Vanderbilt Journal of Transnational Law

Volume 19
Issue 1 *Winter 1986*

Article 6

1986

Book Review

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BOOK REVIEW

THE WORLD OF INTERNATIONAL TAX PLANNING. By Milton Grundy. Cambridge: Cambridge University Press, 1984. Pp. X, 140.

*Reviewed by Allaire Urban Karzon**

This slim volume[1] is for the international tax connoisseur. The author, an English barrister and member of the Inner Temple and Gray's Inn, has designed his book for tax professionals already expert in their own jurisdictions who seek information on the tax systems of other countries so that they can take advantage of multijurisdictional planning. Because he assumes his readers know the rudiments of international tax principles, the author explores more innovative advanced techniques. With his British perspective and evident familiarity with the United Kingdom and continental tax systems, he suggests many approaches that United States authors frequently omit because they are not feasible under United States law. As a consequence, his book is of particular interest to those tax attorneys, whether practicing overseas or in the United States, who represent foreign clients that can legitimately arrange their affairs to achieve tax objectives free from United States legal constraints.

Mr. Grundy's British viewpoint is immediately evident. In his discussion of residence, for example, after covering some basic concepts, he focuses on the advantages of emigrating from a high tax jurisdiction to a more favorable jurisdiction and the opportunity such a move offers for the taxpayer to drop off assets on the way.[2] The latter possibility is a concept totally alien to United States law. Mr. Grundy points out that apart from the uniquely unfortunate position of United States citizens — who cannot le-

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1. M. GRUNDY, THE WORLD OF INTERNATIONAL TAX PLANNING (1984).
2. *Id.* at 6-7.

gally shed assets as they remain taxed on their worldwide income from whatever source[3] — it is always advantageous, taxwise, for an individual to change his residence. The advantage lies in his ability to arrive in his adopted

> country of residence as a person without a history. If he arrives a rich man, no one is going to ask him how it came about that he is richer than he was the year before. And if he arrives a (comparatively speaking) poor man, no one is going to ask him what happened to the assets he possessed in a previous year.[4]

The new jurisdiction is not concerned with any income, capital gains, or gifts in which the taxpayer was involved prior to becoming a resident in that jurisdiction. Therefore, Mr. Grundy examines the methods whereby an individual formally can "shed" substantial assets by locating them in a tax haven and can arrive in his new residence country owning little. The lack of correlation and lack of exchange of information among nations who tax on a residency basis apparently permits this maneuver to work. The author does not comment on the wisdom of a worldwide system that lets taxpayers drop assets between the cracks, so to speak, of several jurisdictions. His purpose is to find the cracks and expose them for the reader to use.

Mr. Grundy's plans at times are somewhat elaborate but gain credibility from his evident experience. Thus, he discusses the cost in human terms of a residency change and points out that "the physical move of one's earthly goods requires effort and expense comparable to that of repairing the consequences of a minor fire" and that such a move for some "has proved a recipe for

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3. In *Cook v. Tait*, 265 U.S. 47 (1924), the Supreme Court recognized the principle that the United States taxing jurisdiction extended to the worldwide income of its citizens even when the citizens resided in and were permanently domiciled in a foreign country and even though the income was earned from property located outside the United States. Incorporating this concept, Section 61 of the Internal Revenue Code taxes "all income from whatever source derived" and does not even mention any distinction between United States-sourced and foreign-sourced income. I.R.C. § 61(a) (1982). The operating premise is that - unless some specific exception applies - foreign income is as fully taxable to a United States citizen - as is domestic income. *See* BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 6.1 (1981). Thus, a United States citizen changing residence to a new country cannot drop off assets that will henceforth generate income free from United States tax.

4. Grundy, *supra* note 1, at 6.

alcoholism, divorce and premature death."[5]

Only from first-hand observation could an author write:

> Readers whose profession it is to advise in this field will be familiar with the kind of meeting with clients where both generations are present. While the son and daughter extol the charms of some exotic foreign country, with its blue skies, perpetual sunshine, swimming pools, the opportunities for the grandchildren and the beneficial effects of the climate on arthritis, one can often read in the father's face the thoughts of uprooting and of absence of former friends and familiar ways, and the prospect of uncongenial food and boring neighbors. But the children plan to inherit without the inconvenience of a government levy on father's estate and it is both surprising and depressing how often they succeed in persuading him into what can be a miserable and lonely existence in a strange place.[6]

The sensitivity of the author to the importance of the human factor in good legal counselling adds a dimension to the book not always encountered in purely tax-oriented presentations.

