25

issue twenty five
september 2006

SOVEREIGN

report

Bahamas Bahrain British Virgin Islands Cayman Islands China Cyprus Denmark Germany Gibraltar Hong Kong Isle of Man Malta Mauritius Netherlands Netherlands Antilles Portugal Singapore South Africa Switzerland Turks & Caicos Islands United Arab Emirates United Kingdom Uruguay

contents

introduction 3

4 european news

5 usa + caribbean news

6 asia + pacific news

7 legal news

8 fiscal news

9 profile: **"OECD Global Forum on Taxation"**

10 contact + info

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We hope you all had a great summer and managed to fit in some holiday time. We have been busy and, as you can see from below, the Group continues to expand. This has obviously only been possible with the support of our clients and I would like to take this opportunity to thank you for your business.

25

Hong Kong signs new tax treaty with China

The People's Republic of China and the Hong Kong Special Administrative Region signed their first comprehensive income tax treaty on 21 August 2006. The new treaty extends the scope of the existing 1998 agreement, which was limited to business profits and income from personal services, and will strengthen Hong Kong's competitiveness as the investment gateway to the Chinese mainland.

This is an interesting development in Hong Kong's relationship with the People's Republic of China. We will be examining the implications in a future Sovereign Report. In the meantime, further details about this development may be found on our website at www.SovereignGroup.com

Sovereign Asset Management expands

The success of Gibraltar-based Sovereign Asset Management (SAM) over the last four years under the stewardship of Chris Labrow has been such that we have decided to expand the operation.

To this end, Diccon Martin, has been appointed to take on the role of managing director of SAM's operations. Chris Labrow becomes the chairman of SAM and will continue to grow and guide the business during this change.

Diccon is 39 years-old and was previously Regional Director of New Star Asset Management in Hong Kong. He joined SAM as of 4 September 2006.

chairman

Netherlands Antilles office

We are very pleased to announce the establishment of Sovereign Trust (Netherlands Antilles) Limited based in Curaçao. We are fortunate to have secured the services of Rudsel Lucas who has many years relevant experience in the region, latterly with a large banking group.

The office will focus on business development opportunities in the Caribbean, as well as Central and South America. Contact details are posted on the back page of this Report.

Sovereign European Art Prize

The second European Art Prize, organised by the Sovereign Art Foundation, was formally launched at a cocktail reception in July on the roof terrace of the Peggy Guggenheim Collection in Venice, overlooking the Grand Canal. Many of Venice’s top artists were present and early indications are that the prize will attract an even larger participation than its inaugural year. The prize will be presented at a gala charity auction event in March 2007 in London. Tickets for this occasion will be much in demand. Further details will be announced in future issues.

SovereignGroup.com

We announced in Sovereign Report 24 that our website had recently been re-launched. Our thanks to everyone who has taken the trouble to comment on the new design. We will continue to develop the site for the benefit of both existing and new clients and intermediaries. Please do continue to let us have your comments.

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

Tripartite Commission for Gibraltar reaches agreement

The governments of Gibraltar, Spain and the UK announced on 26 July preliminary agreement on flights to Gibraltar's airport, telecommunications and the border with Spain.

The Tripartite Forum of Dialogue on Gibraltar said: "The three participants confirm that the necessary preparatory work related to agreements on the airport, pensions, telephones and fence/border issues, carried out during the last 18 months, has been agreed. Accordingly, they have decided to convene in Spain the first Ministerial meeting of the Tripartite Forum of Dialogue on Gibraltar on 18 September 2006."

Among the issues considered was whether flights from Spain to Gibraltar would be considered "internal flights"; the sharing of security at the airport between Spain and Gibraltar; the border; and telephone services, which are severely restricted in Gibraltar.

Separately, the governments of Gibraltar and the UK have also published a draft text of a proposed new Constitution for Gibraltar. It will see the UK retaining international responsibility for Gibraltar, including its external relations and defence, and as the state responsible for Gibraltar in the European Union. But it will also afford Gibraltar greater control over its internal affairs and an increased degree of self-government.

UK Minister for Europe Geoff Hoon said: "The UK's long standing commitment that the UK will never enter into arrangements under which the people of Gibraltar would pass under the sovereignty of another state against their wishes will be unchanged."

The government of Gibraltar welcomed the statement. Chief Minister Peter Caruana said the fact that it recognised a referendum to be an act of self-determination cleared the way for the Gibraltar to convene the referendum on the new constitution.

Meanwhile, the Financial Services & Markets Act 2000 (Gibraltar) (Amendment) Order 2006, which gives certain Gibraltar-based investment firms the right of establishment and provision of services in the UK, was brought into force on 31 July. This means that qualifying Gibraltar firms will now enjoy "passport rights" to provide investment services in other EEA States.

