SOVEREIGN

report

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Purchase a bit of art history?

Opposite is a picture of "Moonrise, Tai Ping Shan" by Jeffrey du Vallier d'Aragon Aranita, which won first prize in last year's inaugural Sovereign Asian Art Prize. With the kind assistance of Jeffrey, we have produced a print of his winning painting. The edition has been strictly limited to a total of 33 and each print has been signed and numbered by the artist.

There are a few prints remaining and these are priced at £1,500 each and come with a certificate of authenticity. All proceeds go to aid the work of The Sovereign Art Foundation Limited, which is a Hong Kong registered charity. If anybody would like to purchase a print then please email Tiffany Pinkstone on tpinkstone@SovereignArtFoundation.com and help us to help charity.

The Foundation will auction off this year's finalists at a charity dinner to be held in Hong Kong on 20 May. A few tickets are still available. Please contact Tiffany if you would like to come. It will be a great evening. We promise.

chairman

Launch of European Art Prize

On 7 April, The Sovereign Art Foundation hosted a party at the Hayward Gallery in London to launch the Sovereign European Art Prize. This will work on similar lines to the established Asian version but carries a first prize of Euros 25,000.

Details of the new prize will appear on www.SovereignArtFoundation.com but, as with the Asian prize, it is designed to raise money to aid the charitable work of the Foundation.

As always, we have been helped by many and varied organisations but would welcome further assistance from our friends, colleagues and clients. If anybody is feeling generous they can help by nominating an artist who they feel should enter the prize, give us any practical assistance that they can, make a donation or simply purchase one of the prints.

Sovereign Trust (Switzerland) LLC

We have established a new office in Switzerland. The office is located in Zurich and is headed up by Stuart Denness, who was formally with HSBC in Jersey. Our Swiss office will offer the full range of Sovereign services and contact details are listed in the directory at the back of this report.

Hong Kong Budget

The only item worthy of note in this year's budget was the announcement that Hong Kong estate duty will shortly be abolished. The intention is to make Hong Kong a more competitive jurisdiction in terms of asset administration. The abolition will be welcome. Hong Kong estate duty was always relatively simple to avoid so it was really something of a voluntary tax anyway, but getting rid of it makes things much more straightforward.

UK Budget

There was very little in the recent UK Budget to cause a stir. The Inheritance Tax (IHT) threshold is to be increased, by more than inflation, to £275,000. But as the average price of a house in the south-east of England now exceeds £363,000, this will hardly generate excitement, especially as it is accompanied by a large number of measures designed to counteract schemes to avoid IHT being payable on the family home.

Apart from IHT, the Chancellor announced that he would be further targeting tax avoidance in general. We would remind our clients that it pays to seek advice before implementing any tax saving scheme. You know where to come for that 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

EU forces end to Gibraltar "exempt" regime

The UK government has formally notified the European Commission that the Gibraltar exempt company regime will be phased out by 2010. The announcement, on 18 February, followed the threat of legal action by the Commission.

The regime was one of 66 measures identified across all Member States and their dependent and associated territories as constituting harmful tax competition in 1999 under the EU Code of Conduct for business taxation. Prohibited from trade within Gibraltar, "exempt" companies, were subject to a fixed annual tax of between £225 and £300, and paid no income tax on profits. The standard rate of tax on profits for companies resident in Gibraltar is 35%.

The new agreement provides that the total number of exempt companies will not exceed 8,464 and existing exempt companies will continue to benefit from their tax-exempt status until 31 December 2010, unless they change ownership or activity. Companies changing ownership or activity before 30 June 2006 will continue to benefit from tax-exempt status until 31 December 2007. Any change after that date will result in loss of tax-exempt status.

New exempt companies can be formed up to 30 June 2006, but the number will be limited during 2005 to 60% of the number of exempt companies leaving the register over the same period. And, from January to June 2006, to 50% of the number leaving or the number of exempt companies admitted in 2005. New exempt companies will only benefit from their tax-exempt status until 31 December 2007.

Chief Minister Peter Caruana described the deal as a "reasonably good arrangement, which avoids the worst consequences for Gibraltar". It delivers "absolute legal certainty" to exempt companies, he said, and enables the finance centre to continue operating, pending the European Court of Justice ruling on regional selectivity. The ECJ is expected to issue that ruling before the exempt companies' 2010 deadline and, by then, alternative arrangements will be in place.

