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Firstly, and most importantly, we would like to wish all our clients and friends a very happy Christmas and prosperous New Year. As usual, we will not be sending out Christmas cards but rather will be making a suitable donation to charity in lieu.

The Sovereign Asian Contemporary Art Prize 2005

We have discovered that a few of our clients are budding artists and they kindly entered the 2004 Asian Art competition. Entries for the 2005 competition – which has an increased first prize of US$25,000 – will close at the end of the year, so there are only a few weeks to go. If you are a painter and you live in Asia then please do enter. It's all for charity, so please help support charitable artistic causes and help us to make this year's competition an even bigger success than last. Alternatively, if you know any artists or gallery owners then please encourage them to visit our website at www.SovereignArtFoundation.com where they will find details and an entry form.

We are pleased to announce that this year's gala dinner will be sponsored by Bulgari, the luxury Italian jewellers, and Sotheby's will again be doing the auction for us. It promises to be a great event and details and dates will appear in the next issue of this report.

Sovereign Trust (Singapore) Pte Ltd

Our new office was formally opened on Wednesday, 17th November with an informal cocktail party in our premises at 96A Club Street, Singapore 069464. About 70 guests attended for champagne and canapés. Officially the reception ended at 10pm, but some guests seemed to lose track of time and ended up celebrating until 7am in the morning. Thanks to everyone who attended and to Richard Wilson (the Managing Director) for organising the event. The new Singapore office will be providing the usual range of corporate services, but we will also be concentrating on tax planning for Singapore-resident US persons and UK expatriates, particularly those who have lived there for some time and may be able to change their domicile.

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BVI increase government fees

At the time of writing we have just heard that the annual government fee for a standard BVI company has been increased from US$300 to US$360 and, for a company with a higher share capital, the fee has increased from US$1,000 to US$1,200. The fees will take effect from next year. We will be advising our BVI corporate clients accordingly.

UK Inheritance Tax to increase to 50%

A consultation paper is currently circulating which recommends that the top rate of UK Inheritance Tax be increased from the current 40% to 50%. **This affects any UK national even if they have lived abroad for many years. Many UK expatriates are unaware of their continuing liability to UK Inheritance Tax on their worldwide estate, unless and until they have given up their UK domicile.**

I think we can safely say that we are the experts in this area – we have recently completed our 50th application for non-domiciled status. All applications have been successful.

If you are a long term UK expatriate then you should/must look at this area. Contact your nearest Sovereign office for advice.

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

THE 2005 SOVEREIGN ART PRIZE
US$25,000 PRIZE

Reminding ALL ARTISTS that the deadline for entries is
31st DECEMBER 2004
If you are an established and recognised artist who would like to make a valuable contribution to charity then please enter the Sovereign Art Prize.

OBTAIN YOUR ENTRY FORM ON:
www.sovereignartfoundation.com
or CALL +852 2542 1177 or EMAIL on
art@sovereignartfoundation.com

European Commission to update anti-money laundering Directive

The European Commission issued, on 30 June, a proposal to update the EU's existing anti-money laundering Directive. The new proposal would extend anti-money laundering obligations to providers of services to companies and trusts, and life insurance intermediaries. It would go beyond the FATF requirements in bringing within its scope all persons dealing in goods or providing services for cash payment of Euros 15,000 or more.

The proposal sets out much more detailed "know your customer" requirements and, like the FATF Recommendations, would introduce a risk-based approach. Those subject to the Directive would have to concentrate their efforts on higher risk situations rather than duplicating customer identification procedures. For the sake of clarity the existing 1991 Directive, as amended in 2001, would be repealed and replaced by a new autonomous text.

The proposal will be forwarded to the European Parliament and the EU's Council of Ministers for adoption under the so-called 'co-decision' procedure. Internal Market Commissioner Frits Bolkestein said: "The June 2003 revision of the Forty Recommendations of the Financial Action Task Force (FATF), has strengthened the world anti-money laundering standard and extended the rules to cover the financing of terrorism. The EU Directive must match that standard and ensure its co-ordinated application in the enlarged Union".

