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SOVEREIGN

report

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Happy Christmas and a prosperous 2006

We would like to wish all our readers a very Merry Christmas and a happy Christian and Chinese New Year. This year Chinese New Year falls on 28th, 29th, 30th and 31st of January and next year will be the "Year of the Dog". People born under the Dog sign in previous cycles are supposed to benefit greatly from the influence of their own year. The most recent former years of the Dog are 1934, 1946, 1958, 1970, 1982 and 1994. Endeavours are successful, career achievements are attained and the political climate is perfect for Dog's altruistic sensibilities. Whatever that means. This should be an outstanding time for marriage, children, falling in love, and travel. Sounds good doesn't it?

Visitors to Hong Kong

Increasingly we are discovering that when our valued clients visit Hong Kong, they are booking into expensive hotels and paying expensive rates. We have secured very good corporate rates at some of the best hotels in Hong Kong so, if you are planning to visit, do call us and get us to book you in. There will be a large saving to be made and we are happy to help.

Visitors to London

We also have an excellent room rate at London's very quaint Fox Club, an elegant Georgian townhouse situated in the middle of Mayfair. In former days, the building was the London residence of Charles James Fox the legendary 18th Century statesman, drinker and gambler. The club has good-sized rooms for around £120 for the night, as well as an excellent restaurant and bar, and is placed close to all the best places to visit in London. So let us know if you are visiting and we can make the necessary arrangements for you. See www.FoxClubLondon.com for further details.

Sovereign European Art Prize – Gala Charity Dinner

Hopefully this newsletter will reach some of you before we hold a Gala Charity Dinner to celebrate the first Sovereign European Art Prize. This event will take place at Bonham's refurbished London showrooms in New Bond Street on 13th January. It should be a great evening with some fine food and wine, and

chairman

the opportunity to purchase some extremely collectable art from the 30 finalists. And it's all in aid of charity. If anybody would like to come, you would be most welcome to support this worthy cause. Please contact tpinkstone@SovereignGroup.com for details and booking arrangements.

UK Civil Partnerships Act

The UK has just passed a Civil Partnership Act, which formalises the financial arrangements between same-sex couples. The new rules make it vital for same-sex couples to plan their joint financial affairs properly and the new Act gives rise to, and perhaps necessitates, a number of different planning opportunities. The Sovereign Group, and in particular Sovereign Alternative, has great expertise in this area and we would welcome enquiries from anybody who believes they might be affected.

EU Domain Names

Holders of EU registered trademarks can now apply for registration of an ".eu" domain name. Sovereign has already put in applications to secure Sovereign.eu, SovereignGroup.eu and various other derivative addresses for our businesses. If any clients would like to register an EU domain then please contact us for assistance.

Gibraltar

Finally some good news from the Rock. Gibraltar has just announced that it has reached agreement with the UK for the passporting of investment services under the relevant EU directive. This means that any investment firm authorised to do business in Gibraltar can market its services freely in the UK and throughout the rest of Europe. This should provide a significant boost to the Gibraltar finance centre.

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

Brown targets offshore trusts in UK Pre-Budget Report

UK Chancellor Gordon Brown targeted offshore trusts in his Pre-Budget Report (PBR) on 5 December 2005, and also extended the disclosure regime to cover income, corporation and capital gains tax for schemes established by businesses.

The PBR targeted two schemes designed to mitigate inheritance tax (IHT) and the pre-owned assets tax. The first it termed "avoidance involving second hand interests in foreign trusts", and the second as "the use of artificial trust arrangements to escape both the IHT gift with reservation rules and the pre-owned assets income tax charge". The government will now impose an annual pre-owned assets income tax charge.

The government has also made it harder for UK residents to avoid tax on income from offshore companies and trusts by adding to section 741 of the Income Tax Act in order to place a greater burden of proof on the individual to prove the commercial legitimacy of the offshore trust or company. The involvement of a tax adviser in the decision-making process will also be taken into account in determining whether a tax avoidance motive is present.