Sovereign comment

Gibraltar will devise another system of taxation that will be in compliance with both EU and OECD requirements before the expiry of the deadline on exempt companies. But, existing legislation in Gibraltar still provides for a non-resident company that pays no tax in Gibraltar provided: a) central management and control is exercised outside Gibraltar; b) it is wholly owned by non-residents; c) has no Gibraltar-source profit; and d) does not remit foreign profit to Gibraltar.

In practice, the directors of such a company should be resident somewhere fiscally neutral outside Gibraltar and the bank account should also be outside Gibraltar. There do not seem to be any moves to alter this regime. Such companies are not as convenient as an exempt company to administer, but they do have the advantage of being cheaper as they do not pay any flat rate duty to the government.

europe 20

Andorra joins OECD Global Forum

The Principality of Andorra has accepted the OECD's invitation to participate in the Global Forum on Taxation reviewing issues of transparency and effective exchange of information.

The Global Forum brings together representatives of more than 60 OECD and non-OECD governments to work toward establishing a global level playing field in terms of transparency and exchange of information in tax matters. Its next meeting is expected to take place in November 2005 in Australia.

Bill McCloskey, Chair of the OECD's Committee on Fiscal Affairs and Co-Chair of the Global Forum, said: "We see this as a positive step towards better cooperation and look forward to Andorra's participation in the process."

Sovereign comment. Andorra is one of the few "tax havens" which has yet to make a commitment to the OECD to curb its "harmful tax practices". In particular, it has not committed to introducing exchange of information. The OECD has said that it intends to ask its membership to implement counter measures against any territory that refuses to cooperate with its initiative on harmful tax practices. No counter measures have yet been implemented so it appears as though, for the moment, that was an empty threat. We presume that they wish to give Andorra every opportunity to make the necessary commitment and Andorra seems to be working towards that by joining the Global Forum.

FATF releases Special Recommendation IX

The Financial Action Task Force (FATF) has added a new measure to global counter-terrorist financing defences. Special Recommendation IX, states that countries should have measures in place to detect the physical cross-border transportation of currency and bearer negotiable instruments, including a declaration system or other disclosure obligation.

They should also ensure that their competent authorities have the legal authority to stop or restrain currency or bearer negotiable instruments that are suspected to be related to terrorist financing or money laundering, or that are falsely declared or disclosed. Countries should ensure that effective, proportionate and dissuasive sanctions are available to deal with persons who make false declarations or disclosures.

In cases where the currency or bearer negotiable instruments are related to terrorist financing or money laundering, countries should also adopt measures, including legislative ones, to enable the confiscation of such currency or instruments.

Sovereign comment

Recommendations by the FATF have no legal force or effect but this organisation, which works within the auspices of the OECD, does have tremendous influence so we would expect to see all countries implementing this new recommendation soon.

Of course, there are few legitimate reasons why large amounts of cash or bearer instruments need to be physically transported across borders. Normally it is much easier and safer to transfer funds electronically to the required destination so it is not surprising that the FATF links the physical movement of cash and bearer instruments to money laundering.

usa+caribbean

BVI reforms IBC legislation

The new BVI Business Company Act was brought into force on 1 January. Replacing the International Business Companies (IBC) Act 1984, the foundation of the BVI's offshore financial centre, the new vehicle is designed to comply with the EU Code of Conduct on Business Taxation.

From 1 January 2007, all companies will be governed by the new Act and "ring fencing" will be eliminated because all companies, non-resident and resident, will be subject to a zero tax regime. It is accompanied by the introduction of a new payroll tax to compensate for the loss of the 20% tax on local companies.

The BVI has also taken the opportunity to modernise and upgrade the existing "IBC" legislation, which provided for just one type of company, a company limited by shares. The new Act will permit a company to be incorporated as a company limited by guarantee, as a hybrid company (limited by guarantee and shares) or as an unlimited company, with or without share capital.

The provisions in the Insurance Act for segregated portfolio companies (SPCs), often known as protected cell companies, have been updated and inserted into the new BVI Business Company Act. Only insurance companies and mutual funds will be permitted to incorporate or register as SPCs initially. The new Act also provides for an entirely new type of company, the "restricted purposes company" (RPC), which is designed for use as a special purposes vehicle, especially within structured finance transactions and joint venture operations.

