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Kung Hei Fat Choi

… or Happy New Year in Chinese. This year the lunar Chinese New Year fell at the end of January so a slightly belated Happy Chinese New Year to you all. Just for the record, this year is the year of the monkey.

STOP PRESS – Low cost VAT registration for yachts

Those who wish to sail within EU waters for more than six months in the year must import their boat into the EU and pay VAT. Malta has a VAT rate of only 5% and the European average is about 15%. If the boat is imported into Malta now then the registration should be good for sailing in the European Union as soon as Malta joins on 1st May 2004. But the rate of VAT in Malta is set to rise to somewhere near the European average at the end of March this year, so this leaves only a small window of opportunity. *Do contact us urgently if you think this may be of interest.*

Portuguese property ownership

As we go to press, Portugal has just published a blacklist of those countries which face special tax sanctions. As expected, Malta is not on that list. It is therefore, in our opinion, the best place into which offshore companies can re-domicile in order to avoid the new 5% annual tax which now applies to any property in Portugal owned by a company located in a blacklisted country. The blacklist includes all recognised tax havens.

As reported in previous issues, other places in which it is possible to redomicile tax effectively are Delaware, New Zealand and Luxembourg. But Malta seems to have advantages over all of them and, because it will soon be a full member of the European Union, is unlikely to feature in any future versions of the Portuguese blacklist. Such a move, we believe, would be discriminatory under European law.

Any offshore companies which have yet to redomicile must pay the 5% tax for this year. We had hoped that the Portuguese tax authorities might relent and grant an amnesty, but this has not happened. Anybody who still owns property through an offshore company should do something about it before the next tax year. Procedures for redomiciliation can take two or three months to execute, so realistically the cut off point to avoid next year's tax is in September this year. But better to act now and avoid a rush.

chairman

Sovereign expands in Portugal

Increased demand for personalised tax consultancy and assistance to both foreign residents and non-resident property owners, has obliged us to move to more spacious offices at our current location. Miguel Cristo, a Portuguese lawyer with extensive tax planning experience, has also joined the team. He will be concentrating his efforts on promoting Sovereign's services in Lisbon and Porto, as well as assisting in the Algarve.

Sovereign Art Prize

Entries for the first annual Sovereign Contemporary Asian Art Prize closed at the end of January. We received a total of 172 entries. All entries are displayed on the website at www.SovereignArtFoundation.com so please have a look and vote for your favourite paintings. The third prize will be awarded solely on public vote.

Royal Society of Fellows Conference, Miami, 25th & 26th March

Sovereign are sponsoring the above conference and Simon Denton from our London office will be speaking about the EU Savings Tax Directive. Anybody interested in attending should log on to www.RoyalFellows.org for details.

Mauritius/Indonesia treaty to be terminated

We have just heard that the Mauritius/Indonesia treaty will soon be formally terminated. Anybody holding Indonesian investments via Mauritius will need to revise their arrangements urgently. There are several other beneficial treaties which might be used including Luxembourg, the Netherlands, Switzerland, Singapore, the UAE or the UK.

Howard Bilton BA(Hons)
Barrister-at-Law (England, Wales & Gibraltar)
Professor of Law, St. Thomas School of Law, Miami, USA
Chairman of The Sovereign Group

Maltese Budget sets out financial sector plans

Malta's 2004 Budget, issued on 24 November, contained proposals for new legislation on trusts and a programme designed to help the financial services sector prepare for accession to the European Union.

Malta is a Civil Code jurisdiction – when the island was a British colony, trust law and equity law relating to trusts were never absorbed or incorporated by statute into Maltese law. When trust legislation was first introduced in 1988, it was intended solely for offshore structures. In line with the recommendations of the OECD and FATF, Malta undertook to eliminate ring-fencing and discrimination and to create access to information by the authorities. Malta also undertook to eliminate the nominee company regime.

In relation to trusts, this would have entailed either eliminating trust laws and prohibiting any fiduciary relationships, or permitting Maltese residents to make use of trusts for all forms of property in Malta. The government took the policy decision to retain the Trusts Act in force and incorporate the concept within domestic law.