The 1991 EU Directive concentrated on combating the laundering of drugs proceeds through the traditional financial sector. It was extended in 2001 to cover the proceeds of a much wider range of criminal activities and a number of non-financial activities and professions, including lawyers, notaries, accountants, estate agents, art dealers, jewellers, auctioneers and casinos.

The Dutch Presidency of the Council from July to December 2004 has indicated that it will give priority to this proposal and technical discussions are due to begin imminently.

Sovereign comment

Professionals are now becoming the policemen of the world. We are already under a duty to report details of suspicious transactions, which would include any transaction that is not fully explained. Clients often question why we need such comprehensive details about business undertaken by a company under our management and control, but this Directive further highlights the need for such details. It will represent a huge cost for the financial services industry. Eventually these costs will be passed on to the client but for now, as far as possible, they are being absorbed by organisations such as Sovereign.

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Harrods' owner loses tax appeal

Harrods' owner Mohamed Al Fayed lost his appeal to overturn a Scottish court ruling which removed his special tax status. Al Fayed and his two brothers, regarded by the Inland Revenue for tax purposes as resident but not domiciled in the UK, agreed voluntarily in 1997 to pay a fixed sum of £240,000 annually until 2003. But in 2000, the Inland Revenue returned Al Fayeds' payment and cancelled it.

In the original Court of Session ruling in May 2002, Lord Gill said the Inland Revenue was wrong to agree a "forward tax" agreement. "In a true sense the Al Fayeds thereby became a privileged group who are not so much taxed by law as untaxed by agreement," he said.

Al Fayed challenged the ruling but Lord Cullen, Lord Kirkwood and Lord MacLean backed the initial decision. Al Fayed said he intends to take the case to the House of Lords.

Sovereign comment. It is difficult not to have some sympathy with Mr Al Fayed. The Inland Revenue did agree a special tax status with him and it seems reasonable for him to be able to rely upon that agreement. Treating him more harshly could, and did, result in him leaving the UK – he now lives in Switzerland – and resulted in a loss of revenue to the country. We await the House of Lords decision with interest.

Isle of Man extends protected cell structures to funds

The protected cell companies (PCCs) structure, introduced by the Protected Cell Company Act 2004 for use by insurers, was extended to certain collective investment schemes as of 1 August 2004.

The Protected Cell Companies (Prescribed Class of Business) (Collective Investment Schemes) Regulations 2004 provide for funds constituted as International Schemes, including Experienced Investor Funds and Professional Investment Funds but excluding Exempt International Schemes, to incorporate as, or convert into, protected cell companies.

The Isle of Man government said the PCC concept, which provides statutory segregation through cells within a company into which separate assets may be placed, would be of particular value for schemes that have a series of sub-funds. The liabilities of each cell are legally ring fenced, giving protection from risk arising from gearing, or otherwise, in other cells.

The Financial Supervision Commission has reduced fees for companies applying to redomicile to the Isle of Man under the Companies (Transfer of Domicile) Act 1998 to £300, effective from the 1 August 2004. The fees to redomicile out of the Isle of Man remain unchanged.

The Income Tax (Amendment) Bill 2004, which provides the Assessor with additional powers to obtain information, including documents and information required to enable the Island to comply with international commitments, has received Royal Assent.

Sovereign comment

The Isle of Man professional investor legislation allows for the simple and cheap creation of investment funds that can be sold only to knowledgeable or professional investors. This new legislation will further enhance the attractions of the Isle of Man for this type of fund.

The ability to redomicile in and out of a jurisdiction is useful. The Isle of Man has long since allowed redomiciliation in and out of the jurisdiction but has made the fees very uncompetitive. The fees to redomicile out of the Isle of Man remain expensive but only a fraction of those experienced in the Channel Islands.

BVI sets out procedures to restrict bearer shares

Legislation to restrict the transferability of bearer shares and make them subject to anti-money laundering and due diligence requirements has been passed and is in the process of being brought into force. But, for existing IBCs, there will be a lengthy period before the new rules become effective.

The International Business Companies (Amendment) Act requires holders of bearer shares to register them with licensed financial institutions and keep information on directors within the BVI. The registers will be private, not public.