Since August 2004, tax advisers have been compelled to inform the tax authorities as soon as they start selling a tax-avoidance scheme to their clients. The Chancellor enhanced that disclosure regime by obliging in-house tax experts in large companies to divulge their tax-avoidance plans within 30 days of implementation. The regime will also apply for the first time to tax advisers devising tax avoidance schemes for individuals.

Gordon Brown also announced a major U-turn on the tax benefits of using self-invested personal pensions (Sipps) which are to come into force from 6 April 2006. A 55% tax charge will now be imposed on direct property investments and other assets, such as fine wines, classic cars and art and antiques, held within Sipps. The volte-face came three months after the Treasury defended the rules.

Sovereign comment

Sovereign has already taken informal legal opinion and does not believe that this new directive affects anything that we habitually do for UK resident or domiciled clients. We do not promote anything which falls within the definition of a tax scheme, so neither we, nor our clients, have any need to make any sort of disclosure. In particular, we have taken advice from leading UK counsel on the use of insurance wrappers, which are still extremely effective for UK resident persons. We do not believe these new rules will affect such arrangements in any way.

The government U-turn on Sipps smacks of desperation by Gordon Brown. It was always envisaged that Sipps would be able to hold investment property and assets.

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EU Council adopts Third Money-Laundering Directive

The EU Council adopted the controversial Third EU Money Laundering Directive on 20 September 2005. The directive was adopted at first reading under the co-decision procedure and is to be implemented by 2007. It will incorporate into EU law revisions made to the FATF recommendations in June 2003. It will also extend the provisions to any financial transaction that might be linked to terrorist activities.

Further provisions include identity checks on customers opening accounts, checks apply to any transaction over Euros15,000, stricter checks on “politically exposed persons” and penalties for failure to report suspicious transactions to national financial intelligence units.

It should be noted that in July 2005 the Council also adopted a regulation providing a system of control for cash entering and leaving the Community. It sets a Euros10,000 threshold above which natural persons will be required to declare cash when crossing the EU's external borders.

Sovereign comment

The obligation to declare when cash is leaving or entering the EU is already in place in many other jurisdictions, such as Australia or the US. There are normally few reasons to move large amounts of cash across international borders other than in furtherance of tax evasion, so it is no great surprise that reporting of those amounts will now be required.

Isle of Man signs TIEA with The Netherlands

The Isle of Man and the Netherlands signed a Tax Information Exchange Agreement (TIEA) to facilitate exchange of information on tax matters on 12 October 2005. It covers a wide range of taxes, including the Netherlands' income, wages, company, dividend, gift, and inheritances taxes, and Isle of Man taxes on income or profit.

Under the TIEA, when the competent authority of a contracting state requests information, the responding state must provide information that is "foreseeably" relevant to the assessment and collection of civil tax claims and to the investigation or prosecution of criminal tax matters.

Each competent authority must provide the information available. If that is insufficient, the competent authority will, at its own discretion, take all relevant information gathering measures to supply the requested information. The agreement protects the confidentiality of any exchanged information by preventing disclosure to third parties.

The agreement covers information held by financial institutions and fiduciaries. It also covers information regarding the beneficial ownership of companies, partnerships, and trusts. The competent authorities are not required under the agreement to provide ownership information regarding publicly traded companies unless the information can be obtained without "disproportionate" difficulties. The agreement will enter into force when each party has notified the other of the completion of its necessary internal procedures.

Sovereign comment

This highlights a growing trend. All offshore jurisdictions will soon have TIEAs with most onshore jurisdictions of note. And under the new tax treaties being agreed between onshore jurisdictions, any information provided under a TIEA can also be exchanged creating a worldwide network of exchange agreements. We contend that confidentiality no longer exists offshore. This should not worry any client who has made proper arrangements to reduce their tax, but should rightly worry anybody who has made arrangements that rely solely on confidentiality. If you are concerned, then please call us so we can advise.

US brings more charges in KPMG shelter case

The US federal government added 10 new defendants to its KPMG tax shelter conspiracy case along with several new charges, including obstruction and personal tax evasion, on 17 October 2005.

Michael Garcia, US attorney for the Southern District of New York, and US Internal Revenue Service Commissioner Mark Everson announced the filing of a superseding criminal indictment charging the tax professionals with conspiracy to defraud the IRS, tax evasion, and obstruction.