The proposed amendments are therefore designed to open up trusts to the domestic market and thereby eliminate ring-fencing. But domestic civil law is not applicable when a trust is regulated by a foreign law, or when a trust is regulated by Maltese law but settled by foreign domiciliaries for the benefit of foreign beneficiaries. Trust laws will also be amended to require beneficiaries of trusts represented by nominees to disclose their identities.

Amendments to the Trusts Act and the consequential amendments to various others laws, including the Civil Code, are due to be published soon and, it is hoped, will be brought into force during the first half of this year.

The Malta Financial Services Authority is also in the final stages of consultation on a programme of initiatives to help the financial services sector prepare for EU accession. These initiatives cover human resource development, technology-based services, branding and regulatory development.

Sovereign comment

Malta has a very attractive tax system whereby companies pay tax at rates of anywhere up to 35% but then the shareholders claim refunds bringing the effective rate of taxation suffered down to between 0% and 6%. Despite EU succession it is thought that Malta will not need to make drastic changes to this system and will therefore maintain its appeal. As our clients will know, a solution to the new tax on "offshore" companies which own property in Portugal is to redomicile the company into a non-blacklisted jurisdiction. Malta fits that description. The fact that Malta will join the EU and that it has recently negotiated a tax treaty with Portugal leads us to believe, and the Malta government to confirm, that Malta will stay off the Portuguese blacklist.

17 europe

Portugal intensifies tax fight

Portuguese Prime Minister Jose Manuel Durao Barroso, in his New Year's address, promised to intensify the fight against tax evasion and to apply a "heavy hand" to those who refused to fulfill their fiscal obligations. The Finance Ministry issued more than 250,000 letters threatening repossessions and evictions to those who refuse to pay taxes owed.

Last year, the Finance Ministry implemented a reform of its real estate tax regime by adopting new measures aimed at deterring the use of offshore companies and instituting new rules on the application of double tax treaties. Despite hopes that there would be some form of deferral, publication of the 2004 Budget brought no relief. Imposition of a 5% Municipal Tax rate on offshore held property in respect of the year 2003, payable in 2004 and based on upwardly revised tax department values, will therefore go ahead.

Sovereign comment. For offshore property owners who did not, or were unable to make, a move before the year end, there is nothing that can be done except pay whatever tax is levied this year and consider their position before the end of 2004. For many, re-domiciliation of their company to a safe jurisdiction will be the only alternative due to the likelihood of creating a liability to capital gains tax on reversion of the property to individual ownership.

Isle of Man Companies Amendment Act comes into force

Legislation to permit the re-domiciliation of companies into and out of the Isle of Man, whether or not they are listed on an exchange, came into force on 19 December 2003. Previously only listed companies were allowed to change their place of domicile.

Under the Companies, etc. (Amendment) Act 2003 it will now be possible for the secretary of an exempt company to be a corporation and for licensed Corporate Service Providers and key staff to act as secretary. No further issues of bearer shares will be allowed and existing bearer shares will need to be registered before any of their rights can be exercised.

The Act also provides for electronic filing in advance of the Registry's move to on-line facilities and a new dissolution procedure will be brought into force from 1 April 2004.

The International Monetary Fund (IMF) found the financial regulatory and supervisory system of the Isle of Man complied well with international standards in a report released on 25 November 2003.

The Isle of Man had a high level of compliance with the IMF's four key standards, and the legal framework for company and trust service providers (TSPs) was fully consistent with the Offshore Group of Banking Supervisors' Statement on Best Practices.

In particular, the IMF noted: the comprehensive, if somewhat complex, regulatory framework; the proactive approach of the regulators to achieve high standards in the financial services sector; and an off-site and on-site supervisory process that addresses key reputational risks.

