issue ten

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SOVEREIGN

report

contents

chairman

By the time this edition of The Sovereign Report reaches you Christmas will have passed so we hope you had a good one and wish everybody reading this a very happy and prosperous New Year. Kung Hei Fat Choi!

This year (as last year) we didn't send out any greetings cards to try and save a few trees and money. We have, however, made-over the savings to suitable charities and donations have been made to Great Ormond Street Hospital, London; Royal National Institute for the Blind; an Indian orphanage; the Fire Brigade in Lagoa, Portugal; and Action Asia Foundation, Hong Kong. We also contributed to a special fund for Andy Fields who was paralysed after breaking his neck playing rugby in Singapore in order to repatriate him to Stoke Mandeville Hospital in the UK which is the best in the field for spinal injuries.

OECD

Once again, the OECD have postponed the deadline for tax havens to make commitments and have modified the scope of the required commitments. The deadline for making commitments is now extended to 28th February 2002 and more information on this and the required form of the commitments can be found on page 8.

R vs. Dimsey

Regular readers may recall the Dimsey and Allen cases which went to the Court of Appeal last year and resulted in convictions for both Mr Dimsey and Mr Allen. Mr Dimsey appealed to the House of Lords and judgement affirming the Court of Appeal decision was handed down on 11 October, 2001. Robert Venables writing in the ITPA Journal argues quite strenuously that the Court of Appeal decision was severely in error on a number of different points of tax law but he was unable to convince the Law Lords of this when representing the appellant in the House of Lords – or at least did not manage to convince the House of Lords that these errors should result in any change in the decision. Mr Dimsey, the advisor to Mr Allen, has therefore had his conviction upheld and this has potentially serious consequences for those who engage in offshore tax planning and the advisors who assist them. A more detailed analysis of the case and its implications can be found on page 9.

Merry Christmas & a Happy New Year
Kung Hei Fat Choi!

EU talks on Savings Tax Directive

It has recently been reported on Tax-News.com that the EU talks on the proposed automatic exchange of information on any account opened by an EU resident within the EU (or territories under their control which would include most British offshore islands such as Cayman Islands, BVI, TCI, Jersey, Guernsey, Isle of Man etc.) have collapsed. Luxembourg and Austria have objected to the proposals and backtracked on their earlier agreement. It could be that this is just posturing designed to gain amendments to the proposal and other reports suggest that talks will be recommenced shortly.

OECD exchange of information

Things have become a little clearer about what is required here. It is envisaged that all Offshore Financial Centres (OFCs) would be required to introduce procedures for exchange of information upon request for criminal tax matters by the end of 2003 and on civil tax matters by the end of 2005. Simply stated, if an OECD resident comes under investigation by his local tax authority and that investigation reveals a connection between that resident and a structure in an OFC then the relevant authority (the onshore tax department) will make inquiry from the relevant authority in the OFC who will be bound to release information about that structure and who was behind it. Procedures to guarantee a speedy and unimpeded release of that information will have to be implemented by any OFC that wishes to stay off the OECD blacklist of uncooperative jurisdictions referred to above.

As always, we repeat out contention that offshore tax planning is alive and well but any planning which relies upon secrecy – as opposed to confidentiality – is fast becoming a liability.

howard bilton BA(Hons)
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Chairman of The Sovereign Group

Isle of Man corporate service providers regime

The Corporate Service Providers Act became fully operational on 1 January. From this date, it became illegal to carry on regulated Corporate Service Provider business without a licence granted by the Financial Supervision Commission. But anyone who applied for a licence before 1 January 2002 will be able to continue in business pending determination of the licence application.

The Financial Supervision Commission (FSC) has issued a consultative paper on a new Companies (Amendment) Bill which is to be introduced to Tynwald during the current legislative session. The proposed Bill, designed to make urgently needed changes to the Companies Acts 1931 – 1993 and other related legislation, will also facilitate the introduction of on-line company incorporation, filing and searching service at the Companies Registry. The Companies (Amendment) Bill will also include legislation to provide for the formation of protected cell companies (PCCs) following a detailed review by the Insurance & Pensions Authority.