IBCs incorporated before 1 January 2005 which have the power to issue bearer shares, even if they have not actually issued any bearer shares, will be subject to an increased licence fee from 2008. Any bearer shares in issue will eventually have to be lodged with licensed custodians, but not until 31 December 2010.

For IBCs incorporated on or after 1 January 2005, an increased government incorporation fee of US$1,000 will be payable immediately for any companies which have the power to issue bearer shares, even if bearer shares have not been issued. Any bearer shares that are issued will have to be lodged with licensed custodians immediately on issue.

The BVI government has set up a Financial Investigation Agency (FIA) to investigate financial crime. The agency was established as an independent body under the Financial Investigation Agency Act (2003), which was brought into force on 1 April 2004.

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The agency's functions will include the processing of requests for legal assistance from international judicial and law enforcement bodies. It will also be responsible for collecting, analysing and investigating suspicious transaction reports filed under the Proceeds of the Criminal Conduct Act. It takes over from the Royal Virgin Islands Police Force.

Sovereign comment

For a long time we have been advising against the use of bearer shares. We don't believe that those who hold them fully understand the implications and we frequently come across clients who have lodged them with lawyers or held them in high tax countries. Either way the client is vulnerable. Lodging bearer shares with a lawyer makes him the proper owner of the shares or perhaps the trustee of them without any written document suggesting the terms of the trust. Holding them in a high tax jurisdiction probably makes them subject to inheritance tax in that jurisdiction because they become property situated in the jurisdiction. Attempts to use bearer shares to by-pass the normal probate procedures will almost certainly be risky and probably an inheritance tax fraud on the home country tax authority. We believe that bearer shares can have a place but their legitimate uses are few and far between.

IRS wins right to seek credit card information

A US District Court granted the Internal Revenue Service (IRS) the right to seek information from First Data Corporation about certain credit card transactions the company has processed in a ruling of 2 August 2004. Colorado-based First Data processed 12.2 billion payment transactions in 2003.

The IRS is seeking information about holders of American Express, Visa and MasterCard credit cards that were issued by, or on behalf of, certain financial institutions based in more than 30 offshore jurisdictions, including Aruba, the Bahamas, Bermuda, the Cayman Islands, Hong Kong, Singapore and Switzerland. The IRS is targeting people who held such accounts between 31 December 1999 and 31 December 2003.

Sovereign comment. An offshore-based credit card can be used quite legitimately to pay the business expenses generated by an executive working on behalf of an offshore company. They should never be used as a means of drawing cash or paying personal bills without the employee declaring those payments in his country of tax residence. Sovereign offers its own Mastercard but strongly dissuades its clients from irresponsible use of such card.

Caribbean Court of Justice to begin operations

The first President of the Caribbean Court of Justice (CCJ), the Right Honourable Justice Michael de la Bastide of Trinidad and Tobago was sworn in on 18 August. The new Court was scheduled to begin operations in November 2004 as the final court of appeal for 13 countries.

The CCJ will replace the Judicial Committee UK Privy Council, which currently serves as an appeals court for some UK Commonwealth countries and Overseas Territories, and as the final court of appeal for Caricom members.

An agreement to establish the CCJ was signed by 13 of the 15 Caricom members and entered into force in 2002. They are Antigua, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Haiti, St Kitts and Nevis, Saint Lucia, St Vincent, Suriname, and Trinidad & Tobago.

The Court will function in two jurisdictions – an original and an appellate. In its appellate jurisdiction, the Court will apply the laws of the Member States from which they are hearing appeals. In the exercise of its original jurisdiction, the CCJ will perform the role of an international Court, applying rules of international law.

Sovereign comment

We prefer jurisdictions where the ultimate Court of Appeal is still the UK Privy Council as we believe this is the best guarantee of the quality of the decisions made and the strict application of principles of UK law. For this reason we still favour the Caribbean jurisdictions of the Cayman Islands, Turks & Caicos Islands, British Virgin Islands and the Bahamas over and above the 13 jurisdictions which have signed up to the CCJ.