The BVI has provided a two-year transition period to allow existing (pre-2005) companies to come into compliance. During 2005, new incorporations will be possible under all three Acts – the Companies Act, the International Business Companies Act and the new BVI Business Companies Act. Next year, new incorporations will only be possible under the BVI Business Companies Act. Existing companies will be permitted to continue to operate under the IBC and Companies Acts for one final year, during which they must prepare to re-register under the BVI Business Companies Act. By 2007, all companies registered in the BVI must be operating under the BVI Business Companies Act.

Sovereign comment

All offshore jurisdictions are under pressure to eliminate any distinction between companies owned by residents and non-residents. The IBC type company paid zero tax in the BVI, whereas local companies were taxed at 20%. The new act abolishes this distinction and provides an even playing field in accordance with EU and OECD requirements. The introduction of a payroll tax is similar to the system initially proposed by Gibraltar, which was blocked by the EU because it considered it to be a form of state aid.

US and New Zealand clarify treatment of fiscally transparent entities

The US and New Zealand entered, on 10 February, a mutual agreement to clarify the entitlement of members of certain fiscally transparent entities to benefits under the 1982 tax treaty.

If a US resident is a partner or member of a US entity that is treated for US federal tax purposes as a partnership or is disregarded as an entity separate from its owner (eg. a limited partnership or a Limited Liability Company, including one owned by a single member), the US resident would be afforded the benefits of the treaty on the income that the resident derives from New Zealand through the entity, even if New Zealand does not treat the entity as fiscally transparent under its domestic law. Such benefits extend only to the resident's share of the income received by the fiscally transparent entity.

Sovereign comment

This makes sense. The agreement applies only to the US and New Zealand treaty but we can assume that similar treatment will apply to other treaties. As an example, let us assume that an US LLC is owned 90% by a BVI company and 10% by a US tax payer. That entity invests in New Zealand and seeks to extract dividends from New Zealand. Ordinarily 30% tax would need to be withheld in New Zealand on dividends paid to a non-resident corporation but the US/NZ treaty reduces the tax to 15%. The new agreement means that the 10% of the income beneficially owned by the US taxpayer could be paid at the reduced rate of withholding tax but the other 90% would suffer the full 30% withholding tax in New Zealand because the receiving entity is transparent and the beneficial owner is not a US taxpayer (and not resident in another country which has a treaty with New Zealand).

Barbados-US tax treaty protocol comes into force

A second protocol to amend the 1984 Barbados-US income tax treaty was ratified by both governments on 20 December. The protocol, which amends the limitation-on-benefits article, is intended to prevent exploitation of the treaty by US corporations to secure "inappropriate US tax reductions in connection with a corporate inversion transaction".

The protocol also provides that the treaty's reductions in US withholding taxes do not apply for entities that benefit from a preferential tax regime rather than being subject to the standard Barbados tax system.

The protocol is effective for tax years beginning on or after 1 January 2005 and the provisions relating to withholding taxes are effective for amounts paid or credited on or after 1 February 2005.

Sovereign comment. We believe that ALL US tax treaties now contain a limitation on benefits clause. This is designed to prevent treaty shopping and use by non-residents of the treaty country. The US has inserted clauses that prevent non-residents of Barbados gaining access to the treaty by setting up a Barbados company.

Hong Kong consults on offshore funds' exemption

The Financial Services & Treasury Bureau (FSTB) issued, on 4 January, a consultation paper on a revised approach to exempting offshore funds from Hong Kong profits tax.

The proposal would exempt both fund and non-fund entities that are resident outside Hong Kong from profits tax on income from securities trading transactions conducted through a broker or approved investment adviser resident in Hong Kong. Non-residents that carry on a trade, profession or business in Hong Kong would not be covered by the exemption.

Hong Kong's Inland Revenue Ordinance (IRO) currently exempts specified investment funds from profits tax, but many offshore funds do not qualify and are therefore subject to tax. Exemption for offshore funds is intended to boost Hong Kong's fund management and hedge funds sectors.

