

WHAT ARE FINANCIAL CENTRES?



While there is no precise definition of what a Financial Centre (or FC), the term is usually meant to refer to low-tax, lightly regulated jurisdictions which specialise in providing the corporate and commercial infrastructure to facilitate the use of those jurisdictions for the formation of offshore companies.

In addition to the broad definition above, there a number of further interpretations, that can be ranked in order of market size, with activities described by the following headings:

- Offshore Banking Units (OBUs);
- Offshore/International/Regional Financial Centres (OFC/IFC/RFCs);
- Regional Headquarter Status (RHQs);
- Global Financial Centres (GFCs).

The IMF considers the following to be characteristics of an Offshore Financial Centre (OFC):

- jurisdictions with large numbers of financial institutions engaged primarily in business with non-residents;
- financial systems with external assets and liabilities out of proportion to domestic financial intermediation designed to finance domestic economies; and
- centres which provide some or all of the following services: low or zero taxation, moderate or light financial regulation, banking secrecy and anonymity.

To further clarify what constitutes a FC or OFC, it is easiest to look at few examples of various financial centres and their respective subtleties.

OFFSHORE BANKING UNIT – AUSTRALIA

An OBU is an entity which intermediates in financial transactions between non-resident borrowers and lenders.

Income derived by an offshore banking unit from certain offshore banking activities is taxed at an effective rate of 10 per cent. The normal company rate of 30 per cent applies to capital gains and other income. Furthermore, the offshore banking unit is exempt from interest withholding tax in relation to certain offshore borrowings.

An offshore banking activity must satisfy four conditions:

- the activity undertaken by the OBU must be one of the eight defined types of activity;
- the other party to the transaction must generally be an 'offshore person';
- the activity must be undertaken by an entity declared to be an OBU (ie business units of Australian offshore financial intermediaries located in Australia); and
- the OBU must be a resident of Australia or carrying

on business in Australia at or through a permanent establishment.

The eight types of offshore banking activity are:

- borrowing or lending activity;
- guarantee-type activity;
- trading activity;
- eligible contract activity;
- investment activity;
- advisory activity;
- hedging activity; and
- any other activity declared in regulations.

Before the passage of the Taxation Laws Amendment Act (No. 2) 1999, entities eligible to apply to become OBUs were banks, fully owned subsidiary companies of such banks and other financial institutions authorised to deal in foreign exchange.

The range of entities eligible to apply to be OBUs has been extended to funds managers, life insurance companies falling within the Life Insurance Act 1995, and certain other companies operating in the financial sector determined by the Treasurer (including providers of custodial services).

The Act also extends the range of eligible activities to include:

- custodial services;
- trading in Australian dollars where the other party to the transaction is an offshore person;
- offshore trading in gold bullion in any currency;
- trading in gold bullion with any person other than in Australian dollars;
- trading in base metals and palladium with offshore persons in any currency;
- other trading activities (apart from currency trading) in Australian dollars with offshore persons;
- eligible contract activities in Australian dollars with offshore persons; and
- hedging in Australian dollars with related offshore persons.

An 'offshore person' is a non-resident entity excluding its Australian operations, the overseas branch of a resident entity or another OBU.

OFFSHORE FINANCIAL CENTRE

Compared to the Australian OBU model, which is broadly centred around Treasury type activities the OFC/IFC/RFC model provides a slightly more expanded list of activities:

- structured debt and special purpose vehicles for bond

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- markets, and other capital markets applications;
- specialised leasing including cross border leases;
- insurance and reinsurance products;
- special purpose vehicles for securitizations;
- international tax and estate planning;
- international employee stock option plans; and
- shipping and aircraft financing structures.

OFCs play a substantial commercial role facilitating tax neutral transactions particularly in lease transactions.

Offshore is a concept more appropriately defined not by whether a financial centre is large or small, but rather by whether the client resides outside the jurisdiction providing the particular financial service.

Offshore facilities for non-resident clients include tax-free bank deposits, investment management, bonds and locally established trusts or companies.

REGIONAL HEADQUARTERS STATUS

RHQ's are a further extension of the activities included in OBUs and OFCs. They are designed to attract companies wishing to provide headquarters services to its related corporations. The country or capital city chosen benefits in terms of increased employment and spin-off demands for services, so there is considerable competition for the title of regional headquarters (often associated with tax benefits specifically designed to win business). Some tax advantages have been introduced to encourage the establishment of regional headquarters. This usually involves companies that have been granted RHQ status paying a lower corporate tax rate. For example, in Singapore companies with RHQ status pay 15 per cent tax versus 20 per cent tax.

RHQ activities broadly include:

- administration and management;
- business planning & coordination;
- procurement of raw materials and components ;
- corporate finance advisory services;
- marketing control and sales promotion planning;
- regional training and personnel management;
- treasury & Fund management;
- logistic services;
- R&D services and product development;
- regional technical support and maintenance;
- data/information management & processing; and
- business development.

RHQ incentives can include some or all of the following:

- tax holiday on foreign sourced income and reduced corporate tax thereafter;
- tax free dividends;
- duty free import of office furniture, equipment and belonging of expatriate employees;
- duty free import of a maximum of two cars for expatriate staff; and
- 50 per cent reduction on personal income tax for two expatriates for the first four years of employment.

GLOBAL FINANCIAL CENTRE

Global Financial Centres can be described as an intense concentration of a wide variety of international financial businesses and transactions in one location.

The following extracts from the “City of London Report 2005” titled “The Competitive Position of London as a Global Financial Centre” sum up nicely the distinctions between all aspects of finance centres.

The report concluded that London and New York are the only genuine global financial centres in the world and that if a third were to emerge then it is likely to be Shanghai on the back of the China powerhouse. It went on to suggest that Tokyo, Hong Kong, Singapore and Shanghai represent the future of Asian financial services and largely dismissed Sydney's claims as a global financial centre.

The report identified the key competitive factors a financial centre required and listed them in terms of priority as follows:

- availability of skilled personnel;
- robust regulatory environment;
- access to international financial markets;
- availability of business infrastructure;
- proximity to customers;
- a fair and just business environment;
- government responsiveness;
- corporate tax regime;
- operational costs;
- access to suppliers of professional services;
- quality of life;
- culture and language;
- quality or availability of commercial property; and
- personal tax regime.

IMPLICATIONS FOR NEW ZEALAND

Can New Zealand successfully establish itself and compete as a Financial Centre?

The answer is yes, so long as there is a political will to do so. New Zealand satisfies a number of the priorities identified in the City of London report and is equally competitive on most fronts including having:

- a low (relatively speaking) personal tax rates;
- an excellent telecommunications infrastructure;
- a robust legal and regulatory environment;
- a well educated workforce;
- competitive business services, rentals, light, electricity; and
- a favourable time zone and lifestyle.

More importantly, under the normal rules of engagement a financial centre is usually required to undertake transactions with parties that are non-resident to that in which the financial centre is established. Therefore in New Zealand's case, the main target market will be Australia, which empirically is at least 7-10 times larger than the domestic New Zealand market. 