China issues report into economic impact of OFCs

Offshore financial centres (OFC) have become important sources of foreign investment into China, according to a recent report by a research group in the Chinese Academy of International Trade & Economic Cooperation (CAITEC), a part of China's Ministry of Commerce (MOC). By actual investment amount, the British Virgin Islands ranked the second largest source of foreign investment for Mainland China in 2002 and 2003. Western Samoa and the Cayman Islands came eighth and ninth.

Dr Mei Xinyu, author of the report, noted that China could not afford to neglect the effect of OFCs on cross-border capital flow in China. He identified the five principal motives as: the removal of non-performing assets; obtaining an overseas listing; avoiding domestic controls; concealing beneficial ownership; and tax avoidance.

He also noted the considerable "negative impact" and "potential risks" posed to China by the rise of OFCs. In particular he warned that OFCs could: provide an "effective avenue" for embezzling state-owned assets and public properties; create a "transit depot" for capital flight from China; increase potential disputes over investment; facilitate fraud by companies; and make it easier to shift financial risks.

The report recommends that China should take preventative action by: improving the monitoring of capital flow; restricting the provision of offshore financial services in the mainland; stepping up financial regulation to inhibit the shifting of overseas financial risks to China; loosening control of capital flow to facilitate cross border business operations; annulling preferential treatment for foreign businesses; and improving the tax system.

China and South Africa have accepted the offer of full observer status in the OECD's Fiscal Affairs Committee (CFA). They join Argentina and the Russian Federation as permanent observers and took up their new role during meetings in June in Paris. CFA chairman Bill McCloskey said: "This will enable both countries to participate in the work of the CFA more closely in all its aspects and also provide CFA member countries with access to the views of, and developments in countries which have a leadership role in the regions."

Sovereign comment

Sovereign is currently examining the possibility of opening an office in either Beijing or Shanghai. Many of our competitors in Hong Kong have already established a presence in China earlier this year. Of course, offshore companies can be used positively to encourage foreign investment as well as for the negative reasons listed in the above article. A responsible company manager will always ensure that companies they assist in incorporating are used for the former.

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Mauritius to reform financial services legislation

Finance Minister, Pravind Kumar Jugnauth, announced a major reform of financial services legislation in his budget speech on 11 June. New bills are to be introduced to regulate the accounting, securities and insurance sectors, and to provide for limited partnerships and corporate insolvency.

The Ministry of Finance has also published draft versions of three new bills to regulate the financial sector: a Banking Bill 2004 to amend and consolidate the laws relating to banks and other financial institutions; a new Bank of Mauritius Bill to repeal and replace the law establishing the Bank of Mauritius; and an Investment Promotion (Miscellaneous Provisions) Bill to amend the Investment Promotion Act and provide for the streamlining of licensing procedures.

Sovereign comment. Mauritius has been very active in promoting new legislation and changes in practice and procedures. The authorities suggested recently that the practice of keeping ready-made companies should cease. We naturally expressed some dismay at this and have subsequently found a way whereby we can retain a limited number of shelf companies – but it was a strange move for an international finance centre.

Niue to close offshore financial centre

The government is to shut down its international business companies (IBC) Registry by the end of 2006, according to Nuie's international business registrar, Panama-based Mossack Fonseca & Co. Legislation to prohibit the incorporation of new IBCs in Niue is due to be enacted later this year or in early 2005.

The rights and legal capacity of currently incorporated companies will remain unchanged until the end of 31 December 2006. By that time, IBCs must either have redomiciled to other jurisdictions or become domestic Niue companies. Companies that fail to do so will cease to exist when the offshore registry is closed.

"Our recommendation is to continue (redomicile) Niue IBCs to other jurisdictions," said Mossack Fonseca. The announcement of the closure of its offshore centre follows the government's decision not to renew four offshore banking licenses.

Niue, which launched offshore centre activities in 1996, has been under pressure by the Financial Action Task Force and the OECD to combat money laundering and end "harmful" tax practices. In April 2002, the government made a commitment to exchange information with overseas tax investigators. The FATF also removed Niue from its money laundering blacklist in October 2002 after the government made changes to its financial sector legislation.

