

Siren Songs

Offshore investors are sailing in treacherous waters

BY ANTHONY NOTO, CFA

Author John Rubino tackled the complex subject of offshore investing in his article “Outward Bound” in the July/August 2009 issue of *CFA Magazine*. Depending on the investor’s goals, offshore strategies may be worth considering. However, offshore investments and service providers need to be approached with due caution.

Operating in regulatory blind spots, some advisers try to take advantage of a customer’s limited knowledge to mis-sell investments. It’s relatively common to hear claims of low-risk/high-return investments, tax-saving strategies based on secret accounts, and “impenetrable” asset protection. Many smart, experienced, and sophisticated investors have fallen for what sounds like a very seductive sales pitch.

Taxes. One relatively common misconception about offshore investments is that bank secrecy enables people to avoid taxes. The idea is that tax authorities cannot tax or pursue money they are unaware of and that tax havens have a vested interest in keeping client information confidential. But governments around the world are sharing more and more information each day. A number of so-called “tax havens” that prided themselves on strict client privacy laws are buckling under the pressure of an increasingly interconnected financial system.

Some countries that have withstood outside pressure have been undermined by rogue employees (for example, when a clerk at LGT Bank in Liechtenstein illegally sold client account information to tax authorities around the world). Between pressure from high-tax governments and breaches caused by rogue employees, tax-saving and asset-protection strategies that rely on bank secrecy are fast becoming obsolete (if they haven’t already).

Once compliant with reporting requirements, the tax treatment of offshore investments depends on the investor’s circumstances, location, and a variety of other factors. These variables can change considerably over time—making inflexible strategies problematic. For U.S. investors, some offshore strategies originally designed to lower tax liabilities could actually increase tax exposure. For example, if the IRS considers a tax-saving strategy to be a “passive foreign investment company,” investors will face punitive taxation.

Asset Protection. Stories of frivolous lawsuits, merciless judges, and confiscatory governments encourage people to move money offshore. Some advisers promote offshore trusts that provide “impenetrable” protection against private claims. U.S. investors interested in exploring this issue further might first want to read *Asset Protection: Concepts and*



Illustration: Robert Megawick

Strategies for Protecting Your Wealth by Jay Adkisson and Chris Riser. The authors include examples of people who used offshore trusts to outfox creditors and subsequently found themselves held in contempt of court and put in jail. Even after seeing these strategies fail miserably in court, some advisers still recommend them.

Our Opportunity

The offshore industry is relatively unregulated and suffers from a general lack of transparency. Often, there is very little real and substantiated information available about the investments and strategies being sold. When people are taken advantage of, they often don’t realize it until years after the initial investment and are then frequently too embarrassed to talk about it. Following their adviser’s recommendations, some investors intentionally or unintentionally fall out of compliance with tax laws. When plans go awry, investors usually have no recourse against offshore advisers.

Collectively, CFA Institute members are in a great position to help the public better understand the world of offshore finance and transform this part of the industry. Demonstrating a high level of commitment to the profession, we should continue to promote clarity and the highest ethical standards into all segments of the industry. If we don’t step up to the challenge, marketing rings will remain a primary source of information regarding offshore strategies for the investing public. //

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