SOVEREIGN

SOVEREIGN REPORT

issue 6 www.SovereignGroup.com

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The Directors and Staff of the **Sovereign Group** would like to wish all our clients and friends a happy and prosperous New Year

I would like to send a personal thanks to all our clients for their support over the last year. Next year we intend to concentrate on consolidation but in the last quarter of this year we are pleased to be able to announce some new developments and services:–

SOVEREIGN ACCOUNTING SERVICES LIMITED

Stephen Barber, a UK tax planning expert, has joined us and will head up a new operation which will offer accountancy services and UK tax planning.

SOVEREIGN TRUST (MAURITIUS) LIMITED

We have set up another licensed operation in Mauritius having experienced demand for Mauritius based entities and having been impressed by the efficiency of the jurisdiction. Mauritius has excellent tax treaties with China, India and South Africa in particular and we have been receiving frequent requests to set up entities to use as a route for investment into those countries.

SOVEREIGN TRUST (ISLE OF MAN) LIMITED

An old friend has rejoined the organisation – Paul Brennock will manage our new Isle of Man operation. We continue to administer a number of Isle of Man companies but have also purchased the business interests of FMS Corporate Services Ltd. Dian Ellison who had previously been the general manager of that company will be retained as a consultant and director.

SOVEREIGN ASSET MANAGEMENT LIMITED

We have obtained an investment manager's licence in Gibraltar and can now offer a Swiss private banking style investment service utilising our existing relationships with Pictet Bank, Credit Suisse, Rock Ltd. and other carefully selected banks and investment managers.

NEW WEB SITE: www.SOVEREIGNGROUP.com

We have completely revised and updated our website to make it much more striking and user friendly. Please have a browse and email us any comments you may have.

I hope you all have a very fine Xmas and prosperous New Year.

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

CAUTION!

TIME-SHARE SCAM – Sovereign's attention has been brought to an alleged scam operating under the name of the '**Sovereign Gold Trust**'. This is believed to be run from the Canary Islands, is possibly time-share related and is linked to a gentleman named Stewart West who is reported as being on bail having been arrested and charged by Tenerife police for unspecified crimes.

The Sovereign Group has nothing whatsoever to do with the Sovereign Gold Trust and has no representation in the Canary Islands. Clients are advised to proceed with extreme caution when considering any time-share type of investment and always to seek independent legal advice before signing any documents.

JERSEY ISSUES ANTI-MONEY LAUNDERING GUIDANCE

The Financial Services Commission (FSC) issued an Anti-Money Laundering Guidance Update stating that the Cayman Islands and Malta may no longer be treated as 'equivalent' jurisdictions under the Money laundering Order 1999.

"The OECD and FATF initiatives are already starting to bite."

It said that following the Financial Action Task Force report on non-cooperative jurisdictions, Jersey financial businesses can no longer assume that business introduced from the Cayman Islands and Malta has been subject to due diligence and 'know-your-customer' procedures that are equivalent to those in Jersey. Due diligence must therefore be carried out by the accepting Jersey institution.

It will no longer be possible to delegate the verification of identity of applicants for business to regulated introducers based in either jurisdiction. Jersey financial institutions are recommended to obtain copies of identification documentation for existing Cayman and Maltese customers.

SOVEREIGN COMMENT: The OECD and FATF initiatives are already starting to bite. The above is an example. We are finding that banks throughout the world are starting to reject account opening applications from companies incorporated in jurisdictions which are criticised by the FATF and/or OECD and appear on their black lists. This is probably a temporary problem as all jurisdictions are now working to comply with the relevant requirements so that they can get themselves off those lists. Those who do not produce good references and other required documents will find it impossible to open bank accounts and delays will be experienced.

SWITZERLAND LEADING BANKS SET OUT DUE DILIGENCE RULES

A group of 11 of the world's leading international private banks led by UBS and Citibank have agreed on a common set of anti-money laundering rules covering their relationship with high networth individuals which they will apply to their operations on a worldwide basis.