Sovereign comment

As a result of the newly found ability for Isle of Man companies to redomicile we are finding great demand for our services in assisting such companies which own property in Portugal to redomicile to Malta. *See above.*

Antigua and St Vincent suspend OECD commitment

The governments of Antigua and St Vincent suspended their commitments to the OECD to exchange information in criminal and civil tax investigations. The move, made in response to the European Union's concessions to three member states under the proposed savings tax Directive, came during a meeting of the OECD's Global Tax Forum in Ottawa.

Under the EU Directive, Belgium, Luxembourg and Austria were exempted from automatic exchange of information in favour of a withholding tax regime because they refused to end banking secrecy unless Switzerland and other key non-EU countries also agreed.

Antigua said it wanted the OECD to accept that all jurisdictions had the right to choose to apply a withholding tax or "equivalent measures" on offshore accounts – instead of exchanging client information. It also called on the OECD to establish a "genuinely" global forum, under a United Nations umbrella, to set standards for tax competition and financial services regulation.

Antigua's High Commissioner, Ronald Sanders, said: "If Antigua agrees to continue its commitment to the harmful tax competition initiative in circumstances where several OECD countries are not obliged to exchange information, we will be killing our financial services industry. The entire industry will drift to Austria, Belgium, Luxembourg, San Marino, Liechtenstein and Monaco."

Antigua, he said, would continue to co-operate with individual countries in tax information exchange cases under existing bilateral agreements.

St Vincent also called on the OECD to address the problem that countries like Hong Kong and Singapore remain outside the OECD's "harmful tax" competition programme.

Antigua and St Vincent were among 41 countries identified by the OECD in 2000 as engaging in "harmful tax competition". All but five of these have subsequently signed letters of commitment to exchange information in tax cases by 31 December 2005. These commitments were conditional on OECD countries agreeing to apply similar standards.

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Sovereign comment

Antigua and St Vincent have correctly identified the likely effect of the OECD and EU projects on exchange of information: people will simply move their accounts to jurisdictions outside the influence of the OECD and EU. Hong Kong and Singapore certainly seem likely beneficiaries and it is rumoured that several Swiss banks are currently exploring opportunities to open subsidiaries in Singapore. Bahamas is another likely recipient of capital inflow.

Bahamas Investment Funds Act comes into force

The Investment Funds Act 2003, to replace the Mutual Funds Act 1995 and increase regulatory oversight of mutual funds, came into force on 15 December 2003.

The act also creates a new type of fund, known as a 'specific mandate alternative regulatory test' (Smart) fund. A Smart fund will be subject to the minimum amount of direct regulation as it would be limited to defined participants. Smart funds would also have to submit more detailed business plans to the regulator.

Funds currently defined as 'exempt' under existing legislation would be able to become Smart funds under the proposed system by converting to a licensed entity under the Bahamas Securities Commission.

Parts of the tax information exchange agreement (TIEA) signed with the US in January 2002 came into force on 1 January 2004. Under the Tax Information Exchange Act 2003, tax information exchange in criminal matters becomes effective for the tax periods beginning 1 January 2004. Information exchange in civil tax investigations will begin on 1 January 2006. Signing the agreement enabled the Bahamas to maintain qualified jurisdiction (QJ) status under the US tax system for non-US sourced investment income. The US granted the Bahamas provisional QJ status in 2000 on the condition that the country signed a TIEA with the US before the provisional period expired.

Sovereign comment

Whilst the Bahamas has tried to simplify the regulation of mutual funds it seems to have achieved the opposite effect. Most hedge funds now consider Cayman Islands as the premier jurisdiction and, for simpler funds, the BVI seems to be very user-friendly. Sovereign has expertise in both jurisdictions, as well as the Bahamas.

The Bahamas is not alone in signing a TIEA with the US. The US expects to sign such agreements with all offshore jurisdictions before the end of this year. Thus, any country who requires information from an offshore centre can ask the US to obtain it under these TIEAs and then exchange it under existing tax treaties.

KPMG accused over tax shelters

The US Justice Department filed documents in federal court on 4 December 2003 accusing KPMG LLP of continuing to withhold documents related to an Internal Revenue Service (IRS) investigation of the firm's alleged promotion of tax shelters.

