SOVEREIGN

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REPORT

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DRIVE TO EXCHANGE INFORMATION TO BE ACCELERATED

Firstly, on behalf of the directors and staff of The Sovereign Group, I would like to extend our best wishes and sympathies to all the family and friends of those affected by the recent events in the USA. Nobody watching those picturescould possibly remain unmoved.

Apart from the immediate and obvious financial effect, there are short and long term consequences for the offshore financial world. In the last edition of the *Sovereign Report* I wrote about the determination of the OECD nations to gain access to information about those who beneficially-own offshore structures. The US has made it clear that, in its fight against terrorism, one of its aims will be to cut off the supply of funds. To achieve this it will need information about the beneficial ownership of structures which might be used as a conduit for such funds. Thus, the resolve to implement the requirement for exchange of information upon request will be hardened and the process for implementing the relevant procedures is likely to be accelerated. If this occurs, structures which should be reported by the beneficial owner but which have not been may result in the owner being fined and possibly imprisoned.

> ***“The resolve to implement the requirement for exchange of information upon request will be hardened.”***

Since the last issue I have been able to talk to the OECD. My understanding is that if a taxpayer is investigated or audited and a connection between the taxpayer and an offshore structure is revealed, this will trigger a request for information about the ownership of that structure and its financial dealings. The competent authority (probably the tax department) in the onshore jurisdiction would request information from the competent authority (probably the offshore regulator) in the offshore jurisdiction. And under the terms of the commitment to the OECD, it would be bound to supply that information.

In some offshore jurisdictions the competent authority already holds the information because it must be supplied before incorporation can take place e.g. Jersey, Bermuda, etc. In all other jurisdictions the competent authority requires the offshore service provider to hold the information and will be in a position to obtain it upon request. The OECD does not particularly mind how the offshore authority gets the information as long as it is able to get it and exchange it upon request. The information supplied will be protected by confidentiality provisions which means that it will only be able to be used for the purpose requested and should not be supplied to any other department or body within the onshore country or beyond. But Court applications by the onshore authority will no longer be needed and it will be relatively simple for the onshore authority to get whatever information it requires.

Offshore jurisdictions must commit to introducing these provisions and actually implement them in relation to criminal tax matters – which will probably include failure to report on the onshore tax form – by end of 2003. And for civil tax matters, by end of 2005.

As we have repeatedly said, good tax planning does not rely on confidentiality but is based upon finding structures which take advantage of intended or unintended tax breaks and loopholes. If the existence of the tax structure or your involvement with that structure should be reported and hasn’t been, then you are in breach of the law and are probably committing tax fraud. This is a criminal matter. Offshore service providers who assist clients to commit tax fraud are also likely to find themselves in great difficulties.

We strongly recommend that all clients review their current structures and contact us for advice if they are in any doubt about their effectiveness under the new regime.

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

ISLE OF MAN

The Financial Supervision Commission has issued a consultation document on the licensing of trust service providers (TSPs) and proposed amendments to the Corporate Service Providers (CSP) Act 2000.

It is proposed to extend the CSP Act to regulate the activities of persons in the Isle of Man who engage in the provision of trust services. Many TSPs will also be CSPs. In both cases the Commission will be regulating the service provider rather than the underlying companies or trusts.

The principal element of the CSP licensing regime is the requirement for the applicant and its key staff to be "fit and proper persons". It is proposed to extend the existing criteria applied in assessing the competence and integrity of CSPs to TSPs, but to apply higher standards to TSPs in assessing solvency.

The Commission is also reviewing the need for a major overhaul of companies legislation in response to a decrease in the number of incorporations.

According to research by the Association of Corporate Service Providers (ACSP), numbers have fallen by 40% over a six-year period. There are currently about 40,000 companies in the Isle of Man administered by 135 CSPs.

But the ACSP data showed that number of incorporations in the Isle of Man had fallen from 5,519 companies in 1994 to 3,295 last year. Over the same period, Jersey had suffered a decline of just 8.25% to 3,092 companies, while Guernsey and Gibraltar had posted increases of 19% and 53.4% respectively.