The PCC structure is particularly relevant to the captive insurance industry, but as a result of the review, the Treasury considers that there may be opportunities for it to be used by other types of companies and therefore it is intended that the proposals will apply to companies in general.

The Trustee Act, to replace and update earlier statutory trustee investment provisions was brought into force, at the beginning of last September. It follows similar legislation introduced into English law.

The Act grants wide investment powers to trustees even where no powers are contained within the trust deed. It retains duties for trustees to have regard to the need for the diversification and suitability of investments and introduces a duty to obtain and consider proper advice before exercising powers of investment.

It is supported by a range of new powers to appoint agents, nominees and custodians, to insure trust property and to pay professional trustees.

Sovereign comment

The Isle of Man has been particularly proactive recently in drafting and enacting new legislation to keep it amongst the premier OFCs. The figures for new incorporations have been steadily falling but the Isle of Man has maintained its position as the pre-eminent jurisdiction for insurance based business. The Isle of Man has several advantages over the competing jurisdictions of Guernsey and Jersey as it has slightly lower taxes, lower employment costs, lower office costs, more space and a bigger pool of labour. In addition there are much less restrictive employment practices so that it is generally possible to bring specialist workers over from the mainland without too much difficulty.

europe

Jersey. The Companies (Amendment No. 6) Law, the first major overhaul of company legislation in Jersey since enactment of the Companies Law in 1991, was approved by the States and is due to be brought into force.

The first major overhaul of company legislation in Jersey since the enactment of the Companies Law 1991, it aims to take account of changes in international standards and provide improved flexibility to participants whilst continuing to ensure appropriate protections. The Law includes provision for:

- companies to be incorporated by guarantee, to issue no par value shares and include members holding unlimited shares;
- private companies to be incorporated with a single member;
- 'hybrid' companies with both limited liability and guarantee members to operate in Jersey;
- two or more Jersey companies to merge and continue as a single company;
- redomiciliation of companies into and out of Jersey;
- the Financial Services Commission to cooperate with domestic and overseas investigations.

The Criminal Justice (International Cooperation) Law, designed to extend the ability of the Commission to cooperate with foreign legal authorities at the investigation stage to all serious crimes, is also due to be brought into force.

Amendments to the Financial Services, Banking Business, Insurance Business and Collective Investment Funds Laws, to widen the gateways for disclosure of information to foreign regulatory bodies, have been approved by the Finance & Economics Committee.

Sovereign Comment. About time! Jersey has been lagging behind other offshore jurisdictions and incorporation numbers have been dropping steadily. Even Jersey-based professionals frequently recommend incorporating an offshore company in another jurisdiction with rather simpler legislation and easier administration. BVI has been the choice of most. Jersey maintains its pre-eminent position or trust business but is no longer one of the premier jurisdictions for private client corporate business. These changes may help to reverse that trend.

Gibraltar rejects joint sovereignty talks

The UK and Spain have brought forward the target date for agreement on a new constitutional settlement for Gibraltar to this summer. They had previously set a deadline for the end of 2002.

The move is designed to make an agreement on a joint sovereignty arrangement possible during the Spanish presidency of the European Union which ends in June. A referendum on a new constitutional settlement could then be held in the second half of 2002. Gibraltar Chief Minister Peter Caruana rejected an invitation to join the bilateral talks that are aimed at delivering a new constitutional settlement that would also allow more self-government for Gibraltar.

He said Gibraltar's policy is that it only wishes to engage Spain in a process of dialogue that is both safe and properly structured. This would require the Gibraltar government to be present throughout all parts of the talks with a separate voice of its own and a right of veto rather than just a vote.

Meanwhile Gibraltar brought the Protected Cell Companies Ordinance into force on 1 November last year. It is first domicile within the European Union to provide such a structure and the Ordinance is intended for use by both the captive insurance and funds sectors.