It claimed that KPMG's actions "demonstrate a concerted pattern of obstruction and non-compliance, threatening the integrity of the IRS examination process." KPMG has denied that it is a tax shelter promoter and said it was not withholding documents to delay the investigation.

In 2002 the IRS issued some 200 summonses seeking tax shelter-related information from 30 accounting firms and other tax shelter promoters. It also began actions against two accounting firms, KPMG and BDO Seidman, and two major law firms, Jenkens & Gilchrist and Sidley Austin Brown & Wood, to obtain information about activities.

Sovereign comment. Aruba and the US signed a tax information exchange agreement (TIEA) on 21 November 2003. In the last two years, the US has signed tax information agreements with Antigua, the Bahamas, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man, Jersey and the Netherlands Antilles.

China and Hong Kong sign Closer Economic Partnership Arrangement

The "Closer Economic Partnership Arrangement" (CEPA) signed between Hong Kong and China will scrap tariffs on 273 types of Hong Kong exports and liberalise market access for 17 service sectors.

The CEPA covers three broad areas: trade in goods, trade in services, and trade and investment facilitation. The specific commitments in liberalising trade in goods and services under CEPA will be implemented from 1 January 2004.

For goods, exports to the Mainland of "Hong Kong origin" from some 270 tariff classes will enjoy zero tariffs from 1 January 2004, provided they meet CEPA rules of origin requirements. China has also agreed to apply zero import tariff by 1 January 2006 upon applications by local manufacturers for other tariff classes and meeting the CEPA rules of origin. Hong Kong will continue to apply zero tariffs for Mainland products.

For services, CEPA removes market access restrictions for 17 service sectors, including financial services (banking, securities and insurance), for "Hong Kong companies" ahead of China's WTO commitments. "Hong Kong companies" must be registered and established in Hong Kong, pay profits tax, have substantive operations in Hong Kong for a specified number of years, rent or own business premises in Hong Kong, and employ staff locally.

It is possible for foreign companies with operations in Hong Kong, including local subsidiaries of multinationals, to enjoy the benefits of CEPA provided they meet the criteria for being defined as a Hong Kong company.

The CEPA also provides for the promotion of cooperation between China and Hong Kong in seven areas, including electronic commerce, trade and investment promotion, and transparency in law and regulations.

Sovereign comment

The Hong Kong economy seems to be moving forward again after a number of years of stagnation or worse. The CEPA should give it a further boost and help to maintain Hong Kong as the service centre of choice for those doing business in the Far East. For some time it was thought that China wished to try and replace Hong Kong as the regional service centre with Shanghai. We believe that China has now accepted that this is not feasible, primarily because Hong Kong still applies British law to commercial matters. As a result, most international investors prefer to route their investment through Hong Kong and have their arrangements settled under Hong Kong law.

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Hong Kong views exemption for offshore funds

The government has put out for consultation a paper on proposed amendments to exempt offshore funds from profits tax. Offshore funds are currently subject to a 17% profits tax.

The proposal would exempt both fund and non-fund entities that reside outside Hong Kong from tax on income from transactions conducted inside Hong Kong through a broker or investment advisor. Anti-avoidance measures are also proposed.

The exemption proposal was included as part of the 2003-2004 budget, presented last March, and is intended to bring Hong Kong into line with major international financial centres such as New York and London where offshore funds meeting specific requirements are not subject to tax.

Hong Kong signed its first comprehensive tax treaty, with Belgium, on 10 December 2003. Hong Kong has an existing Memorandum of Understanding for avoidance of double taxation with the People's Republic of China but this arrangement does not address the treatment of dividend, interest, and royalty income.

Significant provisions in the Hong Kong-Belgium tax treaty include a qualified exemption from tax on intercompany dividends, a qualified exemption from tax on interest, a reduction in royalty withholding tax rates, and the absence of a limitation of benefits provision.

Indian Supreme Court rules on tax treaty with Mauritius

The Supreme Court of India upheld the validity of a Circular issued by the Indian Central Board of Direct Taxation (CBDT), providing that a certificate of tax residence issued by the Mauritius government should be regarded as sufficient evidence of residence when determining residence for purposes of the India-Mauritius tax treaty.