The new defendants include KPMG's former chief financial officer Richard Rosenthal, the former partner in charge of KPMG's professional practice Larry DeLap, and KPMG's former associate general counsel Steve Gremminger. Together with the nine individuals indicted last August, the defendants are charged with 39 substantive counts of tax evasion on the tax returns of KPMG clients. According to Garcia, the investigation is still ongoing.

According to the Justice Department, the 19 defendants conspired to defraud the tax authorities "by designing, marketing and implementing illegal tax shelters between 1996 and this year. It is charged that this illegal course of conduct was approved and perpetrated at the highest levels of KPMG's tax management, and involved numerous KPMG partners and other personnel."

A federal judge gave preliminary approval to a US$225 million settlement that KPMG and law firm Sidley, Austin, Brown & Wood have reached with about 275 former clients who used its tax shelters. The settlement would provide US$195 million compensation to former clients who participated in the tax shelters. The awards, which cannot by law cover back taxes and IRS penalties, will be a portion of the transaction fees paid to arrange the shelters.

The four shelters were the subject of KPMG's settlement agreement with federal prosecutors in New York in August. Under that agreement, KPMG admitted criminal wrongdoing in creating fraudulent tax shelters and agreed to pay US$456 million in penalties. The firm itself will not face criminal prosecution provided it complies with the terms of its agreement with the government. The case is one of several actions brought by former KPMG clients in state and federal courts in the US. According to KPMG's deferred-prosecution agreement with federal prosecutors, KPMG sold the four shelters to about 600 wealthy Americans from 1996 to 2002.

Sovereign comment

Oh dear! Further trouble for one of the big four accountants. The big four are already divesting themselves of their corporate secretarial arms and tax advisory services. They are also frequently resigning as auditors when they cannot be totally comfortable with the figures. It is not difficult to see a trend here. The US has started this process of attacking those who seemed invulnerable and the UK is now moving in the same direction.

Netherlands and Antilles agree zero withholding tax

The governments of the Netherlands and the Netherlands Antilles reached agreement on 1 December for the introduction of a zero per cent withholding tax rate for certain dividend payments between companies in the Netherlands and the Netherlands Antilles.

The zero per cent rate will be subject to the condition that dividends paid to companies in the Netherlands Antilles be invested in a new Herstelbank, a body supervised by the Central Bank of the Netherlands Antilles that will use the funds to support the Antilles' economy.

The while amount of the dividend must remain with the Herstelbank for two years, and during the next two-year period, 75% of the amount must remain with the Herstelbank. Only after four years can the dividend be paid to shareholders free of withholding tax.

The new regime will be implemented through an amendment of the Tax Arrangement for the Kingdom of the Netherlands. The current withholding tax rate for dividends paid to the Netherlands Antilles is 8.3%.

Sovereign comment

The so-called "Dutch sandwich" used to be the holding structure of choice but has been losing its appeal for many years as other jurisdictions compete. These new developments are designed to increase the attractiveness of that structure but the conditions for the investment of the money, we believe, mean that there are still more attractive holding structure options available.

Dividends paid by a Dutch company to an UK company would be free of withholding tax, free of tax on arrival in the UK and free of withholding tax when paid out of the UK – and no particular conditions apply. This could be the ideal holding structure but other options exist which also seem more attractive than the Netherlands/Netherlands Antilles option.

Bermuda signs TIEA with Australia

Bermudian Finance Minister Paula Cox and Australian Treasurer Peter Costello signed a Tax Information Exchange Agreement (TIEA) in Washington DC on 10 November 2005. The agreement marks the first treaty that Bermuda has entered into following a commitment to ban harmful tax practices five years ago.

The Australian authorities were eager to secure a TIEA with Bermuda after it became apparent that a significant proportion of funds flowing in and out of the country were being transmitted through Bermuda. Talks between the two governments commenced in May 2004, with a second round of discussions taking place last August.

The agreement, which takes effect in January, provides for the exchange of information, when requested, on tax matters. Provisions to protect confidentiality of certain information are built into the agreement, a statement said.