Sovereign comment

The fight over the sovereignty of Gibraltar has been rumbling on since 1714. Britain maintains its position that sovereignty will not be given back to Spain unless it is the wish of the Gibraltar people and they would almost certainly overwhelmingly reject any move to give Spain sovereignty over Gibraltar in part or in whole. This issue has received a lot of press coverage in recent months but the present position is unlikely to change in the near, middle or even distant future.

US Patriot Act tightens "offshore" rules

President Bush signed the USA Patriot Act into law on 26 October 2001. Enacted in response to the 11 September attacks, its primary purpose was to provide enhanced powers of enforcement and surveillance in relation to terrorism but it also had significant implications for international financial institutions and offshore jurisdictions.

At the insistence of the Senate it contained provisions to strengthen anti-money laundering rules and give a mandate for subjecting to special scrutiny those foreign jurisdictions, financial institutions operating outside the US, and classes of international transactions or types of accounts that pose particular, identifiable opportunities for criminal abuse.

Under section 311, the Secretary of the Treasury is empowered to take "special measures" against foreign jurisdictions, financial institutions and international transactions that are a "primary money laundering concern".

These include requiring domestic financial institutions to: maintain records and/or file reports concerning transactions; take steps to obtain and retain adequate information concerning the beneficial ownership of any account opened or maintained in the US by a foreign person; identify and obtain background information on the each customer of a financial institution permitted to use a "payable-through" account in the US; and identify each customer and obtain and retain information on them as a condition to opening or maintaining a "correspondent account" with a US financial institution.

Under section 312 any US financial institution that establishes, maintains, administers or manages a private banking account or correspondent account in the US for a foreign person is required to establish enhanced due diligence policies, procedures, and controls to detect and report instances of money laundering.

As a minimum the US financial institution is required to: ascertain each of the beneficial owners of the foreign bank with which the account relationship is established; conduct enhanced scrutiny of such accounts; and ascertain whether the foreign bank provides correspondent accounts to other foreign banks and if so, their identities. Any US financial institution requested to open or maintain an account by or for a non-US person must ascertain the identity of the nominal and beneficial owners of that account and the source of funds deposited into them.

Sovereign comment

It is no surprise to see the US reacting quickly and comprehensively to the events of 11 September. The original draft of these provisions was significantly amended after lobbying by free-market organisations led by the Centre for Freedom & Prosperity. As a result reference to "special tax advantages to non-residents or non-domiciliaries" and "tax havens" as criteria for identifying jurisdictions of primary money laundering concern were removed, making it clear that Congress does not want tax policy alone to be a reason for action.

BVI to establish Financial Services Commission

An independent regulatory body is to be established early this year under the Financial Services Commission Bill. This is the final substantial piece of legislation required for compliance with the core recommendations of the KPMG Review of financial regulation in the UK Overseas Territories.

An Insolvency Act and other legislation recommended by KPMG is in the process of being drafted for introduction in the House after the Financial Services Commission Bill has been passed. A Code of Practice for Mutual Fund Managers and Administrators has also been drafted and will be put out to consultation shortly.

Sovereign comment

BVI has delayed announcing changes to its legislation and procedures for as long as possible. Although these particular changes have been made to conform with the KPMG review they are also in keeping with what is required by the FATF and OECD. We expect further changes in legislation, particularly relating to the companies law, to be announced in the run up to the extended deadline for making commitments to the OECD approaches on 28 February 2002.

Cayman Islands. The Cayman Islands government signed an agreement with the US to provide for exchange of information, upon request, for criminal tax evasion, civil and administrative tax matters relating to US federal income tax.

It also provides for confidential treatment of information exchanged, and, in accordance with US law, any such information may not be disclosed to any third party. It applies to criminal tax evasion for taxable periods commencing 1 January 2004, and to all other tax matters for taxable periods commencing 1 January 2006.

