward."

The good news is that tax evasion and asset protection are separate objectives, and the latter remains both legal and relatively easy to achieve. Simply move some capital overseas, and once there, it's relatively safe from home-country depredations. "Short of sending in the Marines, a government can't go into another country and confiscate its citizens' assets," says James Turk.

As for where to put a last plane account, the following are among the most popular vehicles:

SAFER OFFSHORE BANKS As UBS clients recently discovered, a foreign bank with a significant presence in high-tax countries isn't really foreign at all. But smaller banks without a presence in the United States are less easily intimidated. Most advisers now counsel their clients to avoid the multinationals and instead seek out smaller banks without branches in high-tax countries.

TRUSTS AND LLCS Wealth ownership can be transferred from a person to a different legal entity, such as a trust, foundation, LLC, or corporation created in a hospitable country (Panama, Liechtenstein, or Nevis, for example). These legal entities are not invisible to the world's tax authorities—they generally must be disclosed on tax forms—but they offer rock-solid protection against private claims. And for U.S. citizens, "With an offshore entity operating the account," says Nestmann, "you have a larger selection of offshore banks willing to deal with you because the account is not in the name of an American but of an international entity. The offshore entity managing the account deals with all that, sending a fax from Nevis or wherever."

INSURANCE POLICIES Some offshore financial centers, such as Switzerland and Liechtenstein, specialize in variable annuities and other kinds of insurance policies that allow foreign investors to contribute funds that (1) grow tax free until they're withdrawn and (2) are immune from the claims of most creditors. Insurance companies are generally subject to the same secrecy laws as local banks, which means they're private unless the owner is the target of a tax-evasion case. "Another advantage of using an insurance policy for asset protection is that it's relatively uncontroversial," says Marc Sola, managing partner of Singapore-based NMG International Financial Services. "In all countries, the purchase of an insurance policy is an ordinary and common transaction."

FOREIGN BROKERAGE ACCOUNTS According to Paul Renaud, publisher of Geneva-based ThaiStocks.com, many Thai and other Asian brokerage houses welcome foreign clients. Opening an account frequently requires showing up in person to sign the papers, but "for investors with a valid passport and a notarized signature, several solid Thai brokers will open an online trading account though e-mail, fax, and normal registered mail," says Renaud. Besides the obvious offshore advantages, a foreign brokerage account gives access to the thousands of stocks that don't trade on U.S. or European bourses.

PRECIOUS METAL STORAGE Physical assets, such as gold and silver bullion, don't appear to trigger U.S. reporting requirements when stored abroad in a bank vault. The storage arrangement has to be "allocated," meaning that specific bars or coins are owned. And while the holding itself appears to be private, the movement of funds into and out of the storage facility is reportable—although this is up to the owner. Offshore bullion storage services, such as GoldMoney and London-based Bullion Vault, stress that their customers are required to follow the laws of their respective countries, but the services themselves don't report customer data to the tax authorities.

FOREIGN REAL ESTATE Direct ownership of land and buildings in a foreign country must generally be reported, but real estate is less vulnerable to forced repatriation because it's physical rather than financial. When rented out, it generates cash flow,

and in extremis, it can serve as a shelter from a home-country storm. In short, a vacation/rental house on some gorgeous Latin American or Asian beach is attractive on many levels.

Buying real estate in Latin America, for example, is generally done with cash, because financing is scarce. Other than that, "it works pretty much as in most other parts of the world," says Dan Prescher, publisher of Ireland-based *International Living* magazine. "[A foreign citizen] can own property with the same rights and responsibilities as a local." It's also possible to buy and hold real estate in some types of retirement accounts, such as IRAs. "This kind of arrangement can make the rental and capital gains income tax-free," says Prescher.

"For the past few years," adds Prescher, "the euro and pound were so strong that Europeans found real estate in the Americas extremely attractive. The deals were just raging."

Prescher practices what he preaches, living on Mexico's Yucatan peninsula and owning "a little place in Ecuador up in the mountains." He says that "if it all goes to Hell-in-a-hand basket, we'll just go up there and live on fresh fruits and vegetables."

EXPATRIATION

The surest way to avoid the depredations of a government gone wild is to pack up and leave. This is known as expatriation.

At its most basic, expatriation involves exchanging citizenship of one country for that of another. For a U.S. citizen, taking this step is the only way to end the obligation to pay taxes on worldwide income, because moving to a new country without renouncing citizenship won't work. But it also means paying an "exit tax" on unrealized gains in excess of US$600,000.

Expatriation is easier for citizens of most other countries. "All you need to do to avoid the obligation to pay tax on your worldwide income is to leave," says Nestmann. "After an extended period, normally one year or longer, you no longer have any obligation to pay taxes on your income outside that country (although you may continue to be subject to gift and estate taxes)." For example, he points out that a U.K. citizen can leave for two years and no longer be subject to income tax. Moreover, moving to a non-U.K. domicile means no longer being subject to U.K. inheritance taxes.

Of course, the world is a crowded place, and not every country is open—even to well-off newcomers. But a few are. "Several countries have economic citizenship programs," says Nestmann. "You get checked out and make a contribution and get a new passport. St. Kitts and Nevis work this way. Austria requires a big contribution to a local business, and then they decide if it's sufficient."