The decision, handed down on 7 October, effectively sanctions the income tax exemption for capital gains on investments made in India by Mauritius-based companies and overturns a 2002 decision of the Delhi High Court that quashed the Circular.

In its decision, the Supreme Court noted that Circular No. 789 would prevail, even if its provisions were inconsistent with domestic tax law, to the extent that the taxpayer was covered by the provisions of a tax treaty.

The "place of effective management" test for determining residence under the treaty was to be applied only when a taxpayer, other than an individual, was a resident of both India and Mauritius. The granting of a tax exemption in respect of a particular source of income, it said, did not necessarily mean that a qualifying entity was not "liable to tax" in that country. In the absence of a "limitation of benefits" provision, there was nothing in the India-Mauritius treaty prohibiting a resident of a third country from deriving benefits under the treaty. It was a matter for the respective governments to determine whether treaty shopping practices should continue.

Sovereign comment

This judgment must be correct. Tax treaties are supposed to override domestic tax law and are supposed to be absolute in their wording. Most newer tax treaties have "limitation of benefits" provisions within them which mean that only those entities beneficially-owned by residents of the treaty country can benefit from the treaty. Without such a provision it seems right and proper that residents of other countries can "treaty shop" and set up an entity in Mauritius to access the Mauritius/India tax treaty. We still believe that both Dubai and Cyprus offer interesting alternatives to Mauritius. Both jurisdictions have excellent tax treaties with India and tend to be scrutinised to a much lesser degree.

Hong Kong Court gives anti-avoidance ruling

The Hong Kong Court of Final Appeal on 4 December ruled that it was appropriate to disregard the existence of certain corporate stocks that were created solely for tax avoidance purposes.

In *Collector of Stamp Revenue v Arrowtown Assets Ltd.* (FACV no. 4 of 2003), the parties involved in the sale of a company agreed to use a "deferred shares" strategy in an attempt to avoid stamp duty on the transfer. Before the sale, the share capital of the target company was reorganised by the seller so that it consisted of 1,000 ordinary voting shares of HK$0.01 each, and 100,000 non-voting "B" shares of HK$0.01 each. The seller then sold 98% of the ordinary voting stock to the buyer.

The only meaningful right attached to the "B" shares was the right to appoint a director of the company, but the seller's retention of them was the basis for the claim that no stamp duty was payable, under a statutory exemption for share transfers in which at least 90% of the target company's issued share capital continues to be owned by the transferor's corporate group.

There was no doubt that the 100,000 "B" shares represented more than 90 percent of the company's issued share capital, as a legal matter but the Collector of Stamp Revenue argued that they should be disregarded for purposes of the statutory exemption from stamp duty, because they served no purpose other than the avoidance of the duty.

The Court held in favour of the tax authority. According to Lord Millett, "The words 'issued share capital' in the exemption, properly construed, mean share capital issued for a commercial purpose, and not merely to enable the taxpayer to claim that the requirements of the section have been complied with." Therefore, the "B" shares, which were not issued for a commercial purpose, must be disregarded in applying the exemption, he said.

Sovereign comment

As Lord Millett is a member of the UK House of Lords, his analysis in *Arrowtown* of UK case law on tax-motivated transactions may have implications for the UK and elsewhere. *Barclays Mercantile Business Finance v Mawson*, which involves a tax-motivated sale and leaseback of depreciable equipment, is expected to be heard and decided in the UK this year.

Guernsey Court penalises trust company

In *Cohen v Coutts (Guernsey) Ltd & Brugnone*, decided 22 October 2003, Mr C held a joint investment account with his daughter Mrs B at Coutts (Guernsey). He decided to marry again but before doing so wished to ensure that a Guernsey Trust was constituted for his future wife with £1m of assets transferred from the joint investment account.

In early October 1999 he signed documentation to this effect, married Mrs C and went on honeymoon. He died unexpectedly in November. On 15 October 1999, Coutts (Guernsey) had sent instructions to Coutts (Isle of Man) to effect the transfers of the assets to the trust. This instruction was repeated on 18 October but the assets had not been transferred by the time of Mr C's death.

