SOVEREIGN

Report

The Sovereign Group Report : Issue 4 April – June 2000

Once again *The Sovereign Report* contains news about OECD, EU and US attacks on offshore financial centres and their supposedly harmful tax regimes. However, the good news is that the OECD has recently announced that it is to delay publication of its final 'black list' for 12 months until June 2001. This will give many of the OFCs some much desired breathing space (although the OECD will still publish an interim 'grey list' in June this year). International and offshore tax planning does have a secure future but, as we have mentioned in previous articles, taxpayers need to be more sophisticated. The days of conveniently forgetting to declare offshore profits and relying upon the secrecy laws of the OFC are surely numbered. Good tax planning should never rely solely on confidentiality. All arrangements should be able to stand up to scrutiny by the local revenue and still work.

The Sovereign Group continues to grow.

BAHAMAS

After much delay, **Sovereign (Bahamas) Ltd** received Approved Management Company Status with effect from January this year. The Bahamas' independence and status as a world-renowned financial centre is generating much interest and attracting business from some of the British overseas territories which are seen as at greater risk from interference by the UK government and the EU.

CYPRUS

Again, in January this year, **Sovereign Trust (Cyprus) Ltd** obtained authorisation from the Central Bank of Cyprus to act as a trustee, nominee and company manager. Cyprus continues to be the premier jurisdiction for routing investments into central and eastern Europe due to the very advantageous tax treaties concluded with many of those countries.

MALTA

In March **Sovereign Trust (Malta) Ltd** obtained registration as a Licensed Nominee. We are apparently the first non-Maltese-owned company to obtain such an authorisation, other than HSBC. Malta is experiencing a surge of interest. The tax system requires payment of 35 per cent tax but most of this amount can be reclaimed by shareholders when dividends are paid. The fact that Malta is a high tax country and has a good range of tax treaties means Malta companies can be extremely useful in an international tax plan. Additionally, Malta is making a concerted effort to attract e-commerce and internet gambling businesses. Malta is now one of the few OFCs actively encouraging proposals for setting up internet gambling.

SOVEREIGN CAPITAL LTD

As our financial year comes to a close **Sovereign Capital** can report that over the 12-month period it managed to raise over US$40 million in private finance for our clients. This was the first year of operation for this new Sovereign division and we hope to build on this promising start over the coming years.

IP AND TRADEMARK SERVICES

We have recently been very active in assisting clients with registering and protecting their intellectual property. Many clients give little time and attention to this extremely important matter and do not realise that registering a company or domain name does not prevent others registering similar names in the same jurisdiction or identical names in other jurisdictions. Registering a trademark is the best way of protecting the extremely valuable IP which lies in a company's name and identity.

E-COMMERCE

Business to consumer (B2C) internet enterprises are experiencing a rough ride at the moment but momentum is gathering in the business-to-business (B2B) sector. **Sovereign** can offer one of the best B2B platforms available which allows businesses to present their products in 3D, digitised form and offers a complete and highly sophisticated sourcing, buying and marketing solution. Manufacturing companies who wish to bring themselves into the internet age, increase sales and streamline supply and marketing would be well advised to have a serious look at this platform. Rather than charging large fees for allowing use of the system the company charges a minimal transaction fee based on sales through the system. In this way costs are kept to a minimum and are based solely on results. *Please contact our Hong Kong office for more details if this is of interest to you or your business.*

Howard Bilton BA(Hons)
Barrister-at-Law (England, Wales & Gibraltar)
Chairman of The Sovereign Group

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GIBRALTAR

New Companies Ordinances to transpose EU Company Law Directives

The Companies (Accounts) Ordinance and Companies (Consolidated Accounts) Ordinance to transpose the 4th and 7th EU Company Law Directives into Gibraltar law were brought into force on 1 April 2000.

Under the legislation, all limited companies – except licensed banks and insurance companies which are subject to separate legislation – must file accounts within 13 months of the end of a financial year. Gibraltar companies were previously required to present accounts to the annual general meeting but there was no requirement to file.

However, allowances are made for small and medium-sized companies. Small companies need only file an abridged balance sheet. There is no requirement for a profit and loss account or an auditor's report.

Medium-sized companies must file a profit and loss account and auditor's report in addition to a full balance sheet, but the information in the profit and loss account may be abridged.

Companies undertaking business with residents of Gibraltar have to prepare accounts for submission to the tax authorities but these accounts will not be made available to the public.