Ms Cox said that because Bermuda, which does not have income tax, sees "no direct benefit from an exchange of information regarding its tax system", the Finance Ministry sought some other "measurable and reciprocal benefit" for Bermuda, such as provisions for improved commercial relations between Bermuda and Australia.

Australia has also agreed a protocol to the Australia-New Zealand tax treaty to provide for updated information exchange provisions. "The protocol updates the information exchange provisions to the new OECD standard and provides mutual assistance in collection of taxes," said Costello.

Dubai brings Trust Law into force

The Trust Law, DIFC Law No. 11 of 2005, which provides a fundamental framework for the creation of trusts in the Dubai International Financial Centre, was enacted by His Highness Sheikh Maktoum Bin Rashid Al Maktoum, Ruler of Dubai, on 14 November 2005.

The law comprises ten major parts and provides for matters such as choice of governing law, place of administration, creation, validity and modification of a DIFC trust, office of trustee, and duties and powers of trustees.

The law prescribes two types of trusts: charitable trusts and non-charitable or purpose trusts. Non-charitable trusts or purpose trusts, the most common type, require the appointment of an enforcer to enforce the trust in relation to its non-charitable purposes and the purpose should be possible and sufficiently certain to allow the trust to be carried out. Charitable trusts are created to benefit the public at large.

'The adoption of a legal framework for the creation of trusts will add an important new business dimension to the DIFC," said Dubai Financial Services Authority (DFSA) chief executive David Knott. "This proposal was issued for public comment in August and the new Trust Law reflects positive comments received from the financial and professional services sectors. Those sectors can now develop their trust services with additional certainty and flexibility within the DIFC."

The DFSA also released, on 16 October, a consultative draft Collective Investment Law to provide a comprehensive framework for the regulation of collective investments in the DIFC. This Law has 14 parts dealing with general law, collective investment funds, operators of domestic funds, oversight of domestic funds, auditors of domestic funds, prospectus requirements for domestic funds, registration of domestic funds, exemption of domestic funds, alteration to a domestic fund, transfer schemes and winding up of domestic funds, DFSA powers in relation to a fund, the regulatory appeals committee, the financial markets tribunal and miscellaneous affairs.

"The adoption of a legal framework for the regulation of collective investments will add clarity and certainty, and provide the financial and professional services sectors with additional flexibility in client service delivery," said Knott.

Sovereign comment

This new law focuses the attention of the Middle East client on the use of trusts. Many may prefer to continue using offshore jurisdictions such as Jersey, Isle of Man and Gibraltar for settling their trust affairs, but it will be helpful to have trusts recognised in the Middle East through this new law.

Sovereign has signed joint venture agreements to create Sovereign Bahrain, which will focus on offering high quality trust and corporate services to clients in the Middle East. This will be a useful adjunct to our already successful operations in Dubai.

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South Africa to strengthen anti-avoidance

The South African government announced, on 3 November 2005, measures designed to strengthen existing anti-avoidance legislation to counter the use of tax avoidance schemes, particularly by corporate taxpayers. The government hopes to include tax law changes in its 2006 Budget, which is due to be announced in February.

A report by the South African Revenue Service (SARS) found that the general anti-avoidance rule, in Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962), remains "substantially the same today as it was in 1959", and was proving to be ineffective and inconsistent.

The report proposes to amend existing law by introducing a non-exclusive set of factors to be considered in determining abnormality for schemes in the context of business and create a rebuttable presumption of "abnormality" when some of those factors are present.

It would require that a scheme's purpose be determined objectively and clarify that section 103 may be applied to steps within a larger scheme. It would also introduce new penalties for scheme promoters and for taxpayers that substantially underreport their income.

Sovereign comment

Once South Africa moved from a territorial to a global tax system it was bound to strengthen its anti-avoidance laws. Sovereign has a substantial presence in South Africa and is well-placed to advise on this new legislation. We would recommend that any South African resident who has offshore arrangements seeks advice as to whether they would be affected. The time to do this is NOW and our Cape Town office is ready to assist.

