



EDITORIAL

I could never get a decent reply as to why, when one flies business class, he is afforded the benefit of having his laptop switched on throughout the entire flight; whereas when one flies economy class he is rudely forced by the stewardess to shut it down 30 minutes before landing. Similarly, I could never quite get an answer as to why we are often requested (say) to procure certificates issued by the Registrar of Companies in Cyprus or the Companies House in the UK, when that same information that is sought to be either identified or corroborated is free, up-to-date and publicly available on the internet (say) by either the Registrar of Companies or the Companies House. On neither of the two questions have I managed to be furnished with an (intelligent) reply. And, trust me, there's plenty of similar questions to which no (intelligent) reply is forthcoming.

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Professor Fraser Macdonald, Head of the Department of Orthodontics, had been a constant source of inspiration during my dental studies at King's College, London. Being my neurophysiology tutor, he is the person who instilled on me the need to understand the scientific basis; for example, the physiology of calcium gates in local anaesthesia before being allowed to take a needle and poke around a patient's mouth, trying to administer lidocaine for an inferior alveolar nerve block. He was also kind enough (along with Professor Richard Palmer, Head of the Department of Periodontology) to supervise my research project on the osseointegration of dental implants of varying surface treatments. Had it not been for another professor (no names here), I would have merrily pursued my career in dental surgery, probably specialised in either of those faculties and lived happily ever after drilling patients' teeth and getting myself lower back problems.

Sadly, not only did my dental career come to an abrupt end, but so did the philosophy I was nurtured with during on university studies. One spends years, immersed in books, publications and scientific journals, seeking answers and yearning to deepen his knowledge of "how" and "why" – only to be crash-landed into a world that professional inquisitiveness is crushed with a disappointing realisation that "we know better and we don't need to explain and you are a total idiot for asking and just give me a true copy with lots of stamps and signatures".

I can think of at least two aspects in today's world where this realisation is relevant - the second one is air travel.

Have a pleasant reading.

Pericles

WHAT'S ON TODAY'S EDITION?

CYPRUS GOVERNMENT
REDEFINES THE MODIGLIANI-
MILLER CAPITAL
IRRELEVANCE THEOREM

PAGE 2

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THE BRITISH VIRGIN ISLANDS
FORTIFY THEIR REPUTATION
AS A LEADING
INTERNATIONAL FINANCIAL
CENTER BY INTRODUCING
SPECTACULAR SUBSTANCE
REQUIREMENTS

PAGE 3

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SANDWICHES, LUNCHEONS
AND TRUSTEE EXEMPTION
CLAUSES

PAGE 4

Modigliani-Miller Theorem And Stamp Duty On Shares

Cyprus government abolishes tax on the authorized capital of companies

The Modigliani–Miller theorem is one of the fundamental principles of economic theory and it forms the contemporary basis for capital structure. The theorem states that the value of a company is unaffected by how that company is financed;

all this in an efficient market which is devoid of taxes, bankruptcy costs, agency fees and asymmetric information. Of course, living in a real world which is far from efficient, capital structure *does* matter which leads to the lifelong question – debt or equity?



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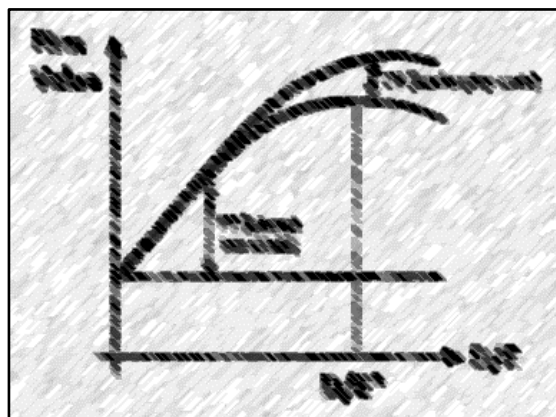
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Well, the Cyprus government has taken at least *two* steps recently in order to tilt the balance in favour of the latter. The first step was the introduction of the notional interest deduction, which provides a tax incentive for Cyprus companies to finance themselves with equity; we discussed this in a previous edition of **uniQue**.

The second step, introduced late last year, is the abolition of the stamp duty (0.6%) on the authorised capital. This measure will allow Cyprus companies to issue shares at nominal value avoiding the hefty payment of a tax that was largely seen as either draconian or unnecessary. By way of an example, a company which would purport to issue capital of €100,000,000 at par would have had to pay stamp duty of €600,000; now, such an exercise would allow the company to get away with an expense of just a few hundred Euros.

In the past, a number of companies had circumvented this predicament by issuing shares at a premium. However, that meant that they ended up with a balance sheet (being an old-school accountant I always forget what the contemporary name for the “balance sheet” is) showing share capital of, say, €100 and a share premium of €99,999,900. One can see that this did not exactly look optically right plus it created the obvious questions of how this premium was generated or how it was quantified.