SOVEREIGN COMMENT: Sovereign has already applied for its own CSP licence which, we expect, will be granted imminently. It appears as though 200 entities were originally identified by the Isle of Man authorities. Some 120 applications have thus far been received and 30 more companies have indicated that they will be applying. The shortfall of 50 from the original number identified is explained, we believe, by the fact that a number of different companies have either closed or merged as they had insufficient resources or infrastructure to meet the licensing requirements.

We believe that there is a general trend for quality at the expense of quantity so do not necessarily feel that the Isle of Man should be too concerned at the fall in the numbers of incorporations.

GIBRALTAR TO INTRODUCE PROTECTED CELL COMPANIES

A draft Protected Cell Companies (PCC) Ordinance was published in June and is expected to be approved at the earliest opportunity. Intended for use by both the captive insurance and funds sectors, the law provides for a single company containing individual cells which are kept separate from each other. Each cell is only liable for its own debts and not for the debts of any other cell within the company.

"Such assets may be collectively invested or collectively managed."

A company may be either incorporated as a PCC or converted into a PCC if so authorised by its articles. Cellular and non-cellular assets may be held by or through a nominee, or by a company whose shares and capital interests may be cellular assets, non-cellular assets, or a combination of both. Such assets may be collectively invested or collectively managed by an investment manager.

A PCC may create and issue shares in respect of any of its cells and may pay a cellular dividend. The rights of creditors are limited to the assets of the cell of which they are creditors.

An Electronic Commerce Ordinance has been brought into force to provide a framework for the use of electronic means in transmitting and storing information and to afford legal recognition to transactions effected electronically.

The legislation, which draws on the models adopted in the Isle of Man and Bermuda as well as the EU Directive on E-Commerce, also provides a framework for the authorisation and recognition of certification service providers, the recognition of overseas providers and the legal effect of electronic signatures supported by an accreditation certificate

The Gibraltar government has set up an e-Business Development Unit and will seek to provide e-commerce operations with a fiscally-attractive environment. It believes the treaty exemption from VAT enjoyed by Gibraltar may become of increasing importance, especially in the provision of services and non-physical products.

SOVEREIGN COMMENT: The PPC legislation is thought to be of particular use for the captive insurance industry and indeed Gibraltar is making a concerted effort to capture some of this type of business. In our opinion, such companies may be more advantageously used as an alternative to traditional collective investment schemes where a group of investors wish to segregate their assets from each other and invest in similar but not identical types of securities or other investments.

In respect of the Electronic Commerce Ordinance, Gibraltar certainly has competitive advantages over most other offshore jurisdictions when it comes to attracting business particularly for those who are doing business within the EU. But we believe that improvements to telecommunication services will have to be made before Gibraltar can become pre-eminent in this field.

CHANNEL ISLANDS ISSUE FIRST FIDUCIARY LICENCES

The first set of registration certificates in respect of trust company business were issued in Jersey in June. Certificates in respect of 111 entities were sent out by the Jersey Financial Services Commission (JFSC) to 14 businesses. Applications were made by 228 businesses in respect of 1,144 entities.

At the same time the Guernsey Financial Services Commission (GFSC) received 179 applications for a Full Fiduciary Licence under the Regulation of Fiduciaries, Administration Businesses & Company Directors Law. These covered more than 800 business entities.

The Commission also received 70 applications for the restricted category of a Personal Fiduciary Licence and a further 40 applications for the grant of a discretionary exemption. All applicants listed are deemed to be licensed fiduciaries until their applications are finally determined.

SOVEREIGN COMMENT: The large number of entities which require licensing can be explained by the fact that each main provider of corporate services normally utilises a number of different in-house subsidiaries to act as nominee shareholders and directors and those companies are covered by the licensing provisions as well.