The government first announced plans to exempt offshore funds from profits tax as part of the 2003-2004 budget but, under the latest proposals, brokers and investment advisers will no longer to be required to maintain records to verify the non-resident status of each and every investor in an offshore fund. A proposal to limit the exemption to entities with at least 80% ownership by non-resident beneficial interests has also been removed.

Resident investors holding, either alone or with associates, 30% or more of the interest in the tax-exempt non-resident will be deemed to have derived taxable profits in respect of the securities trading transactions carried out by the non-resident in Hong Kong and liable to tax. But the profits tax charge on the resident investor will not cover any non-taxable capital gains or offshore profits of the non-resident. Resident investors in a non-resident fund that is genuinely widely held, or that is currently exempted from tax under the IRO, will also not be subject to the deeming provisions.

Sovereign comment

The question is whether a fund and/or fund management company based outside Hong Kong is taxable in Hong Kong on its worldwide profits simply because the investment decisions were taken in Hong Kong by a resident investment manager. If it is taxable, then Hong Kong cannot be regarded as competitive as a fund management centre. These proposals are intended to clarify the position by exempting the fund and its management company from Hong Kong profits tax.

20 asia+ pacific

Mauritius tax treaty with Uganda comes into force

The Mauritius-Uganda tax treaty entered into force on 21 July 2004. The treaty's provisions will generally apply in both countries from 1 July 2005, excepting income subject to withholding taxes in Uganda for which it was applied from 20 April 2004.

The treaty covers income tax, capital gains tax, business profits tax as well as various other levies. Under the treaty, the maximum rate for dividends, interest and royalties are each set at 10%. Capital gains other than on immovable property is taxed in the country of residence.

Mauritius has now signed tax treaties with over 30 countries worldwide and has become the primary channel for foreign direct investment in several countries, most notably India, although last year the Indonesian government revoked its treaty, citing "tax treaty abuses".

Sovereign comment. Mauritius continues to negotiate extremely useful tax treaties with its nearest neighbours that can be accessed by Mauritius GBC1 companies – despite the fact that such companies only pay 3% tax. This is a remarkable achievement. Many countries that have treaties which were negotiated prior to their low tax regimes are finding that their treaty partners are refusing to give preferential tax treatment to companies located in the treaty partner which are no longer subject to the levels of tax applicable when the treaty was first negotiated.

China joins FATF as an observer

The People's Republic of China attended a meeting of the Financial Action Task Force (FATF) in Paris in February as an observer. The Chinese authorities are now working with the FATF to achieve full membership.

The FATF's invitation followed China's commitment to implement the FATF's 40 + 9 Recommendations against money laundering and terrorism financing, to undergo a mutual evaluation and to play an active role, both regionally and worldwide. China will be eligible for FATF membership upon completion of a successful mutual evaluation of its anti-money laundering and counter-terrorist financing system.

Meanwhile the Cook Islands, Indonesia and the Philippines have been removed from the FATF's list of Non-Cooperative Countries & Territories (NCCTs) after recent examinations confirmed that they are effectively implementing anti-money laundering measures to remedy previously-identified deficiencies.

The current NCCT list comprises Myanmar, Nauru, and Nigeria and the FATF calls on financial institutions to scrutinise transactions with persons, businesses, or banks in listed countries with inadequate anti-money laundering infrastructures. The FATF has also welcomed two new FATF-style regional bodies into the global network that combats money laundering – the Eurasian Group (EAG), founded in Moscow last October, and the Middle East & North Africa FATF (MENAFATF), founded in Bahrain last November.

Sovereign comment

China is still largely a cash economy and we hear that it is still common for large cash deposits to be taken by Hong Kong banks from residents of China. At the same time it has become increasingly difficult to open accounts for offshore companies in Hong Kong.

It will be interesting to see whether China's entry into the FATF makes any difference to the apparent contradiction between Hong Kong's policy on cash deposits and its attitude to offshore business.

Offshore company treated as managed and controlled in UK

The UK Special Commissioners ruled that a company was taxable where its central management and control ACTUALLY resided and that mere physical acts of signing board resolutions or documents did not suffice to constitute actual management. Some minimal level of information was required to constitute an informed decision.