Under the terms of the trust, Mr C's new wife was entitled to payments from it if she survived Mr C by 30 days. Despite her repeated requests no payment was made. Mrs C brought an application in May 2000 and Mrs B brought a separate one in July, questioning whether Mr C could break the joint account.

On 22 October 2001, a consent order dealt with the dispute between Mrs C and Mrs B but reserved the issue of costs between them and Coutts. The Court found that the reason for the non-transfer, the failure of Coutts (Isle of Man) to carry out the instructions, was not revealed until June 2000 and therefore provided the setting for the subsequent litigation in which Mrs C and Mrs B were the principal parties. It held that Coutts' conduct disentitled it to the payment of any of its costs.

As regards the other parties, the Court found that "there was intentional concealment of Coutts' failure to carry out Mr C's instructions, which ... precipitated conflict which Mr C clearly dreaded". It ordered that all of the costs incurred with regard to the applications brought by Mrs C and Mrs B should be borne by Coutts.

Sovereign comment

Many banks are now trying to get out of the trust business as there is a clear conflict of interest between their duty to diversify the investment and their desire to put the investment monies with their own associated companies. We always recommend using an independent trust company which is not subject to any such conflicts and which treats the administration of trusts as mainstream business.

FATF sanctions Myanmar

The Financial Action Task Force (FATF) called on members to apply "counter-measures" to financial transactions involving Myanmar, which was identified by the FATF as a "non-cooperative country or territory" (NCCT) in the fight against money laundering in June 2001.

It said Myanmar had still not addressed major deficiencies in its anti-money laundering regime and, in particular, had failed to establish a framework to engage in effective international cooperation in the fight against money laundering.

The FATF said it would review sanctions against Myanmar at its next meeting in February 2004. Other countries currently identified as NCCTs are the Cook Islands, Egypt, Guatemala, Indonesia, Nauru, Nigeria, the Philippines and the Ukraine.

OECD removes Nauru

Nauru has been removed the OECD's list of uncooperative tax havens after submitting a letter of commitment to exchange information on tax matters through bi-laterally negotiated tax information exchange agreements with OECD member countries.

Nauru will exchange information on criminal tax matters in the first tax year after 31 December 2003. Exchange of information on civil tax matters will become effective for the first tax year after 31 December 2005.

Only Andorra, Liberia, Liechtenstein, the Marshall Islands and Monaco remain on the OECD's list of uncooperative tax havens.

Swiss agree outline deal with OECD over tax practices

Switzerland and the OECD reached a compromise in January over Swiss tax practices identified as harmful by the OECD. After three years of negotiation, an outline settlement was reached on two of three tax practices.

The compromise may also assist separate efforts to persuade Switzerland to co-operate with the OECD's plans for a crackdown on tax evasion through access to banking information. The OECD's fiscal affairs committee said in a 2000 report that three tax practices in Switzerland, focused on administrative, holding and service companies, were regarded as potentially harmful "preferential tax regimes".

They were amongst 47 tax practices identified as harmful by the committee across all member countries because they could enable countries to poach inward investments, and allow companies to avoid tax.

After discussions with the committee, Switzerland has agreed to exchange information with other countries on Swiss-based holding companies. This should ensure that they meet their tax obligations.

Switzerland also agreed to warn Swiss-based service companies they must abide by OECD guidelines on "transfer pricing" activity, which determines how groups allocate profits to their subsidiaries. Many companies use the activity to minimise their tax bills.

The OECD's fiscal affairs committee said it will carry out further analysis of the tax regimes offered to Swiss-based finance and leasing companies. A spokesman said: "The committee has made progress with the Swiss in addressing the issues posed by potentially harmful preferential tax regimes."

But Switzerland still has significant differences with the OECD over access to bank information for tax purposes. Last September Switzerland – together with Austria, Belgium and Luxembourg – refused to support a deadline of 2006 for exchange of banking information that would enable tax authorities to verify the liabilities of people who put funds outside their home countries.

