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Cook Islands' approach to balancing privacy and transparency in captives

Alan Taylor, legal and technical advisor at Cook Islands Finance summarises the evolution of captive regulatory compliance in offshore jurisdictions and outlines the Cook Islands' approaches

Over the past two decades, the offshore landscape has changed considerably. 9/11 was arguably the catalyst for this. Following the catastrophic event, governments, and in particular the US, targeted the international transfer of funds as being the primary driver of terrorist activity. It was determined that more information was required to better understand the source of funds entering the banking system, the structures holding them and their owners.

The global financial crisis of 2009 followed, causing economic turmoil for many of the world's largest countries, resulting in enormous debt and the erosion of the tax bases needed to fund that debt and stimulate economies. In the ensuing years, EU and OECD members united to examine their tax laws and the reporting practices of their tax residents, with the aim of ensuring compliance with tax laws and growing the dwindling tax bases.

These events and their consequences have given rise to numerous measures, ostensibly intended to provide international standards for combating money laundering and financial crimes, including tax evasion, and the international exchange of financial information. However, it appears that these measures primarily targeted offshore financial centres, believing that restricting their activities would enable the EU and OECD countries to better control their taxpayers' activities.

International regulatory measures

The international regulatory measures introduced in recent years have significantly impacted offshore financial centres.

The Financial Action Task Force (FATF) Recommendations: The FATF has developed a comprehensive framework of measures that countries are to implement in order to combat money laundering and terrorist financing.

The FATF Recommendations provide an international standard that countries must adhere to. The FATF evaluates each country's Anti-Money Laundering (AML) regime against the recommendations and their specific circumstances.

The Foreign Account Tax Compliance Act (FATCA): The US requires all countries to automatically provide financial information held on US tax residents to the Internal Revenue Service (IRS).

The purpose of FATCA is to prevent US persons from using banks and other financial institutions outside the US to park their wealth and potentially avoid US taxation on income generated from such wealth.

The Common Reporting Standard (CRS): The OECD has implemented its version of FATCA, whereby all countries must agree and pass laws to ensure the automatic exchange of financial information held on tax residents of the requesting country. The CRS requires financial institutions to gather and share specific information with their respective tax authorities.

OECD Base Erosion and Profit Shifting Project (BEPS): The OECD has implemented a programme to address tax avoidance, primarily by multinational enterprises, and the shifting of profits to low or no-tax jurisdictions.

The BEPS project aims to equip governments with regulations and tools to combat tax avoidance and guarantee that the economic activity that generates profits is subject to taxation.

EU list of non-cooperative tax jurisdictions: In 2017, the EU notified more than 70 jurisdictions, mostly those regarded as no or low tax jurisdictions, that they would be blacklisted unless they amended tax laws that the EU regarded as harmful and preferential.

The EU also required those jurisdictions to be transparent with financial information and to have signed up to the OECD's BEPS project.

The imposition of these measures on offshore financial centres, such as the Cook Islands, disregards the costs and resources necessary for the implementation and maintenance of the mandated laws and systems, as well as the potential negative impact on their economies that depend on foreign investment and the autonomy to establish their own tax laws.

The Cook Islands' response

The Cook Islands is a small Pacific nation of 15 islands in the heart of the South Pacific. It has a resident population of around 15,000. Notwithstanding its lack of resources — financial and human — it had no choice but to comply with the onerous requirements stipulated by the world's most powerful nations.

It could not bear the thought of blacklisting, the ensuing reputational and economic harm, and the ensuing international isolation.

It has been an extremely challenging road for the Cook Islands to navigate. Still, it has progressed by committing to meet the standards demanded while preserving its ability to be innovative in enacting laws to meet the needs of its people and being responsive to its international client base, which requires certainty, continuity, and legitimate privacy.

Over recent years, the Cook Islands has received an outstanding Mutual Evaluation Report (MER) from the FATF, indicating it has one of the best AML/CFT regimes in the world.

The Cook Islands has incorporated the CRS and FATCA into its laws to promote transparency by automatically exchanging financial information with other jurisdictions, thereby aiding in the fight against tax evasion and other financial crimes.

The Cook Islands is a member of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes as well as its BEPS Inclusive Framework. It has avoided being placed on the EU's AML/CFT blacklist by virtue of its MER report and the EU's non-cooperative tax jurisdiction list by amending laws to, among other things, remove the Cook Islands tax exemptions for companies incorporated under the International Companies Act 1981-82. The EU regards the Cook Islands as a cooperative tax jurisdiction.