Prime Minister Peter Caruana won a second four-year term in office at the general election on 10 February. His Gibraltar Social Democrat Party secured 58 per cent of the vote against the 40 per cent polled by former prime minister Joe Bossano's Socialist Labour Party.

Under the legislation, all limited companies – except licensed banks and insurance companies which are subject to separate legislation – must file accounts within 13 months of the end of a financial year

Keith Azopardi has been appointed as Minister for Trade, Industry & Telecommunications. He will be responsible for the financial services sector and a new e-commerce initiative.

SOVEREIGN COMMENT

While the need to file accounts may be new, the requirement to produce accounts is not. We believe that, without exception, the companies legislation of each and every jurisdiction provides that a balance sheet and profit and loss account must be prepared by the directors and laid before the company in general meeting every year. In jurisdictions where it has not been necessary to present these accounts to any public authority and it has been the practice for them not to be prepared, this is a technical offence.

As a full member of the EU, Gibraltar had no choice but to implement the relevant EU Directives which call for the filing of accounts, but it is likely that other 'offshore' jurisdictions will implement similar changes to comply with the OECD requirements for greater transparency.

UK CROWN DEPENDENCIES

UK concludes Edwards' Review

Improvements in financial regulation and the policing of financial services by the Isle of Man and the Channel Islands in response to the Edwards Report would help secure their future as 'top division' financial centres, said the UK government.

'The programme of reforms set out in the implementation plans clearly demonstrates the Islands' willingness to take forward the issues raised by Edwards,' said Home Office Minister Lord Bassam.

Melanie Johnson, economic secretary to the Treasury, said the UK government had 'no problem in principle' with countries which earned their living, by providing financial services to non-residents countries but it was important that all comply with international standards.

'We consider,' she said, 'that the true division is not between onshore and offshore but between those countries which comply with international standards and those that do not. Keeping up with developments of international standards in future will be as important as the developments which have already taken place today.'

The Edwards Report on Financial Regulation in the Crown Dependencies was published in November 1988. Lord Bassam said the responses submitted by all three Islands had highlighted progress, particularly in the key areas of:

- increased resources devoted to regulating and policing financial systems and measures to increase the independence of the regulators;
- enactment of 'all crimes' anti-money laundering legislation;
- measures to regulate company and trust service providers.

All three Crown Dependencies, he said, had committed themselves to complying with international standards of regulation of their financial services industries; keeping their regulatory frameworks under review; and responding to any changes in international standards.

FINANCIAL ACTION TASK FORCE

FATF to suspend Austria over 'passbook' accounts

The Financial Action Task Force (FATF) has announced that Austria will be suspended as a member, with effect from 15 June, due to its continued failure to take action to eliminate anonymous savings 'passbook' accounts.

Suspension will be automatic unless Austria states that it will take all necessary steps to end the system of anonymous passbooks by the end of June 2002 and brings through legislation to prohibit the opening of new passbooks and to eliminate existing passbooks.

SOVEREIGN COMMENT

Austria remains a jurisdiction which offers the greatest banking secrecy. We have never particularly favoured anonymous passbook accounts but the confidentiality which can be offered to offshore corporate accounts can be useful.

ISLE OF MAN

Corporate Services Green Paper published

The Corporate Services Providers Bill, to provide for a licensing system for company formation and management practitioners based on 'fit and proper' criteria, has been published in the form of a government Green Paper and tabled in the House of Keys. The legislation is due to be effective from June.

A Companies (Transfer of Functions) Bill, to centralise all matters relating to the regulation of companies with the Financial Supervision Commission (FSC) is to be brought into force on 1 April 2000.

The Bill will transfer responsibility for the Companies Registry from the Chief Registrar to the FSC and will also transfer to the FSC any functions of the Chief Registrar in relation to the registration of business names, limited partnerships, limited liability companies, industrial and building societies and credit unions.

SOVEREIGN COMMENT

The Isle of Man is one of the last major OFCs to introduce a regime for regulating company formation and management agents. Those applying for a licence must be able to demonstrate that they have the necessary resources and expertise for the proper management of the applicant. It must also be demonstrated that the applicant is owned by persons of integrity. It is thought that a number of Isle of Man-based companies, including some recognisable names, may fail to meet the necessary criteria and may be forced to flee to less well regulated jurisdictions or close down.

TURKS & CAICOS ISLANDS

Proceeds of Crime Ord.

A Proceeds of Crime Ordinance has brought in 'all crimes' anti-money laundering legislation on a dual criminality basis.