The agreement followed bilateral negotiations between officials from the US Department of the Treasury and the government of the Cayman Islands but takes the form of a UK/US agreement because the Cayman Islands is a UK Overseas Territory. It is structured to conform with the Cayman Islands' commitment to the OECD of May 2000.

The Companies (Segregates Portfolio Companies) Law has been amended to provide that any exempted company, including mutual funds, may apply to be registered as a segregated portfolio company. Use of segregated portfolio companies was previously restricted to exempt insurance companies.

Sovereign Comment. As can be seen, the US is pursuing its own objectives separately as well as in tandem with the OECD. The US prompted the refocusing of the OECD's "harmful tax" initiative away from tax rates and on to exchange of information and expects to sign exchange of information agreements with over half of the 35 OECD-listed tax havens within a year. We would again stress that nobody need fear these agreements if they are using OFCs legitimately for tax avoidance rather than tax evasion. The signing of such a treaty brings forward the inevitable imposition of exchange of information procedures required by the OECD but will largely effect only US citizens who deal with or through the OFCs. What should be noted, however, is that information obtained by the US may be exchanged with treaty partners under the terms of the bilateral taxation treaties signed by the US with most developed nations.

Mauritius makes changes to Companies Act

The President assented to three major pieces of new legislation to upgrade the regulatory framework and the key underlying financial services structures last December.

The Companies Act 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.

Public companies holding a Category 1 Global Business Licence must maintain a register open to the public at the office of the Registrar of Companies. But private companies holding a Category 1 or Category 2 Global Business Licence are exempted from public access unless such a request is made by a shareholder of that company.

The Trusts Act 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 Act also incorporates the concept of protective and spendthrift trust aimed at ensuring more efficient management of assets.

The Financial Services Development (FSD) Act provides for the establishment of a Financial Services Commission which will be the statutory body regulating non-bank financial services. Further to the Mauritius Offshore Business Activities Act 1992, it sets out new requirements for licensing those conducting financial services in Mauritius and new obligations in terms of record-keeping and disclosure.

Sovereign comment

Mauritius is still tinkering with this legislation but most of the major changes have already been made. Mauritius was one of the first OFCs to make a commitment to the OECD and this has paid dividends as it has attracted business which liked the certainty and might have otherwise gone elsewhere. The new Companies Act regulates both offshore companies and international companies – now know as Category 1 and Category 2 Global Business Companies – and consolidates the previous two Acts into one. In effect there is little change to the administration procedures for the incorporation and management of the two types of companies.

far east

Hong Kong. Advisory Committee on New Broad-based Taxes issued a consultation document last year on what types of broad-based taxes may be suitable for Hong Kong if required. The committee was established by the Financial Secretary last June in the light of projected future operating deficits.

Entitled "A Broader-Based Tax System for Hong Kong?", the consultation document sets out 13 options to broaden the tax base. The options fall into two groups – those that would increase the revenue productivity of existing taxes and those relating to introduction of new taxes.

The former includes raising the rates of salaries tax, profits tax and stamp duty on property as well as reducing allowances and deductions under salaries tax. Possible new taxes include capital gains tax, tax on interest, on dividends and worldwide income, a land and sea departures tax, payroll and social security taxes, poll tax, a general consumption tax and tax on mobile telephones and signboards.

In making its recommendations, the Committee must have regard to the overriding principle of maintaining a low and simple taxation regime and preserving Hong Kong's competitiveness.

Sovereign Comment. The Hong Kong economy is under some pressure. Unemployment is at record levels but is still less than 6% which is a rate most countries would be proud of. There will be a large budget deficit this year and the government is no longer able to generate much by the way of taxes from land transactions. Hong Kong is having a precautionary look at alternatives but as yet there is no suggestion but the current corporate taxation system will be altered so Hong Kong, being outside the OECD and the EU but still able to offer stability, an excellent banking system and a low or zero rate of tax may prove THE offshore jurisdiction for the future.