The Cook Islands has always shown itself to be flexible, innovative, and understanding in meeting the needs of international business. An example of this is the enactment of the Captive Insurance Act in 2013. The Act provides for the licensing, regulation, and supervision of captive insurance business conducted outside of the Cook Islands by international companies, as well as certain captive insurance business conducted within the Cook Islands by companies incorporated under the Companies Act 1970-71.

Captive insurance business in the Cook Islands means the business of an international company insuring interests in its holding company or in companies that it is affiliated with or associated with, or which is organised within a group or agency relationship.

In passing the Act, the Cook Islands placed itself at the forefront of an industry in the Asia Pacific region that is continually growing and seeking strong, well-respected jurisdictions from which to establish and administer captive insurance structures. The Act contains features that, together with the benefits of doing business in the Cook Islands, provide strong technical and commercial reasons for organisations to incorporate Cook Islands captive insurance in their business plans.

Captive licencing in the Cook Islands

Features of a Cook Islands licensed captive insurance company (LCIC) include:

- The prescribed minimum share capital and surplus requirement for a LCIC is NZ$100,000 (US$61,000).
- Only assets prescribed in the Captive Insurance Regulations of 2013 will be admissible when determining the value of an LCIC's assets and its surplus.
- The Cook Islands Financial Supervisory Commission must audit and file an LCIC's annual accounts. A LCIC must establish and maintain a clearly defined risk management strategy commensurate with the size, nature, and complexity of the LCIC's business.
- Each LCIC must appoint an "approved insurance manager" who must be licensed under the Cook Islands Insurance Act 2008 or an external manager approved under the Act.
- Captive owners can be individuals, corporations, and unincorporated bodies, groups, and associations.
- The LCIC will only pay Cook Islands tax on income it sources in the Cook Islands.

Tax changes, CRS classification and privacy requirements

In removing tax exemptions for international companies, including LCICs, to comply with the EU's mandate, those companies then became subject to Cook Islands company tax on their worldwide income. This enactment kept the Cook Islands off of the EU's blacklist of non-cooperative tax jurisdictions but put at risk all of its international company business, including captive insurance. ■

The Cook Islands responded quickly, however, by commissioning a review of its corporate tax regime to find a solution enabling it to retain and further grow its international company business.

The Income Tax Amendment Act 2021, which changed the Cook Islands company residence test for taxation purposes from incorporation to location of mind and management, was the result of this review. International companies, including LCICs, are therefore able to structure their governance to have a majority of directors resident outside of the Cook Islands, thereby ensuring they are not tax-resident for Cook Islands tax purposes.

Given that the Cook Islands is a member of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, as well as its BEPS Inclusive Framework, and has passed laws to implement the CRS, it is imperative that each LCIC understands its CRS classification, as this will determine whether or not it has reporting obligations under the CRS. If so, it must comply with the Cook Islands CRS laws and regulations.

The Cook Islands exchanges the CRS information with its international CRS partners automatically on an annual basis. LCICs and all financial institutions in the Cook Islands, which include custodial institutions, depository institutions, investment entities, and specified insurance companies, must be CRS compliant.

Despite its commitment to meet its international obligations through compliance with EU, OECD, and FATF standards, the Cook Islands has been able to maintain its reputation for accountability and responsibility while continuing to be a safe haven for those seeking legitimate privacy for their personal affairs.

The ongoing global movement to establish transparency on financial matters suggests that we can no longer take the confidentiality and privacy of one's financial affairs for granted.

However, while governments should not be denied their rightful tax take and those profiting from crime should not be encouraged, there needs to be some comfort for those going about their lawful business that their personal information will not be available to those with no lawful need for it.

In this regard, the Cook Islands strikes a balance between fulfilling its international obligations and safeguarding an individual's right to legitimate confidentiality through its laws.

The Cook Islands does not have public registers for beneficial ownership of incorporated entities or trusts. The Commissioner of the Financial Supervisory Commission and the Financial Intelligence Unit do have investigative powers where there is reason to believe financial misconduct has taken place.

However, they will only share the obtained information in accordance with the law's provisions. Fishing expeditions will not be tolerated.

The Cook Islands' approach to meeting its international obligations while recognising and providing legitimate confidentiality for those doing business in and with the islands should give governments, institutions, businesses, and individuals globally great comfort when dealing with the jurisdiction and its financial services industry.

Notwithstanding the measures it has undertaken to ensure compliance with international regulatory standards, the Cook Islands has been able to maintain its reputation for innovation, accountability, and being a good international citizen without any significant impact on its business operations, in particular its captive insurance business.

International clients expect adherence to international standards and obtain comfort knowing the Cook Islands and its service providers continue to provide the highest quality service in a compliant and responsible manner. ■