TCI IMPLEMENTS KPMG REVIEW RECOMMENDATIONS

A package of legislation to implement the recommendations of the KPMG review of financial regulation in British Overseas Territories was brought into force at the end of May.

The Companies (Amendment) Ordinance 2001 provides that bearer shares must be kept at the office of the company's manager or agent licensed under the Company Management (Licensing) Ordinance 1999 or secretary; or the office of an accountant, attorney, bank or trustee licensed under the Trustees Licensing Ordinance.

"All offshore jurisdictions are either abolishing or immobilising bearer shares."

The company manager, agent or secretary is to be responsible for maintaining records of the location, ownership and beneficial ownership of each certificate. An accountant, attorney, bank or licensed trustee which holds bearer shares must notify the company manager, agent or secretary of any change in owner or beneficial owner within seven days of the change.

Other legislation included: the Financial Services Commission Ordinance which established the Financial Services Commission as the statutory board responsible for the regulation of the financial services industry; the Overseas Regulatory Authority (Assistance) Ordinance which provides for assistance to be given to overseas authorities in relation to their regulatory functions; and the Customs (Amendment) Ordinance 2001 which makes it an offence for a person entering the TCI not to make a declaration of carrying cash or negotiable instruments of more than US$10,000.

The new legislation addresses the key features of the KPMG review of financial regulation in the UK Overseas Territories which was published last October.

SOVEREIGN COMMENT: All offshore jurisdictions are either abolishing or immobilising bearer shares. The KPMG review recommended immobilising bearer shares rather than abolishing them so it is no surprise to see TCI following that recommendation and producing legislation similar to that already implemented in the Cayman Islands. Other Caribbean jurisdictions who haven't already made these changes are expected to follow shortly.

US SENATE INTRODUCES ANTI-MONEY LAUNDERING BILL

Senators Carl Levin and Chuck Grassley introduced a bipartisan bill designed to combat money laundering and to deter money launderers from infiltrating the US banking system.

The main provisions of the Money Laundering Abatement Bill include adding foreign corruption offences, such as bribery and theft of government funds, to the list of crimes that can trigger a US money-laundering prosecution and stopping US banks from providing banking services to foreign shell banks that are considered high-risk for money laundering.

A depositor's funds in a foreign bank's US correspondent account are to made subject to the same civil forfeiture rules that apply to a depositor's funds in any other US bank account.

US banks will also be required to conduct enhanced due diligence reviews to safeguard against money laundering when a private bank account with US$1m or more is opened by a foreign person or when a correspondent account is opened for an offshore bank or foreign bank in a country considered a high risk for money laundering.

The bill would further give federal law enforcement authorities the power to subpoena the records of a foreign bank that has a US correspondent account. If a foreign bank were to refuse to provide the subpoenaed records, the US bank would be required to close the foreign institution's account.

SOVEREIGN COMMENT: Anti-money laundering legislation has failed to make headway in the US in recent years. But following the tragic events of 11 September and the US announcement that it intends to cut off the money supply to terrorists, it is expected that resistance to these changes will be dropped and future initiatives to prevent money laundering will be sped through the legislative process and into law.

BAHAMAS

The International Business Companies Act 2000 has been amended to extend the deadline for compliance with the new law for pre-existing IBCs from June to the year end. The move came in response to a perceived need for clarification in respect to a number of issues relating to implementation.

The Financial Transactions Reporting Act was also amended to define cash as including travellers' cheques, bearer shares and postal and money orders, and clarify that the requirement for customer verification applies to opening a bank account or to transactions in cash of more than US$10,000.

Provisions relating to international cooperation have been extended to the Insurance Act, Lotteries & Gaming Act, Financial & Corporate Service Providers Act, External Insurance Act, Mutual Funds Act and Securities Industry Act.

Draft guidelines on money laundering for financial service providers were issued by the Financial Intelligence Unit at the end of July. They apply to real estate brokers, trustees, administration managers and investment managers, securities dealers, life assurance agents, lawyers, accountants and other corporate service providers.