Hong Kong abolishes Estate Duty

Hong Kong's Legislative Council passed the Revenue (Abolition of Estate Duty) Bill 2005 on 2 November 2005. The Ordinance, which seeks to implement the proposal announced in the 2005-06 Budget to abolish estate duty, is due to commence operation on 11 February 2006.

Frederick Ma, Secretary for Financial Services & the Treasury, said that apart from removing the unfairness and obstacles arising from the collection of estate duty, another key objective of the proposed abolition was to facilitate the further development of Hong Kong as an important asset management centre and, as a result, make it more competitive as an international financial centre.

"The abolition of estate duty is not only a tax concession but also a long term strategic investment in Hong Kong's financial services industry and the overall development of the economy," said Ma. "As asset management services can foster growth in other financial activities and a series of high value-added professional services, other industries will also benefit indirectly. The community, and hence members of the public, will enjoy the subsequent economic benefits."

It is estimated that the abolition of estate duty will cost the government annual revenue of around HK$ 1.5 billion (US$ 193.55 million). But the government estimated that the move would help promote trading in Hong Kong's financial and property markets, and contribute additional revenue from stamp duty and other taxes.

Sovereign comment

Estate duty in Hong Kong was largely considered as a "voluntary tax" as it was relatively simple to arrange one's affairs to avoid it. This premise is borne out by the relatively paltry sum the tax raised each year (US$ 190 million), so it is no great loss to the treasury of Hong Kong to abolish this tax. On the other hand, the abolition does simplify tax planning in Hong Kong and sends the right message to the Asia region – that Hong Kong is the premier planning centre for Asia.

Privy Council finds trustee liable of dishonest assistance

The Privy Council upheld an Isle of Man High Court ruling against a trustee involved in the misappropriation of millions of pounds of Barlow Clowes funds in the 1980s. The proceedings were brought by the Barlow Clowes receivers, PwC and Ernst & Young, against Peter Henwood, a director of Isle of Man-based offshore financial services provider International Trust Corporation (ITC), subsequently known as Eurotrust International. The decision of 10 October will enable the receivers to pursue Henwood for over £9.3 million.

Barlow Clowes operated a fraudulent offshore investment scheme that purported to invest funds in UK gilt-edged securities. But most of the money funded personal business ventures and high living by chairman Peter Clowes and his associates. Clowes was imprisoned after the scheme collapsed in 1988 with losses in excess of £100m. In 1987 about £6.8m of investors' funds were paid through bank accounts, maintained by companies administered from the Isle of Man by ITC.

In *Barlow Clowes International (in liquidation) & Ors v Eurotrust International & Ors*, the Isle of Man High Court found Henwood liable for payments after 1987 because " ... by that time Mr Henwood knew enough about the origins of the money to have suspected misappropriation and that he acted dishonestly in assisting in its disposal".

Liability for dishonest assistance, it held, requires a dishonest state of mind on the part of the person who assists in a breach of trust. Such a state of mind may consist of knowledge that the transaction is one in which he cannot honestly participate or a suspicion combined with a conscious decision not to make enquiries which might result in knowledge.

Henwood successfully appealed the decision. Barlow Clowes then appealed to the Privy Council. Counsel for Henwood at the Privy Council argued that it needed to be shown that Henwood was aware that his state of mind would by ordinary standards be regarded as dishonest – only then could it be said to be consciously dishonest. The Privy Council disagreed, holding that the High Court judge had had sufficient evidence to decide that Henwood gave dishonest assistance. It said that it was not necessary that Henwood should have concluded that the disposals were of moneys held in trust – having a clear suspicion was sufficient. The money in Barlow Clowes either belonged to the company, and was subject to fiduciary duties of the directors, or was held in trust.

Sovereign comment
The decision shows that a defendant cannot hide behind assertions that he did not know the money was held on trust or what a trust meant. The receivers said they would now "pursue Henwood and take the appropriate action to seize his assets worldwide in satisfaction of this final judgment."