The guidelines, designed to ensure a global standard of due diligence for banks, cover issues such as acceptance of clients, situations requiring additional attention, practices for identifying unusual or suspicious transactions and the education of bank staff.

Known as the Wolfesburg Principles, they begin with a commitment from the banks to 'endeavour to accept only those clients whose source of wealth and funds can be reasonably established to be legitimate'.

But the banks did not agree to change information on wealthy clients and rejected the idea of imposing sanctions on banks that failed to impose the guidelines.

UBS's chief risk officer Hans-Peter Bauer said the new rules were a 'clear recognition by private commercial banks of their responsibility in the fight against serious international crime. We cannot afford to chase clients by having looser standards than others'.

The other banks involved are: ABN Amro, Barclays Bank, Banco Santander Central Hispano, Chase Manhattan Private Bank, Credit Suisse Group, Deutsche Bank, HSBC, J. P. Morgan and Sociètè Gènèrale.

SOVEREIGN COMMENT: The move follows growing evidence that existing measures to combat the estimated US$590bn-a-year laundering industry are ineffective. Citigroup was criticised for its handling of the money for Raul Salinas, brother of the former Mexican president, in US Congressional hearings last year and Credit Suisse was reprimanded by the Swiss banking commission over its dealings with the family of former Nigerian dictator Sani Abacha.

"Banks to endeavour to accept only those clients whose source of wealth and funds can be reasonably established to be legitimate."

UNITED NATIONS

The Vienna-based UN Office for Drug Control & Crime Prevention said 31 international financial centres had made a high level political commitment to join in a global initiative to adopt internationally accepted standards of financial regulation and anti-money laundering measures.

The GPML Forum is to concentrate its activities and resources on the provision of technical assistance that will facilitate the development or enhancement of financial intelligence units, as that concept is defined by the Egmont Group.

The 31 states and territories are: Anguilla, Antigua, Aruba, Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liechtenstein, Malaysia, Marshall Islands, Mauritius, Nauru, Netherlands Antilles, Niue, Panama, Samoa, Seychelles, St. Kitts & Nevis, St. Lucia, Trinidad, Tobago and Turks & Caicos Islands.

EUROPEAN UNION

European finance and home affairs ministers, in their first ever joint meeting, agreed in principle to lift bank secrecy and tax confidentiality when judicial investigations were involved. The measures are to be incorporated into a draft convention for mutual assistance in criminal matters that is currently under negotiation.

The ministers also suggested June 2001 as the deadline for the Financial Action Task Force to fix retaliatory measures against countries considered non-cooperative. These measures would include systematic transaction reporting by EU financial institutions and identification of companies and persons prior to opening bank accounts.

LIECHTENSTEIN

The parliament approved amendments to strengthen the Due Diligence Law 1996 which are due to come into force on 1 January 2001. Liechtenstein was one of the 15 jurisdictions classified as 'non-cooperative' by the Financial Action Task Force in June.

The Law now applies to all financial transactions, not just to the receipt of assets. The 'personal acquaintance' exception to the 'identification requirement' is removed and lawyers and trustees will no longer be permitted to open bank accounts for third parties without disclosing the identity of the beneficial owner to the bank.

UK OVERSEAS TERRITORIES

The UK Caribbean Overseas Territories and Bermuda have agreed to submit proposals to the UK government for implementing the recommendations of an independent review of financial regulation by 15 January 2001. The core measures are to be 'substantively in place' by 30 September 2001.

The review, carried out by KPMG, assessed the extent to which the Overseas Territories – Anguilla, British Virgin Islands, Cayman Islands, Montserrat, Turks & Caicos Islands – and Bermuda comply with international standards and good practice in the regulation of international financial sectors. It was commissioned jointly by the governments of the Overseas Territories and the UK.