It is now a criminal offence for anyone to: assist another person to retain the benefit from any criminal conduct; acquire, possess or use the proceeds of criminal conduct; or conceal or transfer the proceeds of criminal conduct. Tipping off is also an offence.

Criminal conduct is defined as any conduct which constitutes a criminal offence under the laws of the TCI or which would have constituted such an offence if it had taken place in the TCI.

This does not account for tax evasion because there are no direct taxes in the TCI. But the government has decided to review its policy on the prosecution of tax fraud. Any changes will not be retrospective and will apply to criminal prosecutions only.

SOVEREIGN COMMENT

The Company Managers Licensing Ordinance will take effect shortly and will apply to all corporate service providers. **Sovereign Trust (TCI)** already holds a professional trustee licence and will be exempt from the requirement to make application for a Company Management Licence. Pursuant to the OECD report and the British Government review of its overseas territories, all OFCs which do not currently require company managers to be licensed will have to introduce suitable regulations.

BAHAMAS

Purpose Trusts Bill

A Purpose Trusts Bill is in the final stages of drafting by the Association of International Banks & Trust Companies. Due to be submitted to the Law Reform Commission for approval, it is hoped to be enacted this year.

Purpose trust legislation was originally to be included in the Trustee Act 1998, which was brought into force on 27 July 1998, but was excluded to permit further consideration of the Cayman Islands' Special Trust (Alternative Regime) Law 1997 and the Bermuda Trusts (Special Provisions) Amendment Act 1998.

The Association is also assisting in drafting a Private Foundations Bill which, it is hoped, will be tabled in the House of Assembly next year.

SOVEREIGN COMMENT

Purpose trusts can be useful in a tax planning exercise because they have no identifiable individual beneficiaries and therefore may escape anti-avoidance legislation aimed at taxing trust profits in the hands of beneficiaries whether they receive distributions from the trust or not.

UNITED STATES

US anti-money laundering strategy

US Treasury secretary Lawrence Summers unveiled proposals – announced as part of the National Money Laundering Strategy for 2000 – for new powers to act against money laundering through domestic and foreign financial institutions.

The proposals will enable the Treasury to determine when a foreign country, institution or type of transaction represents a 'primary money laundering concern' and implement action.

The US Treasury also announced new measures to curb the use of transactions that have no legitimate business purpose

Under existing rules, the US can only issue advisory notices to 'name and shame' offending jurisdictions but proposed new measures will range from imposing new reporting requirements on US financial institutions doing business with them to barring US institutions from operating correspondent banking relationships with them.

The US Treasury also announced new measures to curb the use of transactions that have no legitimate business purpose. They are designed to force the disclosure of new tax shelters as soon as they are created so that they can be reviewed by the IRS and, if found improper, prohibited.

The most significant is a set of regulations requiring promoters of corporate tax shelters to register with the IRS any transactions that:

- have been structured for a significant purpose of tax avoidance or evasion;
- are offered to corporate participants under conditions of confidentiality;
- will accrue fees for the tax shelter promoters in excess of US$100,000.

Another set of regulations requires promoters of corporate tax shelters to maintain lists of investors and copies of all offering materials and to make this information available for inspection by the IRS upon request.

A third set of regulations requires corporate taxpayers to disclose their participation in reportable transactions by filing a statement with their income tax returns for each reportable transaction for each taxable year in which a corporation's federal income tax liability is affected by its participation in such a transaction.

A new IRS Office of Tax Shelter Analysis will review all reports by promoters and taxpayers under the new disclosure regulations and coordinate follow-up activities by IRS examiners.

From 1 January 2001, qualifying foreign intermediaries will be eligible to grant treaty relief on behalf of beneficial owners of US-source income. This will involve significant changes in terms of internal procedures, client relationships, disclosures and relationships with the IRS.

US-source income is currently subject to the address system whereby a foreign address is sufficient for the application of treaty relief, but foreign intermediaries are required to impose an additional withholding tax which is reimbursed or credited to beneficiaries when the income is declared in the appropriate State of residency.

At present it is the beneficiary who applies for treaty relief, but under new US withholding tax rules, qualfied foreign intermediaries will be permitted to report on behalf of the beneficiaries. Non-US intermediaries will be required to enter into a Qualified Intermediary agreement with the IRS,demonstrate adequate resources and undergo a special audit.

The 'General Revision of Regulations Relating to Withholding of Tax on Certain US-Source Income Paid to Foreign Persons and Related Collection, Refunds, and Credits' will apply to payments made after 31 December 2000.