UAE approves Anti-Money Laundering Bill

A bill against money-laundering was approved by the Council of Ministers and will come into effect when signed into law by President Sheik Zayed bin Sultan Al Nahyan.

The United Arab Emirates (UAE) was identified as a conduit for funds tied to the 11 September terrorist attacks and the Central Bank froze accounts in respect of one of the names on a US list of people connected to the attacks.

The Law Regarding the Criminalisation of Laundering of Property Derived from Unlawful Activity gives the Central Bank power to monitor and control banks, money changers and other financial institutions.

It permits the UAE Central Bank to freeze suspicious accounts for up to a week, allows the courts to freeze such accounts indefinitely and provides penalties of up to seven years and fines of up to dirham300,000. The Law also provides for the creation of a National Anti Money-Laundering Committee to work with local and international financial institutions to combat money laundering.

EU to open information exchange talks

EU Finance Ministers reached agreement last October on a mandate to authorise the opening of a formal phase of savings taxation negotiations with six key non-EU countries on ways to tackle tax evasion.

The aim of the talks is to persuade the USA, Switzerland, Liechtenstein, San Marino, Monaco and Andorra to agree to adopt anti-tax evasion measures, already agreed to by Member States, whereby an information exchange system would be implemented regarding interest payments on non-residents' savings.

The Feira European Council set a deadline of the end of 2002 for agreement to be reached with key non-EU countries to adopt an information-sharing system, and if that is achieved then the system will go fully into effect by 2009.

Under the EU proposals, member states and the six non-EU countries would be expected to share information on interest they pay to individual savers resident in the other relevant countries. For a transitional period of seven years, Belgium, Luxembourg and Austria would be allowed to apply a withholding tax instead of providing information, at a rate of 15% for the first three years and 20% for the remainder of the period.

Sovereign comment

It seems clear that there will be little resistance from the USA to implementing the exchange of information system requested by the EU but it is also difficult to see why Switzerland, in particular, would agree to introduce such measures because (a) they are in direct conflict with its banking secrecy laws; (b) Switzerland could expect to see a massive inwards movement of capital if it stays outside the EU system and a massive outflow of capital if it joins. Jurisdictions outside the EU system of exchange of information would expect to benefit enormously if the EU savings directive goes ahead. Suitable jurisdictions may include Bahamas, Hong Kong, Singapore and other well regulated and stable banking centres which are neither within the EU nor under the control of an EU member.

Pavarotti pleads not guilty to tax evasion

Opera singer Luciano Pavarotti pleaded not guilty to tax evasion before a court in his home town of Modena. He faces a three-year prison sentence if convicted.

Italian prosecutors allege that Pavarotti still owes the government unpaid taxes for the period 1989 to 1995 – despite his payment of £7.8m in back taxes last year. But under Italian law once the authorities have been notified of a criminal act there is a duty to prosecute.

The singer needs to convince prosecutors that he was resident in Monte Carlo for the period in question – and not in Italy.

Sovereign comment

Pavarotti is not the first high profile figure to have had his supposed residency in Monaco questioned and tax bills raised when found not to be a bona fide resident of Monaco.

Ofcourse, it is possible to be a resident of Monaco and a resident of Italy or elsewhere at the same time and liable to tax in both jurisdictions. In order to maintain Monagesque residency it is necessary to spend a minimum of 90 days within the Principality.

This compares with other tax advantageous jurisdictions in which an expatriate may settle such as Cyprus, Malta and some of the Caribbean jurisdictions where there is no minimum required period to maintain residency. This gives travellers an advantage in that if they are seeking to avoid tax in one place it is helpful (but not conclusive) to be able to point to a properly maintained legal residency elsewhere.

FATF. The Financial Action Task Force (FATF) agreed to expand its mission beyond money laundering to lead the international effort to combat terrorist financing in response to the 11 September terrorist attacks in the USA.