The core measures identified by the review are:

- legislation for the establishment of independent regulatory authorities;
- any necessary enhancements to their laws and systems to combat money laundering;
- and introducing legal powers that would allow regulatory authorities to obtain key information, and share this with overseas regulators in order to assist their investigations.

UK Treasury minister Melanie Johnson said: "It is evident that some Overseas Territories have more to do than others before they can deliver fully what is necessary. It is equally clear that not everything can be done immediately".

USA

The US Department of Treasury Financial Crimes Enforcement Network (FinCen) issued advisories to US financial institutions in respect of the 15 jurisdictions listed by the Financial Action Task Force in June as non-cooperative countries.

The advisories were issued to inform banks and other financial institutions operating in the US of serious deficiencies in the counter-money laundering systems of the named jurisdictions and advise them to give enhanced scrutiny to financial transactions involving them.

The countries identified by the FATF as having 'serious systemic problems' were: the Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts & Nevis, St. Vincent & the Grenadines.

BAHAMAS LEGISLATES TO ACHIEVE REGULATORY COMPLIANCE

The Financial Intelligence Unit Bill and Criminal Justice (International Co-operation) Bill were tabled as part of a programme of legislative and administrative changes to upgrade anti-money laundering processes.

Currently under review are the following pieces of legislation: Central Bank of the Bahamas (Amendment) Bill; Banks & Trust Companies Regulation (Amendment) Bill; Banks (Amendment) Bill; new Proceeds of Crime Act; new International Business Companies Bill; new Financial Service Providers Bill; new Financial Transactions Reporting Bill; and a Mutual Legal Assistance (Amendment) Bill.

"The move by the Bahamas to abolish bearer shares was expected and follows the moves by Mauritius and BVI."

When adopted and brought into force the legislation, together with new administrative and supervisory processes presently being introduced by the Central Bank, are intended to bring the Bahamas' financial services sector into full compliance with international standards and practices.

Of particular importance is the impact which the legislation will have in reducing opportunities for anonymous use of Bahamian entities for unauthorised purposes. The new IBC Act, by elimination of bearer shares and new reporting requirements, will reduce concerns over transparency.

The elimination of a prohibition against IBCs conducting business in the Bahamas and the removal of artificial tax exemptions in the existing Act will also address charges of ring fencing made by the OECD.

SOVEREIGN COMMENT: The Bahamas is making strenuous efforts to put its house in order. In the last issue of the Sovereign Report we mentioned, in relation to Mauritius, that most offshore jurisdictions were likely to outlaw bearer shares and require offshore companies to file details of their directors and, possibly, accounts. The move by the Bahamas to abolish bearer shares was expected and followed the moves by Mauritius and BVI.

CANADA POSTPONES TAX CHANGES FOR NON-RESIDENT TRUSTS

Finance minister Paul Martin announced a delay to the implementation of legislation on the taxation of non-resident trusts and foreign investment entities by one year, to taxation years beginning after 2001.

The proposed non-resident trust rules provide that a family trust will be considered to be resident in Canada – and therefore subject to tax on its worldwide income for a taxation year – where certain non-arm's length contributions are made by a person resident in Canada at the end of the year.

A foreign investment entity will generally be a non-resident entity that has investment properties representing at least one-half of its assets. Canadian investors may, if they so elect, include in taxable income their annual share of the income earned by the entity but, if information is insufficient, would be required to include in income the annual increase in the fair market value of the interest in the entity.

The draft legislation includes specific anti-avoidance measures against the use of foreign insurance policies and interests in non-resident entities that are designed to track returns earned on investment properties.

"We believe that the hybrid company can be effective in mitigating Canadian tax."

SOVEREIGN COMMENT: It is becoming increasingly difficult for residents of many jurisdictions to gain advantage through the legitimate use of trusts in a tax planning exercise. However, hybrid companies and other specialist corporate entities may be the answer. We believe that for the US, Canada and Australia – who each have very aggressive tax authorities and well developed anti-avoidance legislation – the hybrid company, if correctly structured and administered, can be effective in mitigating tax.