There is an excellent chapter examining the international tax opportunities that exist within the United Kingdom, despite the fact that it is a country with a high tax rate and "a relatively high level of tax morality."[7] The presence of the City of London, with its heritage as a center for international business and finance, has necessitated the development of a tax system that allows nonresidents to conduct many activities within the United Kingdom "without suffering any local tax."[8] For example, nonresident companies deriving income from the United Kingdom can avoid its tax on United Kingdom-sourced capital gain and on all non-United Kingdom income, if the beneficial owners of such companies are also nonresidents. Unlike United States law, United Kingdom law provides that the residence of a company depends upon the place of management and control, rather than on the place of incorporation. Consequently, the author advises on the need to document the place of management outside the United Kingdom. He also recommends the insertion of a tax haven company as the record owner of the shares in the nonresident United Kingdom company in lieu of direct shareholding by the beneficial

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5. *Id.* at 8.
6. *Id.*
7. *Id.* at 23.
8. *Id.*

owners to protect such owners against United Kingdom gift and death taxes.[9]

Tax havens, it is clear, play an important role in the world of international tax planning for a variety of purposes. Thus, on several occasions, the author evaluates havens according to different criteria. He has adopted a two-level structure for this analysis. The bulk of the detail is housed in a concise appendix.[10] There, the author classifies tax havens by nineteen criteria, including, among others, havens that impose a zero or low tax rate, that tax on a territorial basis (i.e. they tax only the income earned within the territory), or on a remittance basis, that grant exemptions for specific activities, or that permit a foreigner to own land or have a numbered account. The tabular organization of the appendix provides a quick reference and an opportunity for the reader to cross check and determine which jurisdictions possess the most features a particular occasion warrants.

In contrast, the narrative in the text is a blend of information and personal observations that make for lively reading. Thus, in the context of havens that may be suitable for individual residence purposes, Mr. Grundy points out that Costa Rica is one of the few countries "where a foreigner can obtain a passport;"[11] Switzerland is a difficult country in which to obtain a residence permit unless the taxpayer is retired and over age sixty or will "make a significant investment" in a new Swiss industrial enterprise;[12] and the United States is a tax haven for foreigners who can shed assets before assuming United States residence, invest in municipal bonds, and utilize the unlimited marital deduction on death.[13]

In comparing the historically classic havens of Liberia and Panama with Costa Rica for corporate purposes, Mr. Grundy notes:

> The greater advantage of Costa Rica is that it has not yet been 'discovered': the fact that a company is incorporated in Liberia or Panama suggests (rightly or wrongly) to everyone dealing with it that it owes its existence to some kind of tax planning; this is not true of a company incorporated in Costa Rica.[14]

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9. *Id.* at 23-27.
10. *Id.* at 87, app. 1.
11. *Id.* at 10.
12. *Id.*
13. *Id.* at 10-11.
14. *See id.* at 42.

Mr. Grundy also categorizes tax havens in terms of suitability for nonresident companies. Some are more comfortable for United Kingdom taxpayers because of proximity and familiarity of legal concepts (e.g., Guernsey and Jersey, the Isle of Man, the British Virgin Islands, and St. Vincent).[15] Others have unique exemptions: Cyprus (shipping companies); Djibouti (companies established in its tax-free zone); Gibraltar (Exempt Companies); Israel (International Trading Companies); and Seychelles (Exempt Entities).[16] Denmark offers nonresidents the little publicized opportunity to create and operate Danish family foundations which are free of Danish tax if created by a nonresident grantor for nonresident beneficiaries as long as the foundation conducts no business in Denmark and merely holds investment securities.[17]

Throughout, Mr. Grundy displays a sense of political awareness linked with nonjudgmental neutrality. His *laissez-faire* attitude transcends the political climate prevalent in any one country. He thus comments:

> It is sometimes said that the Caribbean is an 'American Lake', which may give the user of its offshore facilities some reassurance about the future political complexion of the area, but by the same token it is not the place to site a transaction which runs counter to American foreign policies for the time being. So if business is to be done with Cuba or Afghanistan, this may not be the area in which to incorporate the company to do the business. And because there are a lot of black people in these territories, it will be wise to incorporate elsewhere if the business is with South Africa, just as Bahrain is not an ideal place for a transaction with Israel.[18]

The effective use of tax treaties is a complex subject. Yet Mr. Grundy writes of this with a directness and simplicity, born of sure first-hand knowledge, that will guide a tax practitioner through this maze, if anything can. He lays down the fundamentals. An individual or corporation may be subject to double taxation by the country of his residence and the country where the income is earned (sourced). Tax treaties try to prevent this double taxation and follow the principle "that the source tax

15. *Id.* at 46-47.
16. *Id.* at 48.
17. *Id.* at 48-49.
18. *Id.* at 57.