Meeting for an extraordinary Plenary on the Financing of Terrorism in Washington, DC, on 31 October, representatives of the 31 FATF members issued a set of Special Recommendations on Terrorist Financing and set a timetable for implementation.

The Special Recommendations commit members to: take immediate steps to ratify and implement the relevant United Nations instruments; criminalise the financing of terrorism, terrorist acts and terrorist organisations; freeze and confiscate terrorist assets; report suspicious transactions linked to terrorism; provide the widest possible range of assistance to other countries' law enforcement and regulatory authorities for terrorist financing investigations; impose anti-money laundering requirements on alternative remittance systems; strengthen customer identification measures in international and domestic wire transfers; and ensure that entities, in particular non-profit organisations, cannot be misused to finance terrorism.

Basel Committee. The Basel Committee on Banking Supervision issued guidance to banks and banking supervisors on customer due diligence processes last October, setting out minimum standards for the development of appropriate practices.

The Guidance said clear and comprehensive 'Know Your Customer' rules are needed if banks are to avoid being used to transfer illicit funds for criminals, corrupt officials and terrorists. The committee also urged closer scrutiny of trusts, fiduciary accounts and companies, where accounts should be closed if the beneficiaries or owners could not be identified.

It said special attention was needed for accounts of politically exposed persons such as heads of state, senior politicians and officials and others who may be able to abuse their position to enrich themselves. The decision to open such accounts should always be approved by a senior manager, and the source of funds investigated.

The Working Group is to undertake further work on developing essential elements of customer identification requirements.

OECD modifies harmful tax initiative

The OECD formally modified the tax haven aspects of its initiative to eliminate harmful tax practices by removing the "no or nominal taxes" and "no substantial activities" elements from the commitments it is seeking from co-operating jurisdictions.

Commitments from listed jurisdictions will now be sought only with respect to the transparency and effective exchange of information criteria. The deadline for making commitments was extended to 28 February 2002.

The move, set out in a 2001 Progress Report published in November, came in response to the shift in US government policy under the Bush Administration. Publication had been delayed by Spanish objections over the status of Gibraltar.

The OECD also conceded that any potential framework of co-ordinated defensive measures would not apply to uncooperative tax havens any earlier than it would apply to OECD Member countries with harmful preferential regimes.

To ensure that committed jurisdictions have sufficient time to develop implementation plans, the time for establishing a schedule has also been extended from six months after the date of making a commitment to one year. The 11 jurisdictions – Aruba, Bahrain, Bermuda, Cayman Islands, Cyprus, Isle of Man, Malta, Mauritius, Netherlands Antilles, San Marino, Seychelles – that had made commitments to eliminate harmful tax practices are to be permitted to review them in respect of the no substantial activity criterion.

Tonga, said the OECD, had addressed those areas that led to its identification as a tax haven in June 2000 and been removed from the list.

The modifications to the tax haven work do not affect the work in relation to Member countries. The OECD also reviewed harmful tax practices in its own Member countries and listed 47 tax regimes across 21 countries.

Sovereign comment

It does seem that every issue of the Sovereign Report devotes a large part to the latest from the all-powerful OECD. This is the third time that the deadline for making commitments has been extended but progress in this area is inexorable and OFCs will have to comply with their demands in order to stay in business. As mentioned on the front page and in previous issues, the focus has firmly switched away from tax rates and to the implementation of exchange of information. The latest progress report simply confirms what we already knew.

fiscal

Netherlands Antilles. The new Kingdom Tax Treaty between the Netherlands and the Netherlands Antilles was due to be ratified by their respective parliaments by the end of last year following final approval by both governments.

The treaty will provide for an effective tax rate of 8.3% on dividends as of 1 January 2002. The Antilles has given 'level one' commitments to permit no erosion of this rate. This is same rate as is currently applied but under the existing treaty the Netherlands collects 5% and the Antilles 3.3%. Under the new treaty the entire amount will be deducted in the Netherlands and then remitted to the Antilles.