HONG KONG LAUNCHES US DOLLAR CLEARING SYSTEM

The first transaction through the new US dollar clearing system was processed in August. The system was commissioned by the Hong Kong Monetary Authority (HKMA) in March and HSBC Ltd appointed as the Settlement Institution.

"We believe that Hong Kong may be THE 'offshore' jurisdiction in the coming years."

The new service, which will allow local financial institutions to settle US dollar transactions real time in the Asian time zone, has been joined by 55 banks as well as the HKMA.

Clauses 3, 7 to 15 and 46 to 50 of the Companies (Amendment) Ordinance 2000 came into force on 1 July 2000. The main purpose of these amendments is to streamline filing requirements, reduce the documents required to be filed and further enable companies to pass written resolutions and dispense with the holding of meetings.

The HKMA has issued a consultation paper on enhancing deposit protection in Hong Kong. It has concluded that the best protection for small depositors would be achieved with an insurance based system which would be publicly administered and privately funded.

Other recommendations include: only licensed banks should be covered by the Deposit Insurance Scheme (DIS) because restricted licence banks and deposit taking companies do not take small deposits; participation by banks in the DIS should be mandatory; the DIS should begin with a coverage cap of HK$100,000; coverage should be on a depositor rather than account basis; and the DIS should be responsible for collecting premia from the banks and paying out depositors but should not have any regulatory functions in its own right.

SOVEREIGN COMMENT: The Hong Kong dollar is pegged to the US dollar. Hong Kong is not on the OECD 'tax haven' black list and was rated as a Group One jurisdiction by the Financial Stability Forum. Hong Kong is one of the world's major financial centres but most Hong Kong companies doing business internationally do not pay tax in Hong Kong because the tax system is territorial rather than residency based. We believe that Hong Kong may be THE 'offshore' jurisdiction in the coming years.

MAURITIUS ANTI-MONEY LAUNDERING LAW IN FORCE

The Economic Crime & Anti-Money Laundering Act 2000, to provide for the prevention, detection and suppression of money laundering and economic offences, has been brought into force. It was passed on 13 June.

The Act lays an obligation on all banks, financial institutions or cash dealers and members of relevant professions to take necessary steps to ensure that they do not facilitate the commission of an offence of economic crime or money laundering.

The Act imposes new obligations on banks or financial institutions to: verify the true identity of all customers and persons with whom they conduct transactions; report every suspicious transaction; keep records; and assist foreign states in relation to money laundering and economic crime.

The Act also provides for the establishment of an Economic Crime Office to investigate suspicious transactions, co-operate and exchange information with local and international law enforcement agencies, and co-ordinate anti-money laundering efforts.

SOVEREIGN COMMENT: Mauritius was not included in the Financial Action Task Force's list of 'non-cooperative' jurisdictions. The FATF said some concerns had been identified regarding the identity of directors and beneficial owners of offshore trusts but the Economic Crime & Anti-Money Laundering Act would reinforce existing legislation in the prevention of and fight against money laundering.

In response to increased interest in Mauritius as an offshore jurisdiction Sovereign has now opened an office under the name Sovereign Trust (Mauritius) Limited. The address is Suite 420, St. James Court, St. Denis Street, Port Louis, Mauritius (Tel: +230 208 1747; Fax: +230 208 1736; Email: mu@SovereignGroup.com).

SEYCHELLES

The Financial Action Task Force has lifted a warning issued against the Seychelles in relation to the Economic Development Act 1995 (EDA) after it was repealed by the Seychelles government in July 2000.

The EDA provided, for those investing US$10m or more in the Seychelles, immunity from prosecution for all criminal offences and protection against seizure of assets unless they committed certain serious crimes in the Seychelles.

Although never brought into force, it was described by the FATF as a 'grave threat to efforts to combat money laundering'. The FATF believed it would attract international criminal enterprises to shelter both themselves and illicitly-gained wealth from pursuit by legal authorities.