Further guidelines are being drafted for banks and trust companies, the securities industry, the insurance sector and licensed casinos.

According to the Bahamas Financial Services Board, more than half of the existing 124 registered managed banks are expected to remain in the Bahamas and comply with the new regulatory regime that came into force last year. The remaining registered managed banks – banks incorporated in the Bahamas but which have no office, employees or records there – were expected to cease operations by 30 September.

SOVEREIGN COMMENT: The changes to the Bahamas legislation have been confusing and certain changes in law have been revoked and then changed again. This has not assisted the jurisdiction and has resulted in a dramatic fall in new incorporations in the Bahamas. But we remain convinced that the Bahamas is an excellent jurisdiction and has the advantage of being outside EU control – unlike Cayman, TCI, BVI, etc – so will not be effected by the EU proposals for the exchange of information on savings.

MAURITIUS

The National Assembly has approved three major pieces of new financial services legislation designed to upgrade the regulatory framework and key structures within it. They now await Presidential Assent.

A Financial Services Development (FSD)Bill provides for the establishment of a Financial Services Commission which will be the statutory body regulating non-bank financial services. It also sets out new requirements for licensing those conducting financial services in Mauritius and new obligations in terms of record-keeping and disclosure.

The Bill empowers the Commission to inspect financial services licensees and inquire into the conduct of their business. Provision is made to investigate customer complaints and for a compensation fund to assist investors who suffer financial losses as a result of fraud or insolvency.

A Companies Bill is intended to upgrade the Companies Act 1984 in line with the latest developments in company legislation. Based on New Zealand legislation, it streamlines procedures for the incorporation, management and winding up of companies.

Existing Offshore Companies are reclassified as companies holding a Category 1 Global Business Licence and existing International Companies as companies holding a Category 2 Global Business Licence.

A Trusts Bill aims to consolidate the existing laws relating to domestic trusts and offshore trusts into a single piece of legislation. It also contains measures to facilitate administration of trusts, whilst protecting the interests of beneficiaries, through the introduction of new 'functionaries' such as enforcers, in addition to the protector, custodian trustee and managing trustee. The Bill also incorporates the concept of protective and spendthrift trust aimed at ensuring more efficient management of assets.

SOVEREIGN COMMENT: Mauritius appears to us to have dealt with the requirements of the OECD most effectively in a clear and (not an) unambiguous manner. The fact that the required changes have been implemented swiftly has been the cause of much confidence in the jurisdiction and led to a fast increase in the number of companies being incorporated. The stance of Mauritius led Sovereign to open an office there and we have seen a rapid growth to our business in Mauritius.

HONG KONG ISSUES CORPORATE GOVERNANCE PROPOSALS

The Standing Committee on Company Law Reform (SCCLR) has issued proposals to update Hong Kong's corporate governance regime as the first phase of the ongoing Corporate Governance Review which was launched last year *(see Sovereign Report – Issue 5).*

The SCCLR's initial proposals concentrate on measures to address public concerns about standards of corporate governance in relation to three main areas: directors' duties and responsibilities; shareholders' rights; and corporate reporting.

Proposed changes relating to directors' duties include that approval of disinterested shareholders should be obtained for transactions or arrangements above a certain threshold value involving directors or persons connected with directors. Directors' fiduciary duties and standards of care and skill are also to be set out in a "Code of Best Practice".

"Hong Kong is one of only a few offshore financial centres that was not identified as a tax haven by the OECD."

Proposed changes relating to shareholders' rights include that shareholders should have a statutory method of securing access to company records subject to court approval and the court should have a general power to grant an injunction in relation to any proposed contravention of the Companies Ordinance or breach of fiduciary duties.

Proposed changes relating to corporate reporting include the establishment of a body with authority to investigate financial statements and enforce any necessary changes to companies' financial statements and that private companies with limited liability are to be required to file their financial statements with the Companies Registry for public inspection.