In *R v Holden (Inspector of Taxes)* [2004] STC (SCD) 416, the taxpayers were challenging the Revenue's assessment of tax on a sale of shares in a trading company. The case centred on whether a Dutch company, E BV, was UK resident and if it was, whether a BVI company, C Limited, was also UK resident. If E BV was non-UK resident, any gains on the share sale would not be liable to UK tax. If E BV was UK resident, and C Limited was also UK resident, the sale would be an intra group transfer and thus not subject to tax. It was held that E BV was UK resident but that C Limited was not.

The Revenue argued that the directors E BV did not know the business of that company and had insufficient knowledge to make an informed decision. It also contended that the fee paid to the directors of £1,300 per annum was clearly insufficient to allow them to spend any time to get to know the business of the company, and the business of the offshore company was obviously being choreographed from the UK.

Sovereign comment

This case starkly illustrates what we have been telling our clients for many years. Offshore companies must be managed and controlled from offshore if they are to avoid being taxed onshore.

If offshore directors cannot demonstrate knowledge about the affairs of the companies they manage then that is likely to lead to serious tax consequences for the company. Directors should fully debate the merits of the contract and prepare board resolutions which fully set out their deliberations and which could later, if necessary, be produced in evidence.

Whilst onshore taxpayers who have an interest in an offshore company may consider the need to keep the directors fully informed an inconvenience – in terms of both time and money – this case further illustrates the principle that short cuts lead to big tax bills and that a little time and money spent now may save a lot of time and money later.

Accountants held liable in negligence for tax advice

The UK High Court found a firm of accountants to be negligent in its advice to a taxpayer and held it liable to him for the tax he could have saved. In *Slattery v Moore Stephens*, Mr Slattery was a foreign domiciled individual, resident but nor ordinarily resident in the UK. He sought the assistance of accountants Moore Stephens in the preparation of his UK tax returns and alleged that he sought advice on his tax status.

Moore Stephens prepared his tax returns on a basis that assumed that Slattery had been paid in Jersey, when in fact he had been paid in London. Had Slattery been paid in Jersey, he would have been able to avoid UK tax on his earnings derived from work overseas. On the basis of the incorrect tax returns, successful claims to tax refunds were made for two tax years to which Slattery was not, in fact, entitled, and which he was required to repay.

Slattery claimed that he should have advised by Moore Stephens to arrange to be paid in Jersey, in which event he would have been entitled to the tax returns claimed and to an additional refund in an earlier year.

The UK High Court found that the defendant firm was negligent, and its negligence had caused the claimant's losses, together with the interest paid to the Inland Revenue on repayment of the refunds.

Sovereign comment

Advantageous tax arrangements can be made for persons resident but not domiciled in the UK – not just on their salary but also in relation to their accumulated capital and world-wide income. Similarly UK nationals who have lived abroad for a long time may be able to claim a foreign domicile and lose their exposure to UK inheritance and other tax and get the same extremely advantageous tax treatment, even if they return to the UK for short periods. Sovereign has a 100% success record in making applications to the UK Revenue for non-domiciled status on behalf of UK nationals living overseas.

Hong Kong Court refuses to revoke trusts

A settlor's claim that he had the right to revoke two trusts he had set up for three of his children was dismissed by the High Court in Hong Kong in a judgment handed down on 4 March.

Eric Hotung set up a trust for three of his five sons and a separate one for his three daughters in 1979. Last year he revoked the trusts after his children brought lawsuits against the trustees. He sought clarification from the Court of First Instance that he had the right to do so, arguing that he had instructed the trustees orally that the trusts were to carry conditions of secrecy and revocable rights – despite the absence of such clauses in the trust deeds.

Dismissing the application, Mr Justice Tang said there was no suggestion of revocable rights in another trust that Hotung had set up for four of his children, and there was no evidence to show that any blank instruments of transfer had been issued at the time the trusts were set up.

Sovereign comment. We think Mr Hotung was clutching at straws here. If the trusts were supposed to be revocable, then that wording should have been included in the trust deed. It was not. Trusts should always be carefully drafted so they give effect to the exact wishes of the settlor at the time. Even if Mr Hotung's contention is to be believed, this was clearly not done.

Switzerland passes EU Savings Tax Agreement legislation

Both houses of Switzerland's Parliament voted on 17 December to approve legislation to enact the Swiss-EU savings tax agreement. The vote came as part of a series of final votes on seven of the Bilateral II agreements Switzerland signed with the European Union on 26 October in Luxembourg.