In 1996 the FATF urged financial institutions worldwide to scrutinise closely business relations and transactions with persons, companies and financial institutions domiciled in the Seychelles. Repeal of the EDA constitutes a significant step taken by the Seychelles government to strengthen its anti-money laundering system.

BRUNEI

The government brought a package of legislation to establish Brunei as an international financial centre into force. The new laws cover international banking, companies, trusts, limited partnerships and registered agents.

International finance legislation is supervised by the Authority, a segregated unit of the Ministry of Finance acting through the Financial Institutions Division and the Head of Supervision (IFC).

The government intends to make Brunei a regional economic hub and diversify the economy of the oil-rich sultanate. It aims principally to attract Muslims from Indonesia, Malaysia, the western Asian nations, Sudan, Turkey and Morocco to invest in Brunei.

The first tranche of legislation also included a Money-Laundering and Proceeds of (serious) Crime measures to international standards.

SOVEREIGN COMMENT: Although it is interesting that Brunei has elected to set itself up as an offshore financial centre, it seems to offer nothing that is not already being offered elsewhere and it may be an uphill struggle to win a slice of the financial services market.

ISLE OF MAN: PROTECTION WHEN ASSISTING A FOREIGN AUTHORITY

The Isle of Man High Court of Justice held that the Attorney General should have taken into account what protection, if any, would be afforded to the petitioner before exercising his powers under section 24 of the Criminal Justice Act 1990 to provide assistance to a foreign authority investigating a foreign suspected offence.

The petitioner, Peter Michael Bond, alleged that notices had been issued in connection with criminal proceedings in the US relating to suspected serious or complex fraud involving clients of an Isle of Man firm, Valmet. He questioned whether there was 'any Isle of Man dimension to the investigation or any possible prosecution' and sought a declaration that he was entitled to invoke in the Isle of Man the same privilege as he would be entitled to invoke were he being questioned in the US.

He pleaded that it was or should be incumbent upon the Attorney General to ascertain any such privilege and ensure that in responding to the notice he would enjoy the same privilege.

Granting the relief, the Court held that the Attorney General was entitled to exercise his powers under s24 of the Act to provide assistance to a foreign authority investigating a foreign suspected offence involving serious or complex fraud with no real or material connection with the Isle of Man. But before exercising such powers, he should have taken into account what protection, if any, would be afforded to the petitioner.

SOVEREIGN COMMENT: The offshore practitioner fights back. There have been many cases recently where a foreign jurisdiction has been allowed relatively easy access to confidential records and files kept offshore. There is absolutely no case whatsoever for treating those who operate or structure their affairs through an offshore jurisdiction in a way which would not be legal if that same action were heard in an onshore court. Onshore jurisdictions wish the offshore jurisdictions to respect their rules and regulations and the same should apply vice-a-versa. It is a general principle that local laws should govern local affairs and powerful onshore jurisdictions should not be allowed to impose their own morals and laws on smaller neighbours.

JERSEY: DISCLOSURE OF TRUST DOCUMENTS

The Jersey Royal Court held that trust documents, including letters of wishes, should be disclosed to a beneficiary in relation to divorce proceedings in England between the beneficiary and his wife.

In *the matter of the Rabaiotti 1989 Settlement* involved four settlements, two governed by Jersey law and two by the law of the British Virgin Islands, but all administered in Jersey by the respondent, the Latour Trust Company and Latour Trustees Ltd.

"The UK courts are generally very suspicious of trust arrangements."

The trustees sought the direction of the Court under Article 47 of the Trusts (Jersey) Law 1984 as to whether they should disclose all or any of the requested documents to John Rabaiotti and as to whether they should intervene in the English matrimonial proceedings.

The Court was satisfied that there were no good reasons, on the particular facts of the case, for holding that the requested trust documents, including the letter of wishes in relation to each settlement, should not be disclosed to John Rabaiotti. It did not believe it would be in the best interests of the beneficiaries as a whole for the trustees to intervene in the English matrimonial proceedings.

