Understanding customer business models (1/4/17)

Driven by general globalisation trends, it is now the norm for companies to operate in two or more countries and be registered in or linked with a foreign jurisdiction. Opportunities offered by various jurisdictions are increasingly considered by companies planning their business model. This article explores proper ways of taking these opportunities and ensuring compliance with national rules, as well as understanding the importance of risk analysis.

Companies set up abroad

Setting up a company in a jurisdiction most suitable for the industry the company is operating in is now easier than even before. That is why more companies are being set up in jurisdictions that offer excellent opportunities for future business development. A variety of reasons are considered in choosing a particular jurisdiction. Foreign jurisdictions are selected when it comes to restructuring a group, sorting out cash flows, doing an IPO, protecting assets, or for family reasons. Cyprus, for example, is chosen because it has a large number of effective double tax treaties; the Cayman Islands is a suitable jurisdiction for various financial dealings; and more than 40% of the world’s ships are registered in Panama, Liberia, and the Marshal Islands. Apart from an advantageous tax system, tax havens offer plenty of reasons for setting up a company there. A variety of factors influence a company’s development plans, but the importance of benefits from lower tax costs diminishes when it comes to choosing a particular jurisdiction.

Regulation

Along with the OECD’s global standard for automatic exchange of financial account information in tax matters, the EU enacted Directive 2014/107/EU as regards mandatory automatic exchange of information in the field of taxation, and Latvian tax legislation has been amended accordingly (see our article “Automatic financial account information exchange between tax authorities”). Latvia is among the 101 countries committed to exchanging information on financial accounts. As a result, financial institutions must already be able to gather sufficient information about customers in order to pass any requested details to government agencies. The activities of financial institutions are also governed by the Anti-Money Laundering and Counter-Terrorism Financing Act, and so they are required to identify and vet their customers. Customer identification and vetting requirements raise a number of new questions about information to be obtained from customers. Not only financial institutions are liable to gather information about customers and report any suspicious transactions – the activities of external accountants, tax consultants, real estate agents etc are also governed by the Act.

It is therefore crucial to be able to obtain relevant information from customers and analyse it. The professionals whose activities are governed by the Act have become the first bastion of defence against unfair practices in terms of both withholding their services and gathering information about customers and passing it on to government agencies. A proper understanding of how corporate structures work under different business models helps service providers not only stay out of illegal activities but also retain customers with sophisticated corporate structures through understanding their business models. There are plenty of reasons to include other countries in corporate structures, including various commercial and personal reasons, yet unlawful reasons are also possible. When assessing customers, it is important to understand statutory requirements for minimum information and documentation required to form an idea of how genuine a customer’s business is.

Here are a few questions that must be answered when assessing customer risk:

1. Who is responsible for the day-to-day running of the company?
2. Where are the company's management decisions made?
3. Was any advice received from legal, tax and investment consultants at the time of setting up a cross-border corporate structure? What is their reputation?
4. How is the prospective customer's business conducted? What kind of income does he earn?

The main documents relating to a customer that should be obtained as a safeguard against liability being imposed on the service provider include –

1. the customer's certificate of incorporation,
2. details of shareholders,
3. copies of passports,
4. the latest financial statements, and
5. a statement issued by the particular jurisdiction confirming that the company carries on a business and is tax compliant.

It is clearly impossible and unnecessary to collect so many documents in day-to-day dealings with customers in Latvia or the EU. If a customer risk assessment raises no doubts about the legitimacy of the customer's business, then a few documents are enough. Answers to the above questions can often be gleaned from resources available on the Internet. However, the documents should be obtained and the answers found before any services are rendered to companies whose business dealings and corporate structures are not so transparent.