Most of these agreements could still be subject to a Swiss referendum. But in the case of the savings taxation, there have been no indications that such a referendum will be called for. An implementation date of 1 July 2005 would therefore appear achievable in Switzerland, the same day the EU savings tax directive takes effect.

The EU originally planned to bring the savings taxation measures into effect as of 1 January 2005, but this date was put back by six months to allow further time for the EU to conclude separate bilateral agreements with each of the "third countries" targeted for inclusion, as well as securing commitments from the relevant dependent and associated territories of EU members.

The new regime will therefore be implemented simultaneously in all 25 EU countries – Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Luxemburg, Malta, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, The Netherlands, and the UK.

Under the Directive, all EU member states – with the exception of Belgium, Luxembourg and Austria – will introduce a system of automatic information exchange from 1 July 2005 onwards. Belgium, Luxembourg and Austria will introduce a withholding tax, starting at 15% and ultimately increasing to 35%.

At the same time "equivalent measures" are to be introduced in Switzerland, Andorra, Monaco, Liechtenstein and San Marino, and in the dependent and associated territories of the UK and the Netherlands – that is Jersey, Guernsey, Isle of Man, Anguilla, Montserrat, British Virgin Islands, Turks & Caicos Islands, Cayman Islands, Netherlands Antilles and Aruba.

These "third countries" and territories will follow Belgium, Luxembourg and Austria in introducing a withholding tax. The following retention rates will apply: 15% from 1 July 2005, rising to 20% from 1 July 2008 and 35% from 1 July 2011. No personal information whatsoever is disclosed in the case of retention, but taxpayers will also have the option of voluntary disclosure should they wish to avoid the withholding tax. The information sent to the EU country of domicile will include name and address together with information about the relevant interest income.

Sovereign comment

If you are an individual with an income generating account in any of these jurisdictions and you are resident in an EU country, you are probably affected. It is your country of residence and not your nationality that is the determining factor. If your account is in the name of a legal entity then you are not affected. More on this appears at page 9.

20 fiscal

Hong Kong's first tax treaty

Hong Kong's first comprehensive tax treaty, with Belgium, was brought into force on 7 October 2004. Signed by their respective governments on 10 December 2003, the treaty, which applies to income and capital, will apply in Belgium as of 1 January 2004 and in Hong Kong as of 1 April 2004.

Under the treaty, dividends are taxable at a rate not more than 5% provided that the beneficial owner holds directly at least 10% of the capital of the company paying the dividends; in all other cases, dividends are taxable at a rate not to exceed 15%. Interest is taxable at a rate not to exceed 10% and royalties at a rate not to exceed 5%.

Hong Kong's Commissioner of Inland Revenue Lau Mak Yee-ming said the treaty "represents an important milestone in Hong Kong's own programme of comprehensive double taxation agreements." Treaty negotiations with other trading partners are underway or being planned.

Sovereign comment. The new treaty provides many interesting opportunities for companies from jurisdictions that have tax treaties with Belgium. In Canada, for example, undistributed profits rolled up within a low tax jurisdiction would be taxed under Canadian CFC rules. But companies are not taxed on dividends received from a company located in a treaty country. A Canadian corporation could therefore set up a Belgian holding company which in turn owned 100% of a Hong Kong trading subsidiary. The profits of the Hong Kong subsidiary could be remitted to Belgium where they would suffer tax at about 5% and dividends paid back to Canada by the Belgium company could be received free of any further tax.

ECJ opinion finds discrimination in EU tax treaties

Ruiz-Jarabo Colomber, Advocate General of the European Court of Justice (ECJ), opined that the discrimination inherent in granting more favourable treaty terms to residents of certain EU Member States, but not to others, constituted an unjustifiable breach of the free movement of capital provisions contained in Articles 56 and 58 of the EC Treaty.

He delivered the opinion on 26 October 2004 in the case of *D. v Rijksbelastingdienst*, concerning a resident of Germany who had property in the Netherlands. The Dutch tax authorities refused to grant a tax allowance on the same basis as a resident of the Netherlands. Such an allowance was, however, available to residents of Belgium under the Belgium-Netherlands tax treaty.