SOVEREIGN COMMENT: Assets placed into a correctly structured and administered trust should, as a general rule, be safe from seizure by a creditor of the settlor or of any of the beneficiaries. In this case the creditor, or potential creditor, was the estranged spouse. The UK courts are generally very suspicious of trust arrangements and tend to view trust assets as still belonging to the settlor. Alternatively the court tries to value the contingent interest belonging to a beneficiary. In this case the UK court ordered that trust documents be disclosed but clearly the only basis for doing this was to see whether the court could apportion those assets to the estranged spouse and perhaps seize a portion of those assets. This would clearly not be in the interests of other beneficiaries of the trust or the estranged spouse himself so the court refused permission. This would put the Jersey court in direct conflict with the UK court so it will interesting be to see what further action the UK court takes on this matter.

ENGLAND & WALES: FOREIGN ASSET-FREEZING ORDERS

In *Ryan & Another v Friction Dynamics Ltd. & Others,* the High Court held there were several general principles courts should adhere to when granting an asset-freezing order ancillary to proceedings in a foreign jurisdiction under section 25 of the Civil Jurisdiction & Court of Judgments Act 1982.

The court should: always exercise caution before granting any freezing order, particularly where the primary forum for the litigation was abroad and the court was likely to be less fully appraised of the facts; not make an order under s25 unless the claimant had a good arguable case and there was a real risk of dissipation; should expect to be given cogent reasons to justify an overlapping freezing order made under s25 because they could substantially increase costs and court time and should include provision for which court was to have the primary role for enforcing the injunction.

It should also, unless there were good reasons otherwise, follow the terms of the order made by the foreign court.

SOVEREIGN COMMENT: Very often claimants apply for freezing orders as a tactic to put pressure on the defendants. As this case makes clear, the courts will be reluctant to grant a freezing order unless they are convinced that the claimant has a good arguable case which he intends to pursue AND there is a real danger that the defendant will dissipate his assets to avoid paying a judgement against him. Normally the court will require the claimant to give an undertaking for damages before they will grant any sort of freezing order so that if the ultimate case fails then the defendant may claim against the claimant for inconvenience and damage caused.

OECD INVITES 'TAX HAVENS' TO ENDORSE COLLECTIVE MEMORANDUM

The OECD Forum on Harmful Tax Practices has invited jurisdictions identified as tax havens to endorse a collective memorandum of understanding to eliminate harmful tax practices as an alternative to bilateral agreements.

The Forum said 23 of the 35 previously identified jurisdictions have already been in contact with a view to co-operating in the drive against illegal and unfair tax practices. It intends to approach jurisdictions that have not yet been in contact with a view to seeking their co-operation.

"The OECD Forum said 23 of the 35 previously identified jurisdictions have already been in contact."

Bermuda, Cayman Islands, Cyprus, Malta, Mauritius and San Marino have already made advance commitments to co-operate. The OECD has set a deadline of July 2001 for reaching similar agreements with other offshore jurisdictions.

Failing such agreements, it said, 'tax havens' face the prospect of becoming targets of defensive measures on the part of OECD countries, possibly including the abrogation of bilateral tax treaties and enhanced auditing requirements for transactions between residents of OECD countries and persons or institutions resident in unco-operative tax havens.

The OECD is also reviewing the 47 harmful tax regimes identified in its own member countries. These are now being subjected to detailed examination to assist the commitments made by OECD countries in 1998 to eliminate harmful aspects by 2003.

ISLE OF MAN PARLIAMENT APPROVES TAX REFORM PROPOSALS

Parliament has approved the radical tax reforms proposed by the government in June which aim to combine an overall tax share of GDP in line with the European average along with a fair and competitive international tax regime.