UK OVERSEAS TERRITORIES

KPMG appointed to review OTs

The UK government has appointed KPMG to conduct a review of financial regulation in its Overseas Territories which includes Anguilla, Bermuda, BVI, Cayman Islands, Montserrat and the Turks & Caicos Islands.

The review, which was commissioned and financed jointly by the UK and the governments of the Overseas Territories, was initially proposed in the White Paper entitled 'Partnership for Progress and Prosperity – Britain and the Overseas Territories' which was published in March last year.

KPMG will examine practices and legislation covering the banking, insurance and securities sectors, companies and trusts, independence of regulatory authorities, as well as arrangements for international co-operation and anti-money laundering.

The review will assess progress in implementing accepted international standards and good practice in these areas and will determine whether further action is needed by any territory in order to meet those standards and prioritise any recommendations. It is scheduled to report by July this year.

SOVEREIGN COMMENTS

This review is an extension of that carried out by Edwards in relation to the Isle of Man and Channel Islands.

HONG KONG

Consultation begins on new Securities & Futures Bill

A consultation document has been issued for a proposed Securities & Futures Bill to consolidate and modernise the existing legislation for the regulation of the securities and futures market.

The aim is to create a modern regulatory and legal framework that promotes market confidence, provides investor protection, reduces financial crime and facilitates competition. Existing legislation comprises 10 separate Ordinances brought in over a 25-year period.

The proposed composite Bill will streamline the licensing regime for intermediaries so that a single licence encompasses all activities regulated by the Securities & Futures Commission

The proposed composite Bill will streamline the licensing regime for intermediaries so that a single licence encompasses all activities regulated by the Securities & Futures Commission (SFC) and give it a wider range of disciplinary sanctions for improper conduct such as fines and suspension or revocation of licences in respect of only a part of a business;

Consultation on the White Bill will be for three months, until the end of June. The composite Bill is due for enactment by April 2001. The government has proposed a two-year transitional period to the new licensing regime.

Several proposals designated for the composite Bill have been brought forward to fill urgent gaps in the present legislative framework. The Securities (Margin Financing) (Amendment) Ordinance, the Securities (Amendment) Bill (on regulation of short-selling) and the Securities & Futures Legislation (Provision of False Information) Bill will be subsumed into the composite Bill at a later stage.

A Companies (Amendment) Bill to introduce corporate rescue procedure in Hong Kong was gazetted on 6 January 2000. It introduces a statutory stay of proceedings to protect a company from actions against it by its creditors in order to allow a viable business in financial difficulty to restructure.

The initial stay is for 30 days but may be extended by the court for up to a further six months. During the moratorium, control of the company will be vested with an independent professional third party, known as the provisional supervisor. Directors and senior management will be personally liable for debts of a company which traded while insolvent.

The Bill also implements a number of recommendations of the Standing Committee on Company Law Reform. These include reducing the filing requirements for local and overseas companies and their directors and lowering the threshold for the requisition for convening an extraordinary meeting from members holding not less than 10% of the paid-up share capital to 5%. This is to provide better protection for minority shareholders.

SOVEREIGN COMMENT

Hong Kong is, perhaps, the only tax friendly financial centre to stay off the 'hit lists' compiled by the EU, UN and OECD. As such Hong Kong may be well placed to become the jurisdiction for international tax planning structures. Hong Kong has always been well regulated but has an ongoing programme for improving and amending legislation to take account of modern changes in practice.

At the same time as introducing new regulations Hong Kong remains a place which is relatively free from bureaucracy and has annually been voted as the jurisdiction which offers the greatest financial freedom and least barriers to starting a business.

SINGAPORE

New Singapore Exchange opens

The Singapore Exchange, created by the merger of the old Singapore Stock Exchange and the Singapore International Monetary Exchange, opened as the first fully-demutualised financial market in Asia.

The new market is to take commissions on all trades above S$150,000 (US$89,000) negotiable from this year and will lower commissions on smaller retail trades to 0.75 per cent.

The limit at which international members can trade is reduced from S$5m to S$500,000 this year and will be lifted entirely in 2001. Additional international members are to be admitted from July, with open access to follow in 2003.

The Monetary Authority of Singapore has also announced plans to open up entry to the direct insurance industry and lift the 49 per cent restriction on foreign ownership of local insurers, with immediate effect, to enable local players to form alliances with foreign partners and benefit from technology and increased financial strength.