Sovereign comment

Domestic Niue corporations pay tax at a rate of 30% on worldwide income so it is unlikely to be attractive for an IBC in Niue to become a domestic corporation. Sovereign has, upon request, occasionally formed Niue corporations, but Niue was never a jurisdiction that we favoured. We agree with Mossack & Fonseca that redomiciling out of the jurisdiction would be the preferred option and can assist any clients with Niue IBCs to achieve this.

ECJ rejects different treatment for foreign shares

The European Court of Justice held that tax credit discrimination was a clear breach of the EU treaty. As a result, individual and corporate taxpayers in some States may be able to reclaim tax already paid on cross-border dividends.

Petri Manninen, a Finnish taxpayer, owned 2,000 shares in a company quoted on the Stockholm Stock Exchange. He complained that his dividend income would have been virtually free of tax if the company had been Finnish but, because it was based in Sweden, was taxed at the full rate of 29%.

Manninen, who was supported in court by the European Commission, argued that, because dividends are simply distributed profits, the refusal to allow a tax credit against income on which corporation tax had already been paid was a form of double taxation – even though the initial tax payment had been made in another Member State.

Manninen was opposed by the Finnish government, which was backed by France and the UK. They argued that discriminatory taxation was justified by the need to maintain the cohesion of national tax systems; that tax revenue would be reduced if double taxation was outlawed; and that equal treatment of domestic and non-domestic dividends was impossible in practice because of differences in national tax systems.

The court disagreed. It found that denying tax credits on non-domestic dividends did amount to double taxation because corporation tax had already been paid in another Member State. The court said it was perfectly possible to devise systems for assessing the relevance of tax, and added that "possible difficulties in determining the tax actually paid can not ... justify an obstacle to the free movement of capital."

Sovereign comment

Although the ruling is technically a preliminary judgment, the text signals quite clearly that the court will not tolerate discriminatory tax systems that have the effect of deterring people in one Member State from investing capital in companies based in another. The implications are significant.

The discriminatory tax credit system is already being challenged in the UK High Court in a number of class actions brought by corporate shareholders in companies based in other Member States. The ECJ ruling suggests that the litigants will ultimatlely be successful. Individual taxpayers should start to claim tax credits immediately.

Privy Council applies Ramsay doctrine

The UK Privy Council, sitting as the final court of appeal in Jamaica, applied the *Ramsay* doctrine in ruling that a firm must pay transfer tax arising from a transfer of shares in a company in exchange for a debenture.

In the case of *Carreras Group Ltd v The Stamp Commissioner*, on 1 April 2004 (Appeal No. 24 of 2003), Carreras had transferred its shares in the Jamaica Biscuit Company in 1999 to Caribbean Brands, a subsidiary. Caribbean issued a debenture in favour of Carreras for a total of US$37.7 million, which was redeemed for cash 14 days later. The debenture was not secured, nor was it transferable.

The Stamp Commissioner found that the transaction was really a sale of shares disguised to look like a re-organisation. Accordingly transfer tax amounting to J$110 million was charged. Carreras challenged the finding.

The Revenue Court ruled in Carreras' favour in November 2001 and ordered the Commissioner to repay the sum with interest. The Commissioner appealed. By a majority decision, the Court of Appeal held in July 2002 that transfer tax was payable. Carreras appealed to the Privy Council.

The Privy Council followed the line in *Ramsay v Inland Revenue Commissioners* [1982] AC 300, which held that the courts can disregard the significance of individual steps that are incompatible with the commercial unity of a series of transactions. It agreed with the Court of Appeal that, taken as a whole, the transactions could not be appropriately characterised as an exchange of shares for a debenture.

Sovereign comment

We agree that this case falls firmly into the *Ramsay* doctrine. Artificial steps were inserted into a commercial transaction to achieve the desired tax advantage. Possibly the taxpayer will look back and think it was worth having a try. The choices are to pay the tax or devise a scheme which, in theory, mitigates that tax. There are obviously costs involved in defending an action by the Revenue but if you don't try you cannot succeed.

FATF removes Guatemala from non-cooperative list

The FATF has removed Guatemala from its list of non-cooperative countries and territories (NCCTs) because it has addressed the deficiencies identified. It welcomed the progress made by the Cook Islands, Indonesia, Nigeria and the Philippines in addressing deficiencies but said that, until necessary reforms had been sufficiently implemented, scrutiny of transactions with these jurisdictions continued to be necessary.