should give way to the residence tax."[19] Treaties always benefit taxpayers since they do not impose any new tax but only provide relief either by giving a foreign tax credit or by providing exemption from tax in the country of source or the country of residence. The ideal situation, according to Mr. Gundy, is to arrange a combination where the taxpayer is exempt by treaty from the source tax on foreign sourced income while, at the same time, he legitimately avoids any substantial tax in his country of residence. The author cites several illustrations of situations where such combinations can, in fact, be arranged under present treaties.[20]

In the context of the use of treaties, he proposes the "Stepping Stone" transaction — an arrangement designed to capitalize on the interplay between certain beneficial treaty provisions and domestic laws to avoid withholding tax in a source country on interest and royalty payments.[21] The transaction is structured so that the interest and royalties earned in source country A are paid to a Stepping Stone company in country B. Country B's attractions are that it has no withholding tax on outward payments but has a treaty with country A. Because of the treaty, the inward interest or royalty payments are received in country B without diminution by country A withholding tax. The Stepping Stone company then pays the gross amount of the interest and royalty over to the final recipient — often situated in a tax haven that lacks a favorable treaty with the source country A. Mr. Grundy selects six countries with extensive treaty networks as candidates for Stepping Stones.[22]

By United States criteria, the Stepping Stone device is a euphemism for a form of treaty abuse: the manipulative use of a treaty to benefit third parties not resident in the treaty country. Mr. Grundy does pause to alert the reader that what he describes as a Stepping Stone transaction may be considered objectionable treaty shopping by the United States Treasury and observes that in view of United States policy, opportunities to use stepping stones well cease.[23] His counsel, however, is not to forego the technique but to exercise caution. When United States source income is concerned and where the effectiveness of a Stepping

19. *Id.* at 69.
20. *Id.* at 69-71.
21. *Id.* at 71-74.
22. *See id.* at 90, app. 1.
23. *Id.* at 74.

Stone transaction is dependent on treaty shopping, he suggests that the arrangement be short term or terminable if the treaty is cancelled.[24]

The diverse background of Mr. Grundy's audience is most apparent in his chapter on off-shore trusts where he commences with an explanation of the common law concept of the trust and points out that it will be unfamiliar to his European readers trained in the civil law.[25] He then expounds the advantages of the off-shore trust that is created in a host tax haven country which does not tax trust capital income or capital gains and is moveable from one jurisdiction to another as future developments necessitate.[26] Typically, the settlor or grantor is not a citizen or resident of the tax haven country nor of the country in which the beneficiaries are resident.[27] While the off-shore trust is advantageous primarily to non-United States taxpayers, Mr. Grundy does present an ingenious scenario of possible interest to United States citizens or residents: an off-shore grantor trust, with non-United States sourced-income, created by a nonresident alien grantor. The foreign-sourced trust income would be taxed to the foreign grantor, but paid to United States income beneficiaries as tax-free gifts.[28]

After presenting this panoply of possibilities for international tax maneuvering, the author closes with a plea for honesty in operations and moderation of client expectations.[29] Above all, he urges that the transactions be conducted in such a manner that if they were completely disclosed to all interested taxing authorities, the structures would stand up to scrutiny and achieve their economic objectives unscathed by such disclosure. One of his final comments about larger companies may best sum up his personal philosophy: those companies recognize that "there is an amount of tax to be paid and an amount of tax to be saved. International tax planning is not in principle about paying no tax anywhere."[30]

No review of this work is complete without noting the highly informative appendices containing material not readily accessible

24. *Id.* at 75.
25. *Id.* at 77.
26. *Id.* at 78-79.
27. *Id.* at 78-80.
28. *Id.* at 140 n. 7.
29. *See id.* at 85.
30. *Id.*

elsewhere. These include excerpts from the Company Tax in Switzerland, the Cayman Islands Revised Trusts Law, the 1936 Monaco Statute on Trusts, and the 1983 Gibraltar Ordinance concerning taxation of companies.[31] The last appendix[32] is a case study of a United Kingdom resident who formally emigrates to Switzerland. His Grundy plan, explained by extensive narrative as well as an indispensable diagram, consists of the creation of two off-shore trusts, three tax haven corporations in Jersey and Guernsey, a Netherlands Stepping Stone, and a Swiss management company. The reader has the opportunity to examine the intricate case study at his leisure to learn how the author gathers the many diverse tax factors, earlier discussed in the abstract, and skillfully knits them into one coherent — albeit complex — realistic plan.

For those who habitually devise and judge tax plans only in the framework of United States concepts and standards — an approach that is provincial and incompatible with effective representation of foreign clients — Mr. Grundy's book is a recommended antidote. He reminds us that "[t]here is a world elsewhere."[33]

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31. *Id.* at 93, app. 2-5.
32. *Id.* at 119, app. 6.
33. CORIOLANUS III 3, quoted as the epigraph to Grundy, *supra* note 1.