MAURITIUS

India clarifies 'bona fide resident' under treaty

Indian finance minister Yaswant Sinha stated that any institution with a certificate from the Mauritius authorities verifying its status as a bona fide resident of Mauritius would be be eligible for benefits under India's tax treaty with Mauritius.

The clarification came after the Bombay tax authorities issued assessment orders against a number of foreign institutional investors investing in India though Mauritius for the 1996/7 tax year.

They were informed that they did not qualify for exemption from capital gains tax under the 1983 treaty as bona fide investors in Mauritius.

The move threatened investment flows which, in the last financial year, totalled US$2.4bn. Several foreign funds suspended dealings in Indian equities and the Bombay Stock Exchange Sensitive Exchange fell sharply.

The Indian finance ministry acted swiftly to clarify the point within the treaty and rescind the tax demands on foreign institutional investors.

SOVEREIGN COMMENT

India's capital gains tax, which is as high as 30 per cent, is the main reason why so many foreign institutional investors opt to invest via Mauritius. Foreign institutional investors under the tax treaty are exempt from capital gains tax in India and Mauritius does not tax capital gains.

This treaty has been the foundation of the success of Mauritius as an OFC. Despite these problems enthusiasm for using Mauritius as a gateway to India continues, but clients may also care to note that Cyprus has an almost equally advantageous DDT with India.

HONG KONG

HSBC appointed as US$ settlement institution

The Hong Kong Monetary Authority (HKMA) announced that HSBC has been appointed as Settlement Institution for the US dollar clearing system for five years. It had invited applications last year.

The key functions of the US dollar clearing system will include an interbank Real Time Gross Settlement (RTGS) system, electronic bulk clearing for stock market transactions (usually known as CCASS), Payment versus Payment for US$/HK$ foreign exchange transactions, and US dollar paper cheque and CMU interface for the settlement of debt securities.

The system will be implemented in phases. The RTGS and electronic bulk clearing for CCASS are scheduled to commence operation in the third quarter of 2000.

MAURITIUS

Supreme Court sets aside disclosure application

The Supreme Court of Mauritius set aside last November an application for disclosure of information in respect of the beneficial owners of an offshore company, due to procedural defects.

The Mauritius Offshore Business Activities Authority resisted the application because it contended that the case did not qualify for disclosure as it was not related to money laundering and that the offshore company, Olivia Securities, was not actually party to the civil proceedings in South Africa.

HONG KONG

Court of Appeal upholds tax-avoidance ruling

In *Yick Fung Estates v Commissioner of Inland Revenue* (313 of 1998), the Court of Appeal of the Hong Kong Special Administrative Region upheld a High Court ruling of October 1998 that a unilateral act could constitute a transaction under the general anti-avoidance rule within s61A of the Income Tax Ordinance.

A taxpayer, it said, is required to provide a non-tax justification to displace the implication that his sole or dominant purpose was to obtain a tax benefit.

The taxpayer had commenced business before 1 April 1974. Until the year of assessment 1988/89, its accounting date was 30 June each year but in that year it changed to 31 March. It argued that the effect of this change was that the profits of a period of nine months fell out of the charge to tax.

The assistant commissioner raised an additional profits tax assessment for the year 1998/99 and sought to tax the taxpayer on additional profits of HK$108.3m which had been earned in the nine-month period from the end of the preceding accounting period to the end of the new accounting period, a total period of 21 months.

But on a second point, the Court of Appeal found in favour of the taxpayer by concluding that profits tax is a yearly tax and that there would be a presumption that it is payable on yearly profits.

The High Court had decided that under s18E, the Commissioner could determine the profits be reference to a basis period which exceeded 12 months even for trade which commenced before 1 April 1974. The Court of Appeal disagreed, concluding that profits tax is indeed a yearly tax and that there would be a presumption that it is payable on yearly profits.

UNITED KINGDOM

Mareva injunction

In *Federal Bank of the Middle East v Hadkinson & Others* (FC3 99/7317/A2 & others), a world-wide freezing order in the standard form had been granted on the bank's application in November 1997 against the first defendant Charles Hadkinson, an international entrepreneur, and a number of companies in Cyprus through which he dealt.

Hadkinson later authorised the transfer of funds out of bank accounts in his name but to which he himself had no beneficial entitlement. In February 1998, he was declared bankrupt on his own petition. He owed £15.5m to the bank.

The High Court found the defendant, as bare trustee, was in contempt in respect of non-compliance with the order for disclosure and, in respect of two transfers, was in breach of the freezing order.