Singapore and Hong Kong have programs to attract high-net-worth individuals, but the bar is set rather high. "In Kong Kong," says Nestmann, "you need to contribute nearly a million dollars to be considered."

JOBS FOLLOW THE MONEY

All this money bouncing around the globe in search of a home points to rising demand for offshore investing services, which in turn means more openings for people with relevant skills. EFG Bank Singapore is adding tax and trust specialists along with money managers, according to Stoute. In April, Singapore-based wealth management consultancy NMG was seeking consultants at every level from associate to senior. Bermuda-based LOM Asset Management, which manages accounts for "captive" insurance companies domiciled in the Caribbean, was advertizing for a portfolio manager, a corporate financial analyst, and stockbrokers. Some or all of these positions might be filled by professionals from abroad. LOM's Jon Heckscher, for instance, was a portfolio manager with a Boston bank before moving to Bermuda. But the recent changes in U.S. tax policies have made such a move less attractive for U.S. financial professionals. Now, according to Heckscher, the local captive insurance firms hire "a lot" of accountants from India and the Philippines, who find a dollar-based economy attractive.

Offshore investing is already an established specialty in much of the world, where bank accounts denominated in the currencies of neighboring countries are common. In the United States, however, beyond the large multinational financial houses, this field is relatively new. "Of course you have the KPMGs," says Erika Nolan. "Other than that, it's mostly boutiques—two lawyers in Alabama, one in Fort Lauderdale, three in California." But the sector is going to get much bigger.

"I wouldn't mind seeing some CFA [charterholder] resumes," says Nolan. "We're always looking for new partners and new products."

John Rubino, a former financial analyst, is the author of How to Profit from the Coming Real Estate Bust *and* Main Street, Not Wall Street.

A CAVALCADE OF CONFISCATION

Worrying about a government destroying its currency or confiscating its citizens' wealth may seem a bit paranoid—until you read some financial history. The sad fact is that over the centuries, time and again, governments have spent and borrowed themselves into a box and forced their citizens to bail them out. They debase the currency (which is a tax on savers), impose new taxes, or simply take whatever assets are most accessible. To keep their prey from escaping, they impose various kinds of capital controls, including restrictions on the movement of wealth or price increases. A few historical examples, ranging from ancient to more recent times, suffice to make the point.

ROME

The Roman Empire in its heyday ruled pretty much the entire Western world. And as empires tend to do, it eventually opted for both "guns and butter" (or swords and butter, in the Roman case), trying to protect vast borders while pacifying citizens with social programs. To cover the mounting costs, a series of emperors minted copper coins (called denari) in ever increasing quantities. This caused the coins' value to plunge (in effect, confiscating the wealth of savers) and led the emperor Diocletian in 301 AD to impose price controls. When this led merchants (who saw their costs rise but their selling prices stagnate) to close up shop, Rome mandated, on pain of death, that all men should continue with their father's career. This bankrupted generations of merchants but didn't protect the empire from the tribes that eventually overran it.

FRANCE UNDER JOHN LAW

In the early 1700s, a nearly bankrupt France hired itinerate financier John Law to introduce a paper money system, which soon went awry as a result of overprinting. The government limited the amount of gold that citizens were allowed to own but to no avail. The system collapsed, and John Law fled the country.

... AND AFTER THE REVOLUTION

Beginning in 1789, the new French government introduced paper currency and soon inflated it to oblivion. Along the way, it imposed the death penalty on merchants differentiating between gold and paper. Shopkeepers closed their doors, the economy collapsed, and Napoleon eventually became emperor.

WEIMER GERMANY

When post-First World War reparation payments became too heavy, Germany simply printed the paper money it needed, causing the currency's value to plunge and impoverishing a whole generation of savers.

U.S. GOLD CONFISCATION

In 1934, the Roosevelt administration criminalized private gold ownership (gold had up to this time been legal tender) and ordered U.S. citizens to turn in their coins. When most had done so, Roosevelt devalued the dollar in terms of gold from 1/20th of an ounce to 1/35th. At the stroke of a pen, this effectively cut the value of Americans' bank accounts and other forms of dollar savings by more than two-thirds.

NIXON-ERA PRICE CONTROLS

After a decade of printing too many dollars, the U.S. government in 1971 made it a crime for merchants to raise prices (while the government continued to increase spending and print more dollars). This attempt to suspend the law of supply and demand failed, leading to a decade of raging inflation, which cut the value of the dollar in half.

ARGENTINA IN 2001

In the 1990s, Argentina pegged its currency to the U.S. dollar. The resulting period of price stability caused an influx of foreign capital and emboldened the government to ramp up its spending. Consequently, the value of the peso declined, which sent citizens running to the bank to convert pesos to dollars. The government then froze an estimated US$20 billion of dollar-denominated bank accounts and converted them to far less valuable pesos.

... AND IN 2008

Once again in need of revenue and unable to raise capital from international markets, the Argentine government seized US$30 billion of private pension funds.

ICELAND

This picturesque country of 300,000 decided to become a banking center during the recent credit bubble, offering high interest rates on deposits to foreign savers. Its banks borrowed foreign currencies equal to 900 percent of GDP. When the banks inevitably failed, Iceland simply defaulted on its debt by refusing to return depositors' money. It then began forcing exporters to repatriate capital held overseas.