With respect to jurisdictions de-listed prior to June 2003 but still subject to monitoring, the FATF said it would now end formal monitoring of Grenada and St Vincent & the Grenadines. It would however continue to monitor the situation in the Bahamas, because concerns persisted regarding the ability to provide adequate international co-operation.

Counter-measures imposed against Nauru and Myanmar in 2001 and 2003 are to continue pending the cessation of offshore banking and effective international judicial co-operation respectively.

Sovereign comment. No big surprises here. The same culprits continue to ignore the FATF guidelines and are now suffering the consequences. The real practical consequence is that any resident company or individual from an NCCT will find it rather difficult to open bank accounts outside their own territory and generally gain access to the world's financial systems.

EU Savings Tax Directive delayed for six months

The EU Savings Tax Directive for the exchange of information between member states on interest and other investment income paid through bank accounts held by non-residents was due to enter into force on 1 January 2005, but has been delayed for six months.

Implementation was contingent upon Switzerland and other European tax havens agreeing to levy a withholding tax on the income paid to accounts held by EU residents from that date. This was to take the place of information exchange for those countries that wished to retain bank secrecy.

After a long round of negotiations, a provisional agreement for Switzerland to withhold tax was reached last year, but in recent months Switzerland cast doubts on its ability to ratify the treaty in time for it to be able to take effect at the beginning of next year. It said it might even be necessary to hold a referendum.

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Since the banks and tax authorities need up to six months preparation time before the system goes fully operational, the European Council decided to delay EU implementation of the Savings Tax Directive for six months, until 1 July 2005, and to ask the European Commission to keep the situation under review.

The other non-member states affected – Andorra, Liechtenstein, Monaco, San Marino, and the British and Dutch overseas territories – are to be informed accordingly. The Commission has "indicated" that Switzerland will be able to meet the new deadline, although the Council has established a provision for further six-monthly extensions in case it does not.

Sovereign comment

We referred to the agreement between Switzerland and EU on page 3 of Report No. 18. We now have confirmation of the intended effective date of the EU Savings Tax Directive being 1st July 2005. The Swiss parliament has yet to ratify the agreement and may still choose to hold a referendum on the matter.

We continue to monitor the situation closely but it does seem certain that the directive will be implemented in one form or another very soon. Putting a personal account into a corporation name would mean the directive no longer applies but would not relieve the beneficial owner from whatever duties he currently has to declare the underlying income of an offshore structure in his home country. We can give comprehensive advice on every aspect upon request.

Jersey outlines new corporate tax system

The government announced plans to introduce a new tax strategy that will cut headline corporate tax from 20% to zero, and to 10% for finance institutions. The loss of revenue is the made up by a sales tax, public expenditure cuts and plans to grow the economy by 2% a year.

Intended to end discrimination between the taxation of offshore and domestic companies and therefore meet OECD and EU concerns over “harmful tax competition”, the new system will be phased in over a five-year period. At present exempt companies registered in Jersey do not pay income tax on overseas income, while international companies pay between 0-2% on international income and 30% on local income. Local companies pay the standard tax rate of 20% on income.

Sovereign comment. Jersey is following the Isle of Man in reducing corporate tax to zero for most businesses. In previous reports we have referred to the fact that pressure has been brought to bear on OFCs that treat companies owned by residents differently from those owned by non-residents. The pressure has been to remove those distinctions and Jersey is falling into line.

Agassi wins tax match with UK Revenue

US tennis star André Agassi has won a return match with the UK Revenue, after the UK Court of Appeal held in November that section 555(2) of the Income & Corporation Taxes Act 1988, which applies to entertainers and sportsmen not resident in the UK, should not be given extraterritorial effect.

The Court of Appeal ruled that Agassi was not liable to UK tax on income paid by German sportswear makers Nike and Head Sports to his US-based company, Agassi Enterprises Inc., because none of them was resident or had a "tax presence" in Britain.