The proposals include: reduction in the corporate tax rate from 20% to 10% for trading companies over a three to five year period, with a deadline of 2005; exempt insurance companies and ship management companies will be brought within the domestic tax system, but at a zero rate; a simplified approach to capital allowances whilst retaining 100% relief when necessary; a similarly simplified approach for the taxation of individuals by having all income assessed on a current year basis; reduction in the top rate of income tax from 20% to 15%; reduction of the standard rate from 14% to 10%; special treatment for short-term contract executives for up to three years so that they will only be taxed on their Manx-sourced income; personal allowances to be available for non-residents as well as residents; a new tax credit system for distributions will ensure that tax neutrality is preserved for the investor, whether resident or non-resident; and incentives for business start ups and venture capital initiatives.

SOVEREIGN COMMENT: The Isle of Man was listed as a 'tax haven' by the OECD Forum of harmful Tax Practices in June. The new tax strategy is partly aimed at addressing concerns about preferential tax regimes for non-residents. Isle of Man residents pay up to 20% tax but non-residents pay 0% so they are proposing a unitary system of tax to appease the OECD.

"The Isle of Man new tax strategy is partly aimed at addressing concerns about preferential tax regimes for non-residents."

Sovereign has maintained close connections with the Isle of Man for many years and has now opened its own office under the name Sovereign Trust (Isle of Man) Limited.

The address is Trafalgar House, 25 Nelson Street, Douglas, Isle of Man, IM1 2AN, British Isles (Tel: +44 1624 699800; Fax: +44 1624 699801; Email: iom@SovereignGroup.com). The managing director is Paul Brennock. He will be assisted by Dian Ellison and Diane Dentith.

EUROPEAN UNION

EU finance ministers at the European Council in Luxembourg reviewed progress made on the three strands of the proposed tax Directive: savings taxation, interest and royalties and the code of conduct on business taxation.

The working party reported that majority agreement was emerging but further technical work was needed on the following three matters: the nature of the information to be transmitted and the basis for assessment of the withholding tax; the treatment of bodies such as partnerships, trusts, etc.; the procedure for identifying the beneficial owner and the type of information to be provided on that owner.

The Council instructed the working party to submit the terms of an overall compromise to the next Council meeting. It was also to resolve outstanding issues on the Directive on interest and royalties.

GIBRALTAR

The government has restated an election proposal to move to a non-discriminatory corporate tax regime in the medium term. The aim is to remove the discriminatory elements in the current corporate tax regime and achieve a uniform low tax system for resident and non-resident corporations within a three to five year period.

The move is designed to accommodate OECD requirements on harmful tax practices but the government does not intend to accelerate its tax reform programme.

"We have fiscal sovereignty and will adhere to internationally-accepted standards but we do not feel under pressure to respond to the OECD initiative until there is more clarity", he said.

SOVEREIGN COMMENT: Gibraltar saw a sharp decline in business at the end of the 1980's due to Spain clamping down on the use of non-resident companies as a conduit for investment into Spain. Previously Gibraltar had been the jurisdiction of choice for routing investments into Spain due to the bilingual abilities of the local workforce and its close geographical proximity. For the last three years Gibraltar has seen a marked increase in activity and has refocused on attracting quality business rather than quantity. Gibraltar is the only common law 'offshore' jurisdiction which is a full member of the EU which gives the jurisdiction some distinct advantages.

US BRINGS IN 'QUALIFIED INTERMEDIARIES' REGIME FOR BENEFICIAL OWNERS OF US-SOURCE INCOME

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

US-source income was previously subject to the address system whereby a foreign address was sufficient for the application of treaty relief, but foreign intermediaries (banks & financial institutions) were required to levy a supplementary withholding tax.

This additional liability was reimbursed or credited to qualifying beneficiaries of US-source income when such income was appropriately declared by the beneficiary in his state of residency. Formerly it was the beneficiary who applied for treaty relief, but under new US withholding tax rules, foreign intermediaries may do the necessary reporting on behalf of the beneficiaries.

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', published in the Federal Register of 14 October 1997, applies to payments made after 31 December 2000.