If the dispute is not resolved, it may lead to the collapse of the OECD's Harmful Tax Practice initiative. A total of 32 "tax havens" have made commitments to the OECD to scrap harmful tax practices and to exchange banking information from 2006. But they are insisting on "a level playing field" with the OECD's 30 member countries over transparency.

They have also stressed the need to bring Hong Kong, Singapore and other significant non-OECD finance centres within the scope the initiative. The havens fear their finance industries will migrate to Asia if offshore centres in the region do not make commitments to information exchange.

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EU to amend Mutual Assistance

The European Commission published a proposal to amend the Directive on Mutual Assistance in Taxation (77/799/EEC) which governs exchange of information between member states in cross-border tax investigations.

The Directive deals with three types of tax information exchange – information on request, automatic exchange and spontaneous exchange – between EU members and applies to direct taxes, value-added tax and excise duties.

Under the proposed changes, local tax authorities would no longer be required to notify a taxpayer if they have received a request for assistance from another member state and member states would be permitted to disclose information supplied by the tax authorities of another member state at public hearings or in judgments unless the supplying authority objects.

The proposal would clarify that the Directive does not oblige the tax authorities of a member state to conduct enquiries or supply information that would be contrary to local laws or administrative practices, and that a member state may refuse to supply information if the requesting country is unable to reciprocate.

Sovereign comment. It used to be a principle of international law that tax debts occurred in one country would not be enforceable in another. This is no longer the case. Most countries are cooperating to bring offenders to book and the EU is now formalising its procedures. With good planning none of this need be a concern but those who fail to take proper advice may soon find that there is nowhere to hide.

UK Revenue targets offshore subsidiaries

An Inland Revenue programme to identify companies whose shares are held, in whole or in part, by companies or trusts in offshore financial centres identified about 30,000 UK companies. Shareholders with offshore addresses will be subject to further investigation for possible tax evasion.

The Inland Revenue said the "Offshore Arrangements Project" would undertake a risk assessment of specific offshore schemes to evade tax. It was appointing "offshore consultants" to co-ordinate the identification of shareholders listed in offshore financial centres.

"The department knows that companies in offshore financial centres control thousands of UK companies, whilst many more hold minority shareholdings," it said. "Additionally, a significant proportion of land and buildings in the UK is owned, or has been owned, by offshore companies.

"Those companies will be subject to profiling and risk assessment to identify those that, prima facie, represent the highest risk. Revenue will also seek to identify all transactions in UK land and property where either vendor or purchaser is a non-UK company or individual. These transactions will also be subject to risk assessment."

Sovereign comment

The developed onshore countries are finding a greater need for tax revenue and are therefore targeting any arrangement which they think might be used by their own citizens to illegally evade tax. Obviously anything with an offshore connection is going to lead to further enquiries and any information gathered by the UK may be exchanged with any tax authority in a country with whom the UK has a tax treaty, in the EU or within the OECD. The UK is seemingly committed to stamping out tax evasion, not only by its own residents but also residents of most other developed countries of the world. Good planning based on sound principles is essential if tax is to be mitigated and civil, or even criminal, penalties are to be avoided.

Cayman commits to EU savings tax Directive

The Cayman Islands' assembly voted, on 13 February, to commit to adhere to the European Union's proposed savings tax Directive. The UK overseas territory had formerly been one of the plan's fiercest opponents.

The Directive requires EU members, as well as their dependent or associated territories, to tax cross-border interest payments to EU residents from 2005, or provide the names of account holders receiving interest payments.

The Cayman Islands, the world's fifth-largest banking centre, is highly dependent upon financial services. The hedge fund industry in particular is vulnerable to the Directive. It has been estimated that as many as one in five hedge funds may depart the Caymans for rival centres such as Hong Kong and Singapore.

The Directive was to be implemented by 1 January 2004 and applied from 1 January 2005, provided certain third countries, such as Switzerland, and relevant EU dependent or associated territories agree to apply equivalent or the same measures from the same date.