Agassi's appeal was based on his tax liability for the year 1998-99, which the Revenue had assessed at £27,500. In the High Court, Mr Justice Lightman had held that payments Agassi received while playing in the UK from Agassi Enterprises Inc., constituted the carrying on of a trade within the UK.

He noted that sections 555 and 556 were intended to prevent entertainers and sportsmen from avoiding the tax on income earned in the UK. It would be "absurd" to construe the Act so as to allow tax to be avoided by the simple expedient of channeling payments through a foreign company with no presence in the UK. "If this were the case, the tax would effectively become voluntary," he said.

But the Court of Appeal disagreed. It held that tax was only chargeable on payments made directly to the entertainer or sportsperson or made to an associated company by a person with a UK tax presence. As the Act stood, the situation was not "absurd or an invitation to tax evasion" and came nowhere near to providing grounds for disapplying the general principle that UK statutes had no effect in foreign countries. The Inland Revenue is to petition the House of Lords for leave to appeal.

Sovereign comment

As things stand, UK Revenue could now be faced with having to repay up to half a billion pounds to various entertainers and sportspersons who have worked in the UK since the 1988 Act came into force. This demonstrates that such people, who often generate much of their income from the exploitation of their image rights, can achieve substantial tax reductions by structuring those rights correctly.

OECD revises information exchange in Model Tax Convention

The OECD's Committee on Fiscal Affairs agreed on new provisions for the exchange of information between national tax authorities on 1 June 2004. Article 26 of the OECD's Model Tax Convention on Income and on Capital has been changed to clarify that Contracting States should obtain and exchange information, irrespective of whether they also need the information for their own tax purposes, and to prevent bank secrecy from being used as a basis for refusing to exchange information.

The key changes in Article 26 are:

- a new paragraph has been added to prevent "domestic tax interest" requirements from hindering exchange of information. A domestic tax interest requirement refers to laws or practices that would prohibit one treaty partner from obtaining or exchanging information requested by another treaty partner unless the requested treaty partner had an interest in such information for its own tax purposes.

- a new paragraph has been added to ensure that ownership information and information held by banks, financial institutions, nominees, agents and fiduciaries could be exchanged, irrespective of bank secrecy rules.

- the confidentiality rules in Article 26 have also been changed to permit disclosure of information to "oversight authorities" that supervise tax administration and enforcement authorities as part of the general administration of the government of a contracting state.

The OECD said the changes were the first comprehensive revision of the Model Tax Convention's exchange of information provisions since 1977, and were consistent with the 2002 Model Agreement on Exchange of Information in Tax Matters, which was developed jointly with a number of non-member economies committed to the principles of transparency and effective exchange of information.

Bill McCloskey, chair of the OECD's Committee on Fiscal Affairs, said an increasing number of taxpayers are engaging in cross border activity, and tax authorities needed an effective legal mechanism for obtaining information from their treaty partners to ensure compliance with the tax laws.

"Article 26 now reflects the new international standard of information exchange in tax matters," McCloskey added. "The vast majority of OECD member countries already meet the new standard and I am looking forward to other countries, both inside and outside the OECD, moving towards the standard of information exchange now found in Article 26."

Article 26 is amended as follows:

1. The competent authorities of the Contracting States shall exchange such information as is ***forseeably relevant*** for carrying out the provisions of this Convention or ***to the administration or enforcement*** of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under ***paragraph 1*** by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in ***paragraph 1, or the oversight of the above.*** Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

"Article 26 now reflects the new international standard of information exchange in tax matters."

3. In no case shall the provisions of paragraphs 1 ***and 2*** be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).

4. ***If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.***

5. ***In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.***

Austria, Belgium and Luxembourg reserved the right not to include paragraph 5 in their conventions. Switzerland reserved its position on paragraphs 1 and 5, other than in cases involving acts of fraud subject to imprisonment under the laws of both Contracting States.