SOVEREIGN COMMENT: For the private client, the most noticeable proposed change is the requirement for private companies to publicly file their accounts. Previously only public companies had to file their accounts on public file. Additionally, there is a proposal that corporate directorships be abolished. The ability to appoint a corporate director does facilitate administration but abolishing their use would bring the jurisdiction into line with most other non-Caribbean jurisdictions. Hong Kong is one of only a few offshore financial centres which was not identified as a tax haven by the OECD and therefore does not need to make commitments to the OECD or alter its legislation in any way to comply with OECD requirements.

DUBAI TO DRAFT LAW FOR DIGITAL SIGNATURES

The Public Prosecutor's department has been instructed to prepare a draft law to validate the use of electronic signatures. The move will make Dubai the first Arab nation to legally recognise e-signatures.

Under the law, the Public Prosecutor's department will retain a paper copy of files whenever an e-signature is used and these must be stored externally.

General Sheikh Mohammed bin Rashid Al Maktoum, Crown Prince of Dubai and Defence Minister, is keen to promote e-commerce projects throughout Dubai. It is estimated that 42% of United Arab Emirates'companies plan to set up e-commerce operations by the end of this year and 88% already have Internet access.

The Dubai Internet City (DIC) is now firmly established as a centre for e-commerce in the Gulf region. Sheikh Mohammed has also ordered a pilot programme for Dubai's 'e-government' initiative to be launched this year. The project will comprise a network connecting all government departments, their databases and applications.

SOVEREIGN COMMENT: Dubai has been extremely successful with the DIC. Some 40,000 square feet of new office space has been built and 120 companies have already booked space. The zero rate of tax and relatively low cost and simple establishment procedures, together with first class infrastructure and telecommunication services, have propelled Dubai to the forefront of e-commerce.

ISLE OF MAN COURT REJECTS "FISHING EXPEDITION"

Irish High Court Inspectors sought an order, under section 7 of the Bankers' Books Evidence Act 1935 (the 1935 Act), that National Irish Bank (NIB) permit inspection of its books.

This was 'for the purpose of preparing a list of deposit accounts at NIB in the Isle of Man as at 30 September 1992 giving details of names on the accounts and addresses of account holders and account balances as at that date'.

They had been appointed to investigate and report on the affairs of NIB relating to the improper charging of interest and fees to accounts of customers from 1988, the improper removal of funds from accounts over the same period and whether other unlawful or improper practices existed or exist in NIB which served to encourage the evasion of any revenue or other obligations on the part of NIB or third parties.

NIB did not oppose the application but applied to the court for 'guidance'as to whether it was obliged to break client confidentiality and hand over the records to the inspectors.

Dismissing the petition, the Court held that the investigation into the affairs of NIB under the Irish Companies Act 1990 did not fall within the definition of 'legal proceeding' in section 2 of the 1935 Act.

"The 1935 Act should not be used for fishing expeditions."

The Court also found that legal proceedings under the 1935 Act meant only a legal proceeding in the Isle of Man and applicable caselaw stated that the 1935 Act should not be used for fishing expeditions beyond the ordinary rules of disclosure in litigation. The Court further noted that in this case it was NIB that was under investigation by the Court-appointed inspectors and not bank's customers themselves.

SOVEREIGN COMMENT: The Isle of Man has long maintained a practice of not replying to fishing expeditions from foreign revenue authorities and it is good to see that a similar application has again been rejected. Isle of Man banking confidentiality is alive and well.

There is some debate as to whether the Isle of Man would be required to implement the EU Directive on savings. All countries within the EU and territories within their control would be required to implement the directive. The Isle of Man is independent of the UK but in reality tends to be under its control as a matter of practice if not as a matter of law. That position will obviously have to be resolved but until then it does appear as though Isle of Man banks can be used with confidence.

INDIAN AUTHORITY RULES ON MAURITIUS TAX TREATY

Gains on the sale of shares earned by a Mauritius-based private equity fund will be regarded as business profits and not as capital gains according to a landmark ruling by the Indian Authority for Advance Rulings (AAR).