On a preliminary issue, the Advocate General felt there was discrimination between non-residents and Dutch residents, and that the taxpayer was in a sufficiently comparable position to a Dutch resident. He chose to publish an opinion in case the ECJ declined to follow his advice on the preliminary point.

If the ECJ follows the opinion, it will have significant consequences for tax treaties concluded between EU Member States.

Sovereign comment

Where forms of payment are not prescribed under specific Directives, residents of the countries involved should look to tax treaties for guidance as to how those payments should be treated. The natural consequence of this opinion would seem to be that all tax treaties between EU member states should be the same and should be amended accordingly. This may be achievable but is unlikely to happen any time soon. Before then clients can treaty shop and use the differences to their advantage.

Information Exchange – the story so far

To many people, the words "offshore finance centre" are synonymous with secrecy; it is still a common misconception that finance centres are used to hide money not only from tax authorities but also from criminal investigators and regulators. But financial secrecy has been under sustained attack for over a decade now, and gateways to exchange of information about monies, and the beneficial ownership thereof, have now been opened at many different levels.

If the first inroads into secrecy were made under the pretext of combatting money laundering and the proceeds of crime, the campaign took a seismic leap following 11 September 2001 when the focus shifted to terrorist financing. And where criminal investigators led, fiscal authorities have not been slow to follow. The table below sets out the results of these various initiatives in terms of the jurisdictions that are of most consequence to Sovereign and its clients.

Jurisdiction	EU Savings Tax Directive (1)	OECD Harmful Tax Initiative (2)	FATF Compliance (3) & Membership of equivalent regional bodies	TIEA (4)	MLAT (5)	Egmont Group Membership (6)
Anguilla	Withholding Tax	Committed	n/a, CFATF	None	USA (via UK)	Yes
Austria	Withholding Tax	OECD Member	n/a, FATF	None	Canada, EU, USA	Yes
Bahamas	n/a	Committed	Yes *, CFATF, OGBS	USA	Canada, USA, UK	Yes
Belgium	Withholding Tax	OECD Member	n/a, FATF	None	Canada, Hong Kong, USA	Yes
Belize	n/a	Committed	Yes, CFATF	None	USA	Yes
British Virgin Islands	Withholding Tax	Committed	Yes, CFATF, OGBS Observer	USA, UK pending	USA (via UK)	Yes
Cayman Islands	Withholding Tax	Committed	Yes *, CFATF, OGBS	USA, UK & Ireland pending	USA (via UK)	Yes
Cyprus	Information Exchange	Committed	Yes, FATF via EU MONEYVAL, OGBS	USA Belgium	USA	Yes
Dubai (UAE)	n/a	n/a	Yes (UAE), FATF via Gulf Co-operation Council, MENAFATF	None	–	Yes
Gibraltar	Withholding Tax	Committed	Yes, OGBS	As per UK/EU	–	Yes
Guernsey	Withholding Tax	Committed	Yes, OGBS	USA, UK& EU pending	–	Yes
Hong Kong	n/a	n/a	n/a FATF APG OGBS	None	Australia, Belgium, Canada, Ireland, Italy, Korea, Netherlands, New Zealand, Philippines, Portugal, Singapore, Switzerland, Ukraine, UK, USA	Yes
Isle of Man	Withholding Tax	Committed	Yes, OGBS	USA, UK & EU pending	USA via UK	Yes
Jersey	Withholding Tax	Committed	Yes, OGBS	USA, UK & EU pending	–	Yes
Luxembourg	Withholding Tax	OECD Member **	n/a, FATF	None	USA	
Malta	Information Exchange	Committed	Yes, FATF via EU, MONEYVAL	None	–	Yes
Mauritius	n/a	Committed	Yes, ESAAMLG, OGBS	None	–	Yes
Netherlands	Information Exchange	OECD Member	n/a, FATF	USA	USA, Hong Kong, Canada	Yes
Portugal	Information Exchange	OECD Member	n/a, FATF	None	Canada	Yes
Singapore	n/a	Committed	n/a, FATF, APG, OGBS	None	Hong Kong	Yes
Spain	Information Exchange	OECD Member	n/a, FATF, GAFISUD Observer	None	USA, Canada, Philippines	Yes
Switzerland	Withholding Tax	OECD Member **	n/a, FATF	None	Canada, Hong Kong, USA	Yes
Turks & Caicos Is.	Withholding Tax	Committed	Yes, CFATF	None	USA (via UK)	No
UK	Information Exchange	OECD Member	n/a, FATF, APG Observer ESAAMLG Observer	Pending with BVI, Cayman Islands, Guernsey, Isle of Man and Jersey	Bahamas, Canada Hong Kong USA	Yes
Uruguay	n/a	n/a	Yes, GAFISUD	None	USA, Canada	No