The defendant appealed, contending that the order affected only assets owned by him beneficially. Those assets held by him as a bare trustee did not come within its scope.

Upholding the appeal, the Court of Appeal held that a Mareva injunction in the standard form applied only to assets belonging to a defendant and which were available to satisfy the claim made against him.

SOVEREIGN COMMENT

This is a logical decision. Mareva Injunctions are granted to stop the subject of litigation from distributing his assets in order to defeat a possible creditor. Clearly assets which are held as trustee are not available to the creditor of a trustee and allowing those assets to be frozen would hurt the beneficiaries of the trust, not the trustee.

ISLE OF MAN

Ruling on power to add trustees

In *The Matter of the Petition of Osiris Trustees & Goodways*, the two petitioners applied to the Court under s61 of the Trustee Act 1961 for an opinion that their appointment as additional trustees of two trusts was valid and effective.

The two discretionary trusts were settled in 1990 by a Guernsey resident under the law of Jersey. The beneficiaries included his wife and children. Both trusts contained a power for the settlor to appoint additional trustees during his lifetime.

The original trustee, Abacus (Guernsey) Ltd, resigned in 1997 and an Isle of Man company, De Montfort Securities (DMS), was appointed. At the same time, the law of the trusts was changed to the Isle of Man. In July 1999, Osiris and Goodways were appointed as additional trustees by the settlor to act jointly with DMS. They applied to the Court for confirmation of their appointment.

DMS challenged the appointments claiming the power to appoint additional trustees was a fiduciary one and that they were made for the improper purpose of suppressing disclosure relating to the settlor's interference in the affairs of the trust.

The Court held that the appointment of Osiris and Goodways was valid. A power to appoint additional trustees involves a duty of a fiduciary nature and should be exercised in the interests of the beneficiaries.

CAYMAN ISLANDS

Ruling on validity of notarisation

In *Isabelle Al-Ibraheem v Bank of Butterfield International (Cayman) & Others*, a trust governed by Cayman law was established by an agreement of September 1989.

Article 2.1 provided for the settlor to amend the trust agreement by a written instrument which was defined in Art 13.1(d) as an instrument in writing 'which has been duly signed, witnessed and notarised'.

An amendment to the trust agreement was purportedly signed by the settlor and witnessed on July 1996, but was not then notarised. It was assumed that the settlor had mental capacity at that date but had ceased to have it by November 1997.

The plaintiff commenced the action in September 1996. In 1999, the witness swore before a notary in Texas that she saw the settlor execute and deliver the amendment.

The Grand Court held that notarisation is broader in the Cayman Islands than in England and encompassed proof of an instrument on the oath of a subscribing witness provided the oath was administered by a notary public. But a settlor had to sign the document and cause it to be notarised and delivered to the trustee.

In this case, by the time of the notarisation and delivery in 1999, the settlor had ceased to have capacity. Even if the events had perfected the exercise, it would not have had retrospective effect.

OECD

OECD to explore 'tax haven' alternatives

The OECD is exploring ways to assist small economies to reach acceptable international tax standards at the same time as identifying long-term development strategies, as part of OECD governments' efforts to reduce the distortions imposed by harmful tax practices.

It follows on from the recommendations of the 1998 Report 'Harmful Tax Competition: An Emerging Global Issue', which proposed action to:

- eliminate harmful tax practices in the OECD;
- curb the spread of tax havens;
- encourage countries outside the OECD area to associate themselves with the work.

The OECD said that it recognises that curbing harmful tax practices may adversely affect economies, particularly of small island states, that have become dependent on financial service regimes designed to attract investment from those seeking to escape taxes. It wishes to explore with these countries how they may be supported as they move away from harmful tax practices.

These points were discussed at an informal joint meeting in Paris of the OECD's Committee on Fiscal Affairs and Development Assistance Committee which examined specific proposals to:

- initiate a multilateral effort on how these economies could be assisted to meet the new tax, regulatory and financial standards that the international community is embracing;
- bring together interested multilateral institutions and OECD member countries to work together with jurisdictions to identify with them the transitional consequences of adaptation and ways and means to assist them with their adjustment policies.

It is intended to hold another meeting of the two committees at the annual OECD Ministerial meeting to be held on 26–27 June to examine progress made with these initiatives.

SOVEREIGN COMMENT

There remains considerable opposition to the OECD initiatives designed to curb 'harmful tax practices'. The OECD seems to have taken a stance that any jurisdiction which offers a tax rate which is below the norm is, per se, operating a harmful tax regime despite the fact that it recognised within its report that a sovereign state should be able to set it's own rate of tax according to its needs.