The AAR held that a private equity fund set up in Mauritius to hold investments in Indian companies, did not constitute a permanent establishment because both the investment advisor and the custodian were independent agents. In the absence of a permanent establishment, the business profits of the fund are taxable only in Mauritius and not in India.

The principal reason for investing through Mauritius was to utilise the capital gains tax exemption under the India-Mauritius tax treaty. A large number of foreign funds, particularly US, have set up subsidiaries in Mauritius to benefit.

But if gains on shares are to be treated as business profits and not capital gains, they will effectively be given the same treatment as under the US treaty. Provided that a US fund does not have a permanent establishment in India, it can get exemption on business profit directly and has no need to route the investment though a Mauritius subsidiary.

SOVEREIGN COMMENT: Although this ruling may negate the tax advantages of Mauritius, it may also help to settle the controversy over the capital gains tax provisions in the India-Mauritius tax treaty. And it may still be prudent to continue routing investments through subsidiaries in Mauritius in case the Indian tax authorities ever insist that there is a permanent establishment even though there may just be a single investment advisor in India.

FINANCIAL ACTION TASK FORCE

The Financial Action Task Force on Money Laundering (FATF) removed the Bahamas, the Cayman Islands, Liechtenstein and Panama from its list of Non-Cooperating Countries and Territories (NCCT).

The FATF said they had addressed the deficiencies identified and taken sufficient steps to ensure effective implementation. The procedures prescribed in FATF Recommendation 21 were therefore withdrawn.

This calls on financial institutions to give special attention to business relations and transactions with persons, including companies and financial institutions, from non-cooperative countries and, whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.

The FATF also welcomed the progress made by the Cook Islands, Dominica, Israel, Lebanon, Marshall Islands, Niue and St Kitts & Nevis, but said that until the deficiencies have been fully addressed and the necessary reforms sufficiently implemented, scrutiny of transactions with these jurisdictions, as well as those with St Vincent & the Grenadines, continues to be necessary.

But Nauru, the Philippines and Russia, it said, had made inadequate progress in addressing serious deficiencies, and it recommended the imposition of further counter-measures as of 30 September 2001, unless remedial action was taken.

Following the assessment of 13 further countries and territories, it has identified six new jurisdictions as non-cooperative in the fight against money laundering – Egypt, Guatemala, Hungary, Indonesia, Myanmar and Nigeria – and these countries have therefore been added to the NCCT list.

SOVEREIGN COMMENT: Niue, Philippines and Russia have been singled out by the FATF for special attention as they are deemed to be the worst of the Non-Cooperative Countries & Territories (NCCTs). Residents of these countries will find it very difficult to open bank accounts outside their own borders until such time as they clean up their act. This would apply to companies and residents from within the jurisdiction but also any foreign companies beneficially owned by residents of those places.

EUROPEAN UNION

The European Commission has issued an amended draft Directive for the effective taxation of cross-border interest payments to individuals within the European Union.

Under the amended proposal, each Member State would be expected to provide information to other Member States on interest paid to individual savers resident in other Member States.

But it provides for a seven-year transitional period for Belgium, Luxembourg and Austria during which they would be permitted to apply a withholding tax – at a rate of 15% for the first three years and 20% for the remainder – to enable them to amend existing legislation, including banking secrecy rules, to facilitate exchange of information.

The new proposal relies on the co-operation of market operators which directly pay out the interest. The paying agent will be required to provide the information – or, during the transitional period, to apply and pay over the withholding tax – to its Member State of establishment.

This will involve all interest income from savings due to an individual resident in another State, irrespective of whether the income derived from sources within or outside the EU. The paying agent will also be required to apply procedures to establish the identity and residence of the beneficial owner of the interest.

SOVEREIGN COMMENT: Adoption of the draft Directive was made contingent upon the adoption of equivalent measures by a number of third countries – the US, Switzerland, Liechtenstein, Monaco, Andorra and San Marino – and the dependent and associated territories of member states. The Commission is engaged in parallel discussions with these countries.