Under the new rules (1441 Regulations), beneficial owners of US-source income may apply for treaty relief in advance by filing form (W-8) with either a US withholding agent or participating financial institutions – 'qualified intermediaries' (QIs). QI's will be able to undertake to grant treaty relief instead of simply passing on the W-8 forms to the US withholding tax agent.

For each payment received by the owner of US securities via a foreign intermediary, reporting forms requiring disclosure of the beneficial owner's identity in respect to earnings will have to be submitted to the IRS. Non disclosure could result in 30% of any payment to the customer being withheld in the US, whether the customer is a US citizen or not. Institutions not classed as QIs will find it difficult to claim exemption from US withholding tax for their clients.

QIs will have to reveal the identity of all US customers and agree to submit to external audits by the IRS to verify that they are in compliance. But the confidentiality of non-US owners of US securities can be maintained, without subjection to substantial withholding. QIs are required to enter into a contract with the IRS and to meet certain obligations.

"Formerly it was the beneficiary who applied for treaty release, but under new US withholding tax rules, foreign intermediaries may do the necessary reporting on behalf of the beneficiaries."

To qualify as a QI, non-US intermediaries are required to enter into a QI agreement with the IRS and demonstrate adequate resources to carry out QI functions. A special QI audit will also be necessary to gain an IRS-approved audit report.

QI status will allow foreign intermediaries to apply reduced tax rates on US-source income, regardless of the residency of the beneficiary, and to limit client disclosure to IRS and US withholding agents. Where a foreign intermediary wishes to maintain confidentiality, it will need to apply for QI status.

"QIs will have to reveal the identity of all US customers and agree to submit to external audit by the IRS to verify that they are in compliance with 'know-your-customer' rules."

The IRS will not enter into a QI withholding agreement that provides for the use of documentary evidence obtained under a country's 'know-your-customer' rules if it has not received the 'know-your-customer' practices and procedures for opening accounts and responses to 18 specific questions listed in the revenue procedure.

The IRS has issued a list of jurisdictions with approved 'know-your-customer' rules under the new measures. If a country is on the approved list, entities and branches located in that country may submit their QI applications even if the IRS has not yet agreed to a specific attachment for that particular country. Once a specific attachment has been developed for a particular country, the IRS will associate the attachment with the QI agreement it sends for signature.

Jurisdictions with approved 'know-your-customer' rules (as of 20 December 2000) are: Andorra; Australia; Austria; Barbados; Belgium; Bermuda; Canada; Cayman Islands; Denmark; Finland; France; Germany; Gibraltar; Guernsey; Hong Kong; Ireland; Isle of Man; Israel; Italy; Japan (Japanese Trust Banks, Japanese Securities Dealers and Japanese Investment Trust Management Companies); Jersey; Luxembourg; Monaco; Netherlands; Netherlands Antilles; Norway; Portugal; Singapore; Spain; Sweden; Switzerland and the United Kingdom.

Jurisdictions awaiting approval of 'know-your-customer' rules are: Argentina; Bahamas; British Virgin Islands; Czech Republic; Korea; Liechtenstein; Panama; Turks and Caicos Islands and Uruguay.

SOVEREIGN COMMENT: Sovereign has offices in the following jurisdictions with IRS-approved 'know-your-customer' rules: Denmark; Gibraltar; Hong Kong; Isle of Man; Japan; Netherlands; Portugal; Spain and the United Kingdom. We also have offices in the Bahamas, British Virgin Islands, Turks & Caicos Islands and Uruguay which are awaiting approval.

Where US withholding tax might apply or where a client is doing business in the US and withholding tax is a concern, Sovereign will be able to structure that client's affairs through an office in a jurisdiction which has been granted QI status, irrespective of which Sovereign office the client is dealing with.

INFORMATION

MORE INFORMATION

For more information on the services provided by **The Sovereign Group**, please visit our website: **www.SovereignGroup.com** or contact your most convenient **Sovereign** office listed opposite.

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