Ratification of the treaty will enable implementation of the New Fiscal Regime (NFR), approved at the end of 1999, which will repeal existing offshore legislation and remove the discriminatory elements between the offshore and onshore corporate tax regimes.

Under the NFR, resident and non-resident companies will be taxed at the same rate of 34.5%. Previously offshore companies paid tax at a rate between 2.3% and 4%. The NFR was expected to become applicable as of 1 January 2000 but following the delays in agreeing the new Kingdom Tax Treaty it will now be applied retroactively to 1 January 2001. Transitional rules will be applied to taxpayers currently benefiting from the offshore legislation.

Sovereign Comment. One of the best holding company regimes used to be a Netherlands company owned by a Netherlands Antilles company – the "Dutch Sandwich". In recent years several other countries have initiated holding company regimes which compete with Netherlands or compliment the Netherlands regime so that often the best holding company route is either direct into Denmark, Luxembourg, Spain, Switzerland or UK or combines a company incorporated in one of those jurisdictions with the Netherlands. The Dutch Sandwich is now attractive because it is well understood and tested but there may well be better options available depending on the country from which dividends are to be extracted.

Cyprus approves tax reforms for EU membership

The cabinet approved radical tax reform plans last November as part of the preparations for membership of the European Union. The proposals envisage a 10% across-the-board corporate tax on companies, a gradual increase in VAT to the 15% minimum required by the EU and a reshuffle of income tax brackets to widen the tax-free income.

The government's decision to set a uniform corporate tax rate of 10% for both onshore and offshore companies is designed to meet the EU's requirements on fair competition. The main beneficiaries would be onshore companies, which currently pay corporation tax at 25% of net profits.

But for offshore companies, the new tax regime marks a substantial increase from the 4.25% rate introduced when Cyprus opened as an international business centre in the 1970s. It is estimated that the overall tax obligation will be around 15.5 to 18.5%.

Sovereign comment

The headline rate of tax makes Cyprus rather unattractive but it may be that the ability to make deductions will bring the effective rate down from these levels. Otherwise it is difficult to see Cyprus holding much attraction for the international investor other than as a conduit to eastern European countries with whom Cyprus has a range of outstanding tax treaties. Even there it may be that some onshore countries offer more if their treaties can be accessed and those onshore jurisdictions used as a conduit to eastern Europe.

We will keep you updated in future issues as details become clearer.

The Dimsey & Allen Appeals

In the recent House of Lords appeals, *R v. Dimsey* [2001] UKHL 46 and *R v. Allen* [2001] UKHL45, the appellants, Dermot Dimsey and Brian Allen sought to appeal against decisions of the Court of Appeal, Criminal Division [2000] QB 744. Dimsey was accused of conspiring to cheat the public revenue and Allen was accused of actually cheating the public revenue by failing to disclose profits made by offshore companies managed by him. Dimsey was sentenced to 18 months in prison and Allen to 13 concurrent terms of 7 years.[1]

The facts of the Dimsey case[2]:

Dimsey provided financial services to clients from his base in Jersey. These services included, *inter alia*, the establishment and management of offshore companies for UK-resident individuals.

A co-defendant, Chipping, was a UK resident individual involved in the supply of avionics equipment to South Africa and had asked Dimsey to set up two Jersey companies (Thomlyn Supplies and Glenville Supplies) to deal with the South African contracts that Chipping had obtained. The contracts were signed by Dimsey on behalf of the companies. Credit cards were issued to Chipping in the names of the companies, but for his personal use, and a third Jersey company (Lantau) was set up to receive profits from the trading companies and to acquire a flat in England for the use of Chipping's family.

In 1993 the Revenue began an investigation into Chipping's tax affairs. Dimsey assisted Chipping in providing false and misleading information to the revenue. The revenue commenced criminal proceedings against Chipping and he pleaded guilty to counts relating to failing to declare taxable income and benefits derived from the aforementioned offshore companies. Chipping pleaded not guilty to two other counts: a) cheating the revenue of corporation tax by concealing the existence of profits; and b) failure to disclose £200,000 that was paid by the two other involved companies to Lantau. These charges were upheld at trial and Chipping was convicted. The Revenue successfully argued that the Jersey companies were controlled in the UK by Chipping and should therefore have declared their liability to UK corporation tax.