High Court sets aside trustees' decision

The trustees of a settlement succeeded in having a Deed of Appointment set aside by the UK High Court because of the trustees' mistake as to the tax consequences of the appointment. They invoked the principle in *Re Hastings-Bass*, which permits a Court to interfere with the discretionary acts of the trustees if they have failed, when exercising a power, to take into account all relevant considerations or have taken into account any irrelevant ones.

In *Re Bedford Estates, Sieff v Fox*, the consent of a beneficiary and his father was required to effect an appointment of certain assets out of a settlement to a beneficiary and a subsequent assignment into another settlement. The intention was to permit a wider class, including younger female members of the beneficiary's family, to benefit from the assets while incurring no immediate charge to tax and mitigating future inheritance tax charges within the settlement.

It was subsequently discovered that the effect of the appointment and assignment, if valid, would be a substantial immediate charge to capital gains tax together with potentially significant adverse tax consequences for the beneficiary. The trustees applied to the Court seeking to have the appointment set aside under the principle in *Re Hastings-Bass*, or in the alternative, on the grounds of mistake.

On 23 June 2005, Lord Justice Lloyd set aside the appointment under *Re Hastings-Bass*. He said: "where trustees act under a discretion given to them by the terms of the trust ... but the effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account."

Sovereign comment
It's nice to know that if trustees make a mistake they can rely upon the assistance of the court in rectifying that mistake. Sovereign has a number of different trust companies around the world and we do not expect to have to rely on this judgment!

Jersey Court permits "non beneficiaries" access to trust information

In *Re the Internine Trust & the Intertaders Trust, Sheikh Abdullah Ali M Alhamrani v Russa Management & Ors*, the Jersey Court had to consider whether certain individuals, who had signed an agreement divesting themselves of their interests under two Jersey trusts in return for a transfer of assets in Saudi Arabia, had the right to ask the trustees for trust information.

The Saudi Arabian Court of Appeal having declared this agreement to be void, the individuals wished to pursue the matter in the Jersey courts. When it appeared that the trust assets were being depleted, they requested disclosure of the trust documents. The Royal Court upheld their application.

The trustees appealed to the Jersey Court of Appeal arguing that the individuals were not even discretionary beneficiaries under the trust and so had no rights to information.

The Appeal Court dismissed the appeal and held that, in exceptional circumstances, even if it had not yet been determined whether someone was a beneficiary or not, the court had jurisdiction to exercise its supervisory power in favour of an applicant seeking information. In this case, it said, disclosure would facilitate the settlement of a family dispute.

Isle of Man considers introducing “tax cap”

The Isle of Man government is considering the introduction of a "tax cap" for high earners. First announced by Treasury Minister Allan Bell in his Budget this spring, it has not yet been announced whether this will be introduced from 6 April 2006 when the island moves to a zero corporation tax regime.

"We have not yet decided the level of the cap," said Assessor of Tax Malcolm Couch. “But the scheme will work on two principles: it will be a cap, not just a tapering level of tax and it will apply to everyone, existing residents as well as newcomers."

According to Treasury calculations if the cap was £100,000, then people would benefit if their taxable income exceeded £570,000 a year. But if it were set at £200,000 they would have to make £1.25m taxable income per year to benefit.

But it would have short-term revenue implications. A cap of £50,000 of income subject to tax would lead to a potential loss of revenue of £4.53 million, while a cap of £200,000 would produce a loss of £1.67 million.

The aim is to encourage wealthy residents to relocate in the island who are prepared to invest in the local economy. The greater the number of new residents the greater is the future investment potential. The highest individual tax rate is currently 18%, and there is no capital gains or inheritance tax.

Meanwhile, the States of Guernsey published a second consultation document in respect of the proposed Zero-Ten company tax regime. This will apply a 0% income tax rate on company profits and a 10% rate to some financial services companies in order to comply with the EU Code of Conduct on harmful business taxation.

According to the latest document, the government proposes to compensate for the loss of revenue through an increase in social security contributions for employees and employers, rather than the introduction of a sales tax. Similarly to Jersey, income tax will remain at 20%, but allowances will be cut back. A special meeting of the States is to be held on 8 February to decide official policy.