In the case of associate and dependent territories, the Directive provided for the application of identical measures to those proposed for EU members, either automatic exchange of information or a withholding tax at source.

No such commitment was forthcoming from the Cayman Islands and, in December, the UK threatened to compel it to comply by enacting legislation to force it into line. The Cayman Islands responded by threatening to mount a legal challenge – a course of action which would almost certainly have delayed the Directive's implementation.

But following intensive discussions in London and the Caymans in January. McKeeva Bush, chief secretary of the Cayman Islands, said he was confident that if the talks reached a satisfactory conclusion his administration could introduce legislation to comply with the Directive.

The Caymans is thought to have requested three key concessions in return for complying with the Savings Directive: increased access for Cayman financial instruments to the European market; EU recognition of the Cayman Islands Stock Exchange; and investment in the Caymans airport expansion programme.

"Progress is being made and both parties are co-operating warmly," said Bush. "If discussions proceed as we hope, we are satisfied that the offsetting measures we will agree with (the UK) government will outweigh the costs of implementing the Directive in the Cayman Islands."

But at a meeting of EU economic and finance ministers (ECOFIN) on 10 February, UK Chancellor Gordon Brown repeated a pledge to force the Cayman Islands to follow the directive through legislative action if it didn't sign on voluntarily. It was only three days later that the Cayman Islands' assembly voted to commit.

Differences over the application of the Directive in other associated and dependent territories and over negotiations with third countries emerged during the ECOFIN meeting in November.

"The tide does now seem to be moving irrevocably toward implementation of this EU Directive."

In September, UK Chancellor Gordon Brown had told EU finance ministers that Guernsey, Jersey and the Isle of Man would apply a withholding tax regime similar to that permitted in Austria, Belgium, and Luxembourg.

Jersey proposed to introduce a system "equivalent" to that agreed by Switzerland – taxation at source and exchange of information on demand rather than automatically. This was vetoed by Belgium which contended that associate and dependent territories should be required to introduce "identical" measures.

The Netherlands has now proposed that a standard agreement be drawn up to enable Member States to negotiate separate agreements with associate and dependent territories.

The Directive also provided for the conclusion of agreements with third countries to ensure the introduction of "equivalent" measures. Agreement was reached with Switzerland last March and the European Commission said that reciprocal deals with Monaco, San Marino and Andorra were within reach.

But EU internal market commissioner Frits Bolkestein warned that Liechtenstein remained unwilling to co-operate, and said the Commission had asked the EU to apply pressure.

As we have previously reported in the *Sovereign Report*, the tide does now seem to be moving irrevocably toward implementation of this EU Directive. There are still some wrinkles to iron out, as the above makes clear, but we do not see any of these holding up the implementation of the Directive for too long. After all, the big boys are surely capable of bullying Liechtenstein into submission.

The exchange of information provisions and/or withholding tax will affect anybody who is an EU resident and who holds a bank account in his own name in any EU country, associated territory or the six other territories which have agreed to introduce reciprocal measures, particularly Switzerland and the USA.

Professor William Byrnes of The Sovereign Group has co-authored a 600-page Report for the UK Foreign & Commonwealth Office and selected UK Overseas Territories on the socio-economic impact of the Directive and the EU's business tax Code of Conduct.

The Report presents the most comprehensive statistical survey and analysis of the offshore financial industry and potential areas for development of professional services.

Preliminary findings suggest that the Directive's impact on dependent or associated territories will be limited because it does not apply to companies and other entities. Individual's private accounts may be switched into a corporation or moved to non-EU jurisdictions such as Hong Kong and Singapore.

Professor Byrnes will be discussing the Report at the Royal Society of Fellows' Fourth Annual Conference in Miami on March 25 and 26 (http://www.royalfellows.org/congresses.htm) sponsored by The Sovereign Group and Barclays Bank.

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Tel/Fax. +44 (0)20 7266 9920
Email: report@kamilian.com
Website: www.kamilian.com
Printer: Pioneer Printers Limited
Website: www.pionprint.com.hk

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