The facts of the Allen case[3]:

The appeals for Dimsey and Allen were heard at the same time, Lord Scott of Foscote gave opinion in *Dimsey* and Lord Hutton in *Allen*. Lord Hutton adopted Lord Foscote's interpretation that the companies' income was that of Allen's for tax purposes under section 739 ICTA (see below).

Allen had, as in the case of Dimsey, provided false and dishonest information to conceal the fact that he was managing and controlling his offshore companies from within the UK. A ground of appeal advanced before the Court of Appeal was that, as a *shadow* director, the appellant was not liable to tax on the provision of living accommodation and benefits in kind. This particular point was rejected on the grounds that a shadow director falls under the extended meaning of director under section 168(8) of the Income & Corporations Tax Act. Allen also argued that his assets were tied up in a so called "Red Cross Trust" a.k.a. a "Blind Trust" in which the details of the settlor are not mentioned but it wasn't clear what effect this had. The judge was particularly skeptical about this type of arrangement and his background in criminal law, rather than tax and trust law, led him to make some controversial statements to the jury.

The Appeal:

Section 739(1) and (2) of the Income & Corporations Tax Act of the UK is the mainstay of the UK's anti-avoidance measure. It states that income generated by or on any assets transferred out of the UK that may be enjoyed by an individual ordinarily resident in the UK shall be taxable as if the income had been received by him.

The defendants argued that, since the companies' profits were deemed for tax purposes to be those of Chipping under s739(2), the profits could not be deemed for tax purposes to be those of the companies so the companies were not liable to corporation tax and accordingly the convictions for failure to declare their liability could not be sustained. This was a rather novel approach and the court dismissed the appeals. "There could be no distinction between the position of a transferee company and a transferee who is an individual," said Lord Scott.

[1] The Times Law Report, 14 July 1999.
[2] Regina v. Dimsey [2001] UKHL 46, Lord Scott of Foscoe.
[3] Regina v. Allen [2001] UKHL 45, Lord Hutton.

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Sovereign comment

Here we have a case *(Dimsey)* where an individual, Chipping, conspired to cheat the revenue. His professional advisor, Dimsey, assisted by providing false and misleading information. This supports Sovereign's contention that for offshore structures to work it is vital that "management and control" do not just appear to, but actually, take place offshore. Dimsey dishonestly concealed the true place of control and central management of the companies to support his claims that the companies were managed outside the UK (Jersey) and therefore not subject to UK tax. When we provide directors for a company, it is therefore essential that we actually control and manage the company and do not just appear to do that.

Living accommodation and any other benefits in kind provided to a director are, generally, classed as emoluments received by the director. Their Lordships agreed, in the appeals, that the relevant sections of the Income & Corporations Tax Act (s168(8)) also applied to *shadow* directors. Clients must, therefore, be prepared to forego control of an offshore company in order to avoid this particular section and to be able to clearly demonstrate, if required, that they do not control the company.

Some jurisdictions, Hong Kong for example, employ "schedular" taxation systems where the place of effective management and control has no bearing on tax burden. Instead tax is levied according to the source of the income. But the majority of jurisdictions do have anti-avoidance measures that affect the use of offshore companies and, unless properly structured, income derived from these structures will be taxable as if the income had been received directly by the client.

The disputes in *Dimsey* and *Allen* surround offshore planning that went horribly wrong. Perhaps with sound advice in the beginning (or even restructuring of their affairs at a later stage) Messrs Dimsey and Allen would have been free to continue their businesses unhindered by revenue investigations and court cases.

Sovereign does urge its clients to take domestic tax advice in order to ascertain their reporting requirements.

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