The Directive would apply to any EU citizen who banks in another EU state and is in receipt of income. It would not therefore effect non EU residents banking within the EU, nor would it effect any EU resident who is not in receipt of income. The draft Directive replaces plans to institute an EU wide withholding tax.

The likely outcome is that many EU citizens will choose to do their banking outside the EU and territories under the control of the EU. Hong Kong may be a substantial beneficiary of this. We continue to monitor the situation.

GIBRALTAR CHALLENGES EU COMPANIES INVESTIGATION

The government of Gibraltar initiated court actions against the European Commission in a bid to overturn its decision to challenge the legality of Gibraltar's exempt and qualifying company legislation.

The Gibraltar Qualifying Offshore Companies Rules and Gibraltar Exempt Offshore Companies Rules were included in a list of 11 corporate tax schemes in eight member states which the EC announced it was to investigate under Article 88(2) of the EC Treaty dealing with State Aids.

The move is part of the Commission's drive against 'predatory' tax competition which it regards as a distortion to the EU's single market. A resolution on a Code of Conduct for business taxation was adopted in 1997 under which member states agreed to eliminate any harmful measures as soon as possible.

In November 1999, a report by the EU Code of Conduct Group (Business Taxation) positively evaluated 66 tax measures as harmful but member states have so far made little progress towards their elimination. The decision by Competition Commissioner Mario Monti to open investigations is a sign that patience is running out.

"The decision ... is a sign that patience is running out."

Gibraltar is seeking the annulment of the EC's decisions to open investigative procedures. It is also seeking interim relief so that the exempt and qualifying company legislation can remain in force during the EC's investigation.

The other tax provisions which the Commission has decided to investigate are: Germany's Special Fiscal Regime for Control & Co-ordination Centres of Foreign Companies; Spain's Special Fiscal Regime for Bizkaia Co-ordination Centres; France's Headquarters & Logistics Centres Regime and Régime des Centrales de Trésorerie; Ireland's Tax Exemption on Foreign Income; Luxembourg's Co-ordination Centres Regime and Finance Companies Regime; the Netherlands' Special Fiscal Regime for International Financing Activities; and Finland's Åland Island Captive Insurance Regime.

SOVEREIGN COMMENT: If Gibraltar loses the application then it will be forced to immediately abolish the exempt and qualifying companies – despite the fact that the Gibraltar government has issued 25 years guarantees against tax for those companies. This need not be a concern as we are assured that such companies will be replaced with a new vehicle which has an equal rate of tax i.e. zero in the case of the exempt company. Details have yet to be announced and will not be so announced until necessary i.e. not unless and until the ruling goes against Gibraltar.

UNITED NATIONS CALLS FOR GLOBAL TAX BODY

The UNPanel on Financing for Development recommended the creation of an International Tax Organisation to ensure stable global development and combat poverty.

The ITO would, it said, help to counteract the effects of globalisation in undermining the territoriality principle on which tax codes are based.

Its role would be to compile statistics, identify trends and problems, present reports, provide technical assistance, and develop international norms for tax policy and administration. It would also take a lead role in restraining tax competition designed to attract multinationals with excessive and unwise incentives.

Further, it is to develop procedures for arbitration when frictions develop between countries on tax questions and sponsor a mechanism for multilateral sharing of tax information, like that already in place within the OECD, so as to curb the scope for evasion of taxes on investment income earned abroad.

The proposals will form the basis of discussion at a summit on development finance to be held in Mexico next March.

SOVEREIGN COMMENT: It seems to us that this new organisation will only further confuse the picture. There seems to be a huge overlap with the work already being undertaken by the OECD and no real necessity for yet another new body to start interfering with national tax rules and regulations.

UNCERTAIN TIMES = ALTERNATIVE INVESTMENTS

It is difficult to write an article about an event, which is destined for a report that may take some time to reach clients. But the awful events of September 11 cannot go unmentioned. They have shocked the world and the subsequent falls in share markets have made investors understandably nervous, writes David Gilburt.