(1) EU Savings Tax Directive: As of 1 July 2005, information about savings income in the form of interest payments made in one EU Member State to "beneficial owners" who are individual residents for tax purposes in another Member State, is to be shared by automatic exchange of information between Member States. But three Member States who wish to retain bank secrecy are being permitted to instead levy a withholding tax for a transitional period, and key Third Countries, such as Switzerland, as well as the dependent and associated territories of Member States, are being permitted the same option to exchange or withhold.

(2) Organisation for Economic Co-operation and Development (OECD): The OECD has worked since 1998 with both member and non-member countries to address "harmful tax practices". To date, 33 non-member jurisdictions have made commitments to the OECD to improve transparency and establish effective information exchange. The OECD encourages countries to adopt information exchange on an "upon request" basis, whereby a competent authority of one country asks the competent authority of another country for specific information, generally under the authority of a bilateral exchange arrangement between the two countries. The "committed" jurisdictions have worked with the OECD to develop a Model Agreement on Information Exchange on Tax Matters that countries can use to guide their bilateral negotiations.

*** Switzerland and Luxembourg abstained on the OECD Council approval of the 1998 Report, which also applies to any work since undertaken.*

(3) Financial Action Task Force (FATF): The FATF is an inter-governmental body set up in 1998 to develop and promote policies, both at national and international levels, to combat money laundering and terrorist financing. The FATF has published 40 + 9 Recommendations to combat money laundering and the financing of terrorism, and carried out a series of evaluations of countries and territories to identify critical deficiencies in anti-money laundering systems or an unwillingness to co-operate in anti-money laundering efforts. As of 18 February 2005, the FATF listed Myanmar, Nauru and Nigeria as non-cooperative countries and territories (NCCTs).
FATF-recognised equivalent regional bodies include:
APG – the Asia/Pacific Group; **ESAAMLG** – the Eastern & South African Anti Money Laundering Group; **GAFISUD** – the Financial Action Task Force of South America Against Money Laundering; **MENAFATF** – the Middle East & North Africa Financial Action Task Force; **MONEYVAL** (formerly PC-R-EV) – Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures.

** The Bahamas and Cayman Islands were among 15 jurisdictions identified by the FATF as NCCTs in its initial review in 2000. Both were removed from the list in 2001 having "made significant and rapid progress in remedying their deficiencies".*

(4) Tax Information Exchange Agreements (TIEA): TIEAs are bilateral agreements entered into between tax authorities, to allow for the exchange of information. In the past, the exchange of tax information was usually undertaken under the terms of a tax treaty. The USA has signed ten TIEAs with prominent offshore jurisdictions in the last few years, all of which had come into force by the end of 2004. Non-OECD jurisdictions that have made commitments to the OECD under the Harmful Tax Practices initiative have undertaken to bilaterally enter into TIEAs with OECD member states. Dependent and associated territories of EU member states are also obliged under the EU Savings Tax Directive to exchange information on savings income with EU member states; this information will have to be exchanged through a series of bilateral TIEAs with those countries.

(5) Mutual Legal Assistance in Criminal Matters Treaties (MLAT): MLATs are intended to improve the effectiveness of judicial assistance and to regularise and facilitate its procedures. The treaties include the power to summon witnesses, to compel the production of documents and other real evidence, to issue search warrants, and to serve process.

(6) The Egmont Group: A group of "financial intelligence units" or "FIUs" established in 1995 to create a global network by promoting international co-operation between FIUs. There are currently 94 countries with recognised operational FIU units. Most FIUs, under certain provisions, can exchange information with foreign counterpart FIUs. In addition, many FIUs can also be of assistance in providing other government administrative data and public record information to their counterparts.

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