Sovereign comment

We believe that the Isle of Man is looking over its shoulder at Gibraltar. Gibraltar grants special resident status to new tax residents and caps their annual tax bill at a maximum of GBP £20,000. Gibraltar also has a nice climate and easy access to the Golf courses and beaches in Spain. That is a package with which it is hard to compete. However, Gibraltar is fast filling up and decent accommodation is hard to come by. The Isle of Man has many attractions. The climate is not one of them, but the tax regime is. This new legislation will enhance the attractiveness of that tax regime. Now they just need to do something about the weather.

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Dutch may end dividend withholding tax

Dutch State Secretary of Finance Joop Wijn told parliament he is considering abolishing the dividend withholding tax in order to improve the investment climate for foreign investors in the Netherlands. He said a recent survey on foreign investment indicated the dividend withholding tax was a key factor in companies' decisions about where to locate. He also mentioned the positive economic effects of the revocation of the dividend withholding tax by the UK.

The dividend withholding tax currently generates more than Euros1 billion a year for the Dutch government. Wijn indicated that it would not be possible to abolish the tax altogether, but said the government was working on plans to abolish it gradually over time.

Sovereign comment

It is surprising to learn that the Dutch government generates revenue of almost US$1 billion on withholding tax on dividends. It is relatively easy to plan your way out of this withholding tax by having the shares in the company owned by a low or no tax structure incorporated in any EU country. Under EU Directive 90/435 no tax can be withheld on dividends paid from one EU member state to another, and there is little or no anti-avoidance legislation aimed at preventing non-EU residents from taking advantage of this. Spain, Sweden, Denmark, Luxembourg, Cyprus, Malta and the UK all offer low or no tax structures which can be used to extract dividends out of the Netherlands free of withholding tax. We believe the UK may be the best option available.

PRC to unify corporate tax rates in 2006

Finance Minister Jin Renqing said the People's Republic of China (PRC) planned to begin introducing a unified corporate income tax rate for domestic and foreign-funded companies next year.

The reform, intended to encourage new investments and promote more equitable competition, is to be implemented during the country's 11th Five-Year Plan period of 2006 to 2010. No proposals have yet been submitted to either the National People's Republic Congress or to the Chinese People's Political and Consultative Congress.

Sovereign comment

Sovereign has recently opened an office in Shanghai and is ready and able to advise on how to structure a new or existing business enterprise in China. The Chinese regulations are extremely simple, but conversely that makes planning rather complicated because the laws give little guidance as to detail, and the actual practice varies from tax inspector to tax inspector and district to district.

Expert advice is essential before entering China. Sovereign can assist.

Netherlands and South Africa sign tax treaty

A new tax treaty between the Netherlands and South Africa was signed in Pretoria on 10 October 2005, by South African Finance Minister Trevor Manuel and Dutch Foreign Affairs Minister Rudolph Bot. Business owners from both countries, said Bot, had expressed the need for a treaty to strengthen bilateral trade relations. Manuel said the treaty would provide the certainty that Dutch investors needed to invest confidently in South Africa.

Sovereign comment

Dutch companies are still the holding company of choice. The Netherlands has a wide range of tax treaties which allow dividends to be collected without payment of tax. The treaties often eliminate or reduce the withholding tax on dividends suffered in the country of source. Our Amsterdam office manages a large number of licensing and holding companies, and we can advise on their effective use throughout the world.

Sovereign's China Entry Services

The People's Republic of China (PRC) joined the World Trade Organisation (WTO) in 2001 and, after 15 years of knocking at the door, the barriers to trade and investment were finally lowered. The way was opened for foreign investors to flock to the PRC in search of lower production costs and competitive value added services, or simply to take part in a market of 1.3 billion consumers. Sunny Liew, who heads up Sovereign's representative office in Shanghai, explains how Sovereign can act as your guide.

In recent years, annual economic growth in the PRC has averaged 7% to 8% annually and, the OECD also predicts, gross domestic product will grow at 9.4% and 9.2% respectively in 2006 and 2007. Total foreign direct investment (FDI) for 2004 was more than US$60 billion, with the cumulative total reaching, by the end that year, a staggering US$560 billion. Even though few expect such rates to continue, economists still forecast continued growth in FDI until the end of the decade.