Sovereign comment

This is yet another example of the increasing intolerance of tax evasion and is designed to oblige jurisdictions to reveal information that the OECD believes is required for its Member States to tax their residents properly. The OECD has successfully induced "tax havens" to introduce exchange of information upon request, the EU is forcing its Members and their territories – which include most Offshore Financial Centres (OFCs) – to provide automatic exchange of information on savings, and the US has now signed Tax Information Exchange Agreements (TIEAs) with most OFCs. This new clause in the OECD Model will enable greater access to tax information. Confidentiality is dead and should not (and never should have been) relied upon to achieve tax objectives. There are many legitimate ways of achieving a beneficial tax result, but they are undoubtedly more complex than simply relying on confidentiality.

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information

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contact

Bahamas: Alan Cole
Tel: +1 242 322 5444
Fax: +1 242 325 8445
bh@SovereignGroup.com

British Virgin Islands: Susannah Musgrove
Tel: +1 284 495 3232
Fax: +1 284 495 3230
bvi@SovereignGroup.com

Cyprus: Vassos Hadjivassiliou
Tel: +357 22676519
Fax: +357 22679079
cy@SovereignGroup.com

Denmark: Jan Eriksen
Tel: +45 44920127
Fax: +45 43690127
dk@SovereignGroup.com

Germany: Dr Norbert Buchbinder
Tel: +49 (0)911 92668–30
Fax: +49 (0)911 92668–39
de@SovereignGroup.com

Gibraltar: Mike Jones
Tel: +350 76173
Fax: +350 70158
gib@SovereignGroup.com

Sovereign Asset Management Ltd Chris Labrow
Tel: +350 41054
Fax: +350 41036
sam@SovereignGroup.com

Hong Kong: Michael Tsang
Tel: +852 2542 1177
Fax: +852 2545 0550
hk@SovereignGroup.com

Isle of Man: Paul Brennock
Tel: +44 (0)1624 699800
Fax: +44 (0)1624 699801
iom@SovereignGroup.com

Malta: Mark Miggiani
Tel: +356 21 339 218
Fax: +356 21 322 531
ml@SovereignGroup.com

Mauritius: Ben Lim
Tel: +230 208 1747
Fax: +230 208 1736
mu@SovereignGroup.com

Netherlands: Susan Redelaar
Tel: +31 (0)20 428 1630
Fax: +31 (0)20 620 8046
nl@SovereignGroup.com

Portugal: Nigel Anteney-Hoare
Tel: +351 282 340480
Fax: +351 282 342259
port@SovereignGroup.com

Singapore: Richard Wilson
Tel: +(65) 6222 3209
Fax: +(65) 6222 1525
sg@SovereignGroup.com

South Africa, Cape Town: Timothy Mertens
Tel: +27 21 418 4237
Fax: +27 21 418 2196
sact@SovereignGroup.com

South Africa, Johannesburg: Alex Burger
Tel: +27 11 886 7728
Fax: +27 11 781 3083
sajb@SovereignGroup.com

Spain: Richard Melton
Tel: +34 952 764168
Fax: +34 952 825637
spain@SovereignGroup.com

Turks & Caicos Islands: Tennille Darville
Tel: +1 649 946 2050
Fax: +1 649 946 1593
tci@SovereignGroup.com

United Arab Emirates: Kevin O'Farrell & Cecilia D'Cunha
Tel: +971 4 3976552
Fax: +971 4 3978355
dubai@SovereignGroup.com

United Kingdom: Simon Denton
Tel: +44 (0)20 7389 0555
Fax: +44 (0)20 7930 1151
uk@SovereignGroup.com

Sovereign Group Partners LLP Gerry Scanlon, Neil Pidgeon & Hugh de Lusignan
Tel: +44 (0)20 7389 0655
Fax: +44 (0)20 7930 0502
capital@SovereignGroup.com

Sovereign Accounting Services Stephen Barber
Tel: +44 (0)20 7389 0644
Fax: +44 (0)20 7930 4749
sas@SovereignGroup.com

United States of America: William H. Byrnes
Tel: +1 (305) 579 5344
Fax: +1 (305) 579 5345
usa@SovereignGroup.com

Sovereign Education William H. Byrnes
Tel: +1 (305) 474 2468
Fax: +1 (305) 474 2469
edu@SovereignGroup.com

Uruguay: Noel Otero
Tel: +598-2 900 3081
Fax: +598-2 900 1932
uy@SovereignGroup.com

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