EUROPEAN UNION

UK proposes alternative to EU-wide withholding tax

The UK has put forward proposals to combat evasion of taxes due on savings income of individuals resident in the EU member states through information exchange rather than a minimum withholding tax on non-resident savings.

The plans were presented to the first meeting of a new working group set up at the Helsinki Summit last December to resolve the deadlock over the proposed EU tax package. The UK believes a withholding tax would drive London's US$3bn international bond market to non-EU financial centres.

The proposals would involve routine disclosure of information from payers of interest to their domestic tax authority. Tax authorities would then pass it on to other tax authorities concerning non-residents.

The UK has insisted that exchange of information would need to apply to financial centres outside the EU and would also require countries such as Germany and Luxembourg to set aside bank secrecy laws.

UNITED KINGDOM

UK exerts pressure over OECD initiatives

The UK government said that it intends to open talks with other countries, including the British Overseas Territories and Crown Dependencies, as part of its efforts to develop new international standards on exchange of information in support of OECD and G7 initiatives.

Tax Information Exchange Agreements will allow the Inland Revenue to receive information about foreign transactions of UK taxpayers and multinational companies.

The UK government is to encourage its Overseas Territories and Crown Dependencies to enter into exchange of information agreements as 'an important signal of their willingness to co-operate internationally in dealing with tax evasion and avoidance'. Bermuda has already indicated that it is prepared to enter into negotiations.

The initiative is timed to exert maximum pressure, as the OECD prepares to publish its list of 'tax havens' in June. It will also help the UK to resist the proposed EU withholding tax on savings.

FINANCIAL STABILITY FORUM

FSF endorses actions for assessing OFCs

The Financial Stability Forum (FSF) endorsed a range of policy actions based on the recommendations of its working group on offshore financial centres (OFCs) at its third meeting in Singapore.

The group recommended procedures for assessing OFCs' adherence to international standards relating to:

- co-operation and information sharing;
- essential supervisory powers and practices;
- customer identification and record keeping.

It also recommended that assessments should consider the capacity of supervisors and law enforcement authorities to obtain information about the beneficial ownership of corporate vehicles registered in their jurisdiction and the ability to share that information with foreign authorities.

It further proposed a menu of incentives that could be applied to enhance adherence to international standards. The Forum stressed the urgency of making this framework operational.

Established by the G7 countries in February last year, the Forum aims to promote international financial stability through enhanced information exchange and co-operation in financial supervision and surveillance.

CYPRUS

Tax treaty with Belarus

The Cyprus-Belarus tax treaty, which replaces the Cyprus-USSR tax treaty of 1982, was applied from 1 January 2000.

Under the treaty, maximum withholding tax rates are:

- 15 per cent on dividends generally and 10 per cent if the beneficial owner holds, directly or indirectly, at least 25 per cent of the share capital of the company paying the dividends. A 5 per cent rate applies if the beneficial owner of the dividends has invested at least Euro200,000 in the share capital of the company paying the dividends;
- 5 per cent on interest and royalties.

Both states provide for the credit method to avoid double taxation. Cyprus also grants a credit for the underlying tax for dividends paid by a company which is a resident of Belarus to a company which is a resident of Cyprus, provided the underlying tax is included in the taxable base of the recipient company.

SOVEREIGN COMMENT

Cyprus 'offshore' companies pay tax at a rate of only 4.25 per cent. A resident Cyprus company pays tax at 20 per cent. Some countries will specifically exclude the offshore company from benefiting from a treaty signed with Cyprus either by amending the treaty itself or by practise. The new Belarus treaty does not appear to contain any such restrictions.

Taxation of E-Commerce

As the internet explosion forged ahead of ill prepared legislative frameworks, administrations around the world realised that the footloose nature of e-commerce meant that the evasion of taxes was impacting on domestic revenue bases. **MICHAEL FOGGO** examines what can be done to stem the tide of lost revenues.

The taxation of e-commerce is in a genesis phase. Many special advisory and consultative committees have been established by the Organisation for Economic Co-operation and development (OECD), the United States and European Union to study the impact of e-commerce on domestic revenue bases.

The developed countries are, quite understandably, concerned. Internet business is highly mobile so could easily be situated in any low or zero tax jurisdiction thus depriving the high tax jurisdictions of revenue.