All is well that ends well now. Stamp duty is not an issue, at least for share capital, and companies can allot shares at par at their heart’s content, evidencing their robustness and substance. The only thing that one needs to still keep in mind is that the reduction of share capital, as opposed to the repayment of debt, involves a court procedure. Not quite sure what either Franco Modigliani or Merton Miller, both of them Noble laureates, would have to say about this.



Substance Requirements...

Leading international financial center introduces strict criteria for resident companies

The government of the British Virgin Islands has, as of 1 January 2019, passed legislation which forces legal entities (partnerships or companies) to demonstrate adequate economic substance in the country. The so-called Economic Substance (Companies and Limited Partnerships) Act, 2018 also introduces extended reporting obligations.

Although additional guidance is expected during the course of the year, the salient features of this innovative piece of legislature are set out below:

Affected entities

The introduction of substance requirements affects all legal entities, other than those which are non-resident entities, which carry on a “relevant activity”. These requirements could also apply to foreign companies (or limited partnerships) which are registered in the British Virgin Islands as foreign entities.



Affected activities

Some of the so called “relevant activities” are:

- Holding business (which is, perhaps, the one of most relevance)
- Banking business
- Insurance business
- Shipping business
- Fund management business
- Finance and leasing business
- Intellectual property business

Entities which do not carry on a “relevant activity” are not subject to the economic substance requirements but may be subject to certain reporting obligations.

Substance requirements

The requirements for economic substance include the following:

- The “relevant activity” has to be managed and directed in the British Virgin Islands. This will entail the appointment of professional and competent directors with a proven record of experience and expertise.
- The legal entity must engage suitably qualified individuals, physically present in the British Virgin Islands, to carry out the business activities. Such individuals may be employees or external contractors.
- The legal entity must demonstrate that it incurs adequate expenditure in the British Virgin Islands. The expenditure should be proportionate to the extent and complexity of the “relevant activity”.
- The legal entity must maintain appropriate physical offices or premises in the British Virgin Islands.

Consequences of non-compliance

Substantial fines and up to 5 years’ imprisonment can be imposed for non-compliance and the relevant entity may be struck off the register.

Next step

Don’t get creative or rely on the good old internet search. Contact your British Virgin Islands advisor the soonest to ascertain how the above relates to your company.



Although contemporary luncheons that occur during, or shortly after, business meetings tend to include sushi and other oriental finger food, it holds equally true that such events have normally been associated with sandwiches, crisps and light refreshments. Sandwiches are also normally offered at breakfast meetings, along with butter biscuits, scones and a selection of tea or coffee. Come to think of it, sandwiches are an integral part of the standard culinary business practice and one has to only thank John Montagu, 4th Earl of Sandwich for that. For it was in accordance with his instructions that the modern sandwich was invented, still bearing his name, in order to provide him with an appropriate and convenient lunch during the time he was playing cards. What do sandwiches have to do with

the recent financial meltdown and the trustee's duty of care¹?

The Bartlett angle

Sir Herbert Bartlett had set up a trust, and appointed Barclays Bank as the sole trustee. The only asset of the trust was 99.8% of the issued share capital of the family company. The family company expanded its business from managing property to developing property. The speculative developments ended in a disaster when the company failed to secure planning permission for a large development, precipitating a significant loss for the trust. The beneficiaries of the trust sued the trustee.

Judgment in Bartlett

It was held that the trustee had not discharged its duty properly, failing to supervise the new ventures of the company². Brightman J held that the trustee should have been more proactive and not "*confine itself ... to attendance at the annual general meetings and the luncheons that followed*" (the sandwiches that we referred to earlier). The trustee's defence, that they honestly and reasonably believed the board of directors (to which, mind you, they appointed no nominees) to be competent enough to run the business, was rejected.

Modern practice

Countries like the BVI and the Cayman Islands have enacted special legislation (Virgin Islands Special Trusts Act 2003 and The Special Trusts (Alternative Regime) Law respectively) in order to address this predicament. Trustee exemption clauses, aka "anti-Bartlett clauses, have also historically formed part and parcel of off-the-shelf trust deeds, in order not only to eliminate any liability but to also specifically prevent the trustees from meddling in the business affairs of the underlying companies.

Global financial crisis

The tsunami that ensued, following the crisis of 2008, has resulted in substantial losses for a number of trusts' underlying investments. In instances like these, everybody is looking for a culprit. In last year's case of Zhang Hng Li³, the Court held that the trustees were "grossly negligent" in the way they addressed business decisions and were held liable to compensate for the investment losses. The Court's findings were that, in spite of the inclusion of anti-Bartlett clauses, the trustee has a residual high level supervisory role or obligation. My feeling is, and given the current trend we observe in similar cases, the trustee's liability will not be in the least mitigated by the standard exemption clauses on whose protection the trustees seek to rely, forcing trustees to either get more expensive, better insured or more innovative – or possibly all three.

¹ s 4 of the Trustee Act 2000

² Bartlett v Barclays Bank Trust Co Ltd (No. 2) [1980] 1 Ch 515

³ Zhang Hong Li v DBS Bank (Hong Kong) Ltd [2017] HKEC 772