The government appreciates the importance of creating a dynamic and secure platform to continue to attract FDI into the PRC. But equally it has a duty to ensure that foreign companies take part under principles of equality and mutual benefit. To this end, current issues affecting foreign investors include: the proposed unification of tax rates for foreign and domestic companies; improvements in tax regulation and collection; procedures and rules to cover transfer pricing in related party transactions; and the further revaluation of the Yuan.

Sovereign continues to assist clients with selecting the most suitable and tax efficient structures for investing into the PRC market. It is important for clients to think ahead in terms of how a business will develop and what activities it might undertake in the longer term. There are three principal vehicles for market entry, each of which has different implications in terms of tax, permitted activities, registered capital, location and costs.

Representative Office (RO)

For a foreign company that aims to sell goods and services into China without the need to issue Yuan denominated invoices in China, we would recommend an RO. This enables a foreign company to establish a presence in the PRC, administer and monitor sales with clients in the PRC, introduce and promote products, facilitate quality control processes and undertake market surveys.

An RO also offers an opportunity to test the market with a low set up cost before committing further resources. An RO does not require a paid up capital but is obliged to file and pay tax on a monthly basis (typically between 7% to 10% of declared overheads). Any payment offshore for income generated in the PRC is subject to withholding tax of 20%, unless reduced by treaty or arrangement. In certain circumstances, it can be difficult for Chinese companies to make payments to overseas accounts. This may impact on sales and cash flow.

Wholly Foreign Owned Enterprise (WFOE)

A foreign company that proposes to undertake manufacturing, processing or assembly in the PRC for the main purpose of export, should set up a Wholly Foreign Owned Enterprise (WFOE, but often known as a "woofie"). As the name suggests, a Chinese partner is not a requirement but, should a company elect to have one, the foreign company must own at least 25% of the equity. Recently the laws have been changed to allow WFOEs to wholly own other companies in the PRC. The minimum paid up capital requirement differs from province to province and from industry to industry. The authorities will examine the capacity of the plant before approving the paid up capital. The tax incentives available in the manufacturing sector are good.

> "It is important for clients to think ahead in terms of how a business will develop and what activities it might undertake in the longer term."

Foreign Invested Commercial Enterprise (FICE)

A foreign company that proposes to distribute (wholesale and/or retail) imported goods or non-Chinese manufactured products in the PRC, should set up a Foreign Invested Commercial Enterprise (FICE). The regulation of such activities has recently been liberalised by the issuance, in June 2004, of Measures for the Administration of Foreign Investment in the Commercial Sector (the Measures). These are applicable to existing WFOEs that wish to expand their scope of business, but central government approval is required for all applications under this category.

A FICE is permitted to establish retail outlets anywhere in the PRC but is subject to stringent requirements as to the reputation and financial standing of the parent company, its experience and the size of the investment. Under the provision of Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the PRC, Hong Kong companies have enjoyed lower barriers to entry and, from 1 January 2006, there will be zero tariff on all Hong Kong goods in the PRC.

At time of writing, WFOEs undertaking production activities will, typically, enjoy tax free status for the first two profitable years, followed by a 50% reduction in tax for the next three profitable years. In addition, and depending on the location of the plant, they may benefit from a reduced tax rate of 15% available in Special Economic Zones and other similar regimes. Dividends received by foreign investors from WFOEs are exempt from withholding tax. A FICE that undertakes both manufacturing and distribution activities may also benefit, provided that revenues from production exceed 50% of total business revenues.

Both WFOEs and FICEs may be incorporated by way of a joint venture with a Chinese party. The issues concerning joint ventures, in terms of both negotiation and operation, are complex. They are not covered in this article, but we are happy to assist should a joint venture be your preferred mode of entry.

Sovereign advises any client that is looking to set up an investment vehicle in the PRC to speak to us because every company's circumstances and requirements will be different. In addition to our entry services, we continue to advise clients on identifying suitable offshore investment structures and related tax issues. When considering the applicable corporate tax, one should not ignore the potentially substantial liabilities to customs tax, VAT and business taxes in the PRC.

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