The Commission said it could see no merit in the argument that e-commerce requires a period of relief from taxation in order to develop to its full potential

The OECD's Committee on Fiscal Affairs set out the governing principles for taxation issues related to e-commerce in its Taxation Framework Conditions which were presented at a ministerial-level conference on e-commerce held in Ottawa in October 1998.

The key conclusion was that the taxation principles that guide governments in relation to conventional commerce should also guide them in relation to e-commerce. The Framework addresses four areas: tax treaties; consumption taxes; tax administration; and taxpayer service.

In the tax treaty area, it provides that the present international norms are capable of being applied to e-commerce but some clarifications should be given as to how these norms, and in particular the Model Tax Convention, applies.

In the consumption tax area, it provides that taxation should occur in the jurisdiction where consumption takes place and the supply of digitised products should not be treated as a supply of goods.

In the tax administration area, the information reporting requirements and tax collection procedures being developed must be neutral and fair so that the level and standard is comparable to that which is required for traditional commerce.

The work programme includes:

- whether a web site or a server can constitute a permanent establishment giving rise to tax jurisdiction in a country;
- how payments for digitised products should be characterised under tax treaties;
- for consumption tax, obtaining a consensus on defining place of consumption and on internationally compatible definitions of services and intangible property;
- adopting conventional identification and internationally compatible information requirements.

In June 1998 the European Commission set out broad guidelines for the taxation of e-commerce which provided that:

- no new or additional taxes need to be considered and that, in the field of indirect taxes, all efforts should be concentrated on adapting existing taxes – specifically VAT – to cope with the developments of e-commerce;
- a supply that results in a product being placed at the disposal of the recipient in digital form via an electronic network is to be treated, for VAT purposes, as a supply of services;
- services supplied for consumption within the EU should be taxed within the EU and those supplied for consumption outside the EU should not be subject to EU VAT but deduction should be allowed on related inputs. The tax system should also provide legal certainty, simplicity and neutrality.

The Commission said it is inconceivable that the current tax environment – which both favours non-EU e-commerce and threatens EU tax revenues – will remain forever

Following the Ottawa conference, the Commission decided that the most effective contribution which Europe could make to the international process would be to develop a coherent methodology to make VAT function in the world of electronic business.

The Commission said it could see no merit in the argument that e-commerce requires a period of relief from taxation in order to develop to its full potential. Existing taxes can and will be applied. The best contribution for tax administrations was to set out clear and predictable rules about the future tax regime.

The Commission said it is inconceivable that the current tax environment – which both favours non-EU e-commerce and threatens EU tax revenues – will remain forever. Any long-term business strategy which assumes that online sales can be made into the EU without regard to VAT would be most injudicious.

The United States Inland Revenue Service released final regulations for the classification of cross-border software transactions in September 1998. These only relate to software but are important beacause defining software for revenue purposes has, in the past, been a difficult exercise.

The issue is whether a transaction involving software constitutes a sale or a licence. The regulations apply the principles of copyright law to establish whether a software transaction is a transfer of copyright right or a copyrighted article. If a transaction transfers a copyright right then it is a sale, if it transfers a copyrighted article it is a licence.

An important development has been the National Governors' Association's (NGA) proposal to introduce a voluntary tax collection system where 'remote' businesses and domiciled businesses register with an online Transaction Tax Server

The US approach may create difficulties in terms of double taxation, especially if adopted by OECD member countries dealing with non-OECD member countries. But it is nevertheless an important development in e-commerce taxation law and any company looking to export software should be fully aware of the rules that apply in their jurisdiction. There is no official guidance at all, in any state, on downloaded music, books, or video.

The latest news from the US is that the Advisory Commission on Electronic Commerce (ACEC) is stalemated. It failed to reach a majority decision on the issue of how or whether internet business should be taxed. Instead, it passed a proposal to extend the existing moratorium on new taxes on the internet by five years while US states simplify their tax codes.

An important development has been the National Governors' Association's (NGA) proposal to introduce a voluntary tax collection system where 'remote' businesses and domiciled businesses register with an online Transaction Tax Server which will be operated by a trusted third party.

Using the Tax Server, all taxes due on US transactions will be deducted at source and remitted to the relevant authorities. Of course, there is no need for remote vendors to participate, so a comprehensive benefits package may be introduced to attract such businesses.

With the current political climate and with the general acceptance that the existing tax systems can be applied to electronic transactions, very little will change in the immediate term. The remote vendor (no US presence) can continue making sales in the US without being subject to any US federal or state taxes. Larger vendors, however, should look closely at their business structure and seek professional advice.

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