Since the attacks there has been concerted effort to stabilise economies. This effort has been led by the major central banks which have reduced interest rates and introduced other fiscal measures to stimulate markets which have recovered from the lows seen in September. But uncertainty continues and history shows us that uncertainty brings volatile markets. At times of uncertainty we have come to expect stock markets to fall as investors move funds out of equities into cash or other more "secure" investments.

"The markets fell for four months after Pearl Harbour, until April 1942 when they began a four-year rally that saw the Dow Jones index double in value."

The media have made comparisons between the attack on the World Trade Centre and the attack on Pearl Harbour. If we follow this comparison then we see the markets fell for four months after Pearl Harbour, until April 1942 when they began a four-year rally that saw the Dow Jones index double in value. For the future we can only speculate when the recovery will come and in the mean time we must get used to a greater level of uncertainty.

For those nervous about the volatility of the markets, cash deposits offer a safe bolt-hole. But with interest rates at the lowest levels seen for decades, the earnings potential is relatively small and forecasts suggest interest rates will go even lower. For this reason many clients are looking at money market funds which offer higher rates than bank deposits but retain the option of quick and easy access to funds.

For clients able to tie funds up for longer periods, several institutions are seeking to attract investors back to the markets by offering protected or guaranteed investments. These are designed to offer protection to an investor's capital whilst giving an opportunity to enjoy greater earnings if markets recover. Choosing the right product should give investors the security of cash deposits with the potential to participate in much higher earnings when markets recover.

Such funds differ widely in their structure but the key to them all is that they buy options on the derivatives markets, effectively betting that a particular index such as the NASDAQ or the FTSE 100 will either rise or fall. It is this strategy which ensures the guarantees can be honoured.

There are many of these protected products on the market. Some invest heavily in big blue chip companies in an attempt to replicate movements in a particular index or market. They will then retain a small proportion of the funds available, say 5% and use this money to buy options, effectively betting that the market will fall. So if markets gain, the value of the bulk of the investments rises but, if markets fall, the managers win their bets and are able to pay the guaranteed return.

"Choosing the right product should give the investors the security of cash deposits with the potential to participate in much higher earnings when markets recover."

Other products are structured to invest in bonds and cash-based securities to safeguard the original investment. These would obviously underperform the market in the current climate so a proportion of the assets are used to buy call options, betting the market will rise. If the bet pays off the fund benefits. If not, the original cash deposit is secured by the bond investments. Some of these protected products offer to guarantee the original sum invested, and some offer guaranteed growth as well, linking any growth to future movements in one of the major indices. Others will guarantee the capital and pay interest over a period of time with a link to potentially greater growth if markets recover.

These products generally require the investments to be tied up for a period of time which could run from three to ten years. Whichever investment is considered, it is important to understand the nature of the guarantee offered, the index exposure and the level of participation offered, as there is a wealth of variation in the products coming on the market.

"The bargaining power of The Sovereign Group has enabled us to strike deals with private banks, brokers and other financial institutions that would not be available to most private clients."

Guaranteed products offer a safety net to investors in the equity market and are targeted at those investors who are unwilling to risk falls in the value of their investments. But this safety net comes with a cost and, in the longer term, these products are likely to underperform equities when markets return to more normal trading circumstances.

At Sovereign Asset Management Limited (SAM) we are able to review the markets, understand the detail of each product and find those that meet our clients requirements. The bargaining power of The Sovereign Group has enabled us to strike deals with private banks, brokers and other financial institutions that would not be available to most private clients on an individual basis. As a result SAM is able to provide a professional investment service which is both independent and competitive.

For more information on SAM and guaranteed investments, contact David Gilburt or Janet Short on +350 41054 or fax +350 41036 or email: sam@SovereignGroup.com.

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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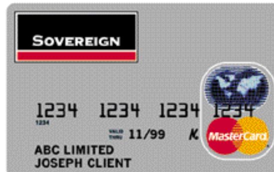

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