Sovereign comment

This proposed agreement has been a long time coming and further details should become known after the September meeting. We welcome the prospect that these long standing issues will finally be put to rest – it should benefit Gibraltar's international clients and everyone working in the jurisdiction. Even without such an agreement, Gibraltar has managed to maintain significant growth in its financial services industry. Sovereign was originally founded in Gibraltar in 1987 and it remains our largest administration centre.

europe

EC demands for dividend change

In July, the European Commission sent formal requests to Belgium, Spain, Italy, Luxembourg, the Netherlands and Portugal to amend their tax legislation on outbound dividend payments to companies. At present, these six Member States tax dividend payments to foreign companies more heavily than dividend payments to domestic ones.

The Commission believes that these rules are contrary to the EC Treaty and the EEA Agreement as they restrict both the free movement of capital and the freedom of establishment. The request is in the form of a "reasoned opinion". If they do not respond satisfactorily within two months the Commission may refer the matter to the European Court of Justice.

EU Taxation and Customs Commissioner László Kovács said: "It is a basic rule of the Internal Market that the Member States cannot tax companies of other Member States more heavily than their own companies. While most Member States respect this rule, the Commission will actively ensure that the others do so too."

Outbound dividends are, in this case, dividends paid by domestic companies to companies in other States. Domestic dividends are dividends paid by domestic companies to other domestic companies.

For Belgium, Spain, Italy, the Netherlands and Portugal, the discrimination concerns outbound dividends paid to Member States and to the three European Free Trade Association (EFTA) countries – Iceland, Liechtenstein and Norway – that are parties to the European Economic Area (EEA). In the case of Luxembourg the discrimination only concerns these last three countries.

EC orders repeal of Luxembourg's "1929" companies

The European Commission decided, on 19 July 2006, that Luxembourg's preferential "1929" holding companies tax regime was in violation of EC Treaty state aid rules. It requires that the regime be repealed by the end of 2006, and completely eliminated by the end of 2010.

Under the 1929 law, the revenues of holding companies providing certain financial and capital-intensive services to related and unrelated business entities within a multinational group are tax-exempt, and distributions are free from withholding taxes.

In June 2003, the Council of EU Finance Ministers found that the exemption constituted a harmful tax measure under the EC Code of Conduct on business and recommended abolition.

In parallel, the Commission had initiated a review under state aid rules and proposed certain measures, which Luxembourg rejected. The Commission therefore opened an in-depth investigation. It concluded that amendments made in 2005 had narrowed the scope of the scheme, but it still constituted state aid because the tax advantages remained unchanged.

As the scheme is existing aid, the Commission's decision is not retrospective. Beneficiaries will not therefore be required to repay aid received until its final elimination. The decision does not affect Luxembourg SOPARFIs, which are ordinary taxable Luxembourg companies.

Luxembourg's Minister of Justice announced that the government would comply with the decision and would be proposing alternative tax structures for private wealth and asset management purposes.

Sovereign comment

This is a further example of a jurisdiction having to change its rules following a decision sent down from the European Commission. Other countries including Malta, Gibraltar, the Channel Islands and the Isle of Man – have had to address similar concerns in recent years and Luxembourg is the latest to face this challenge.

SEC chairman to seek emergency hedge fund rules

Securities & Exchange Commission (SEC) chairman Christopher Cox told the Senate Banking Committee, on 25 July, that he would push for new emergency regulations for hedge funds.

His comments followed a Federal Appeals Court ruling of 23 June that overturned the SEC's new rules for oversight of hedge funds. These required an investment manager to register with the SEC if it had at least 15 US investors and US$30 million in assets, regardless of where the hedge fund was domiciled.

Cox said the SEC had not yet decided whether to appeal the court ruling, but the potential for retail investors to be harmed by hedge fund risk remained a serious concern. "The growth in hedge fund fraud that we have seen accompany the growth in hedge funds implicates the very basic responsibility of the SEC to protect investors from fraud, unfair dealing and market manipulation," he said.

He will recommend that the SEC adopt an anti-fraud rule for hedge funds that would establish serious obligations to investors on the part of fund managers and would meet the legal objections of the Appeals Court.

The US Court of Appeals for the District of Columbia Circuit sent the SEC's hedge fund oversight programme, which was adopted in October 2004, back to the Commission to be reviewed. It found that the SEC had contorted the legal definition of who can be considered a client of a hedge fund. The new rules changed the definition of clients to the individual investors rather than the funds themselves.

Since the ruling, of the 1,200 or so funds that had registered since last year, ten have applied to de-register. Some 2,500 funds are registered in total, but 1,300 of them registered under previous rules, which remain in place.

Cox also said the SEC had seen an increase in hedge fund fraud and would continue to pursue cases vigorously. Over the last five years, it had charged fund managers with defrauding investors of a total exceeding US$1 billion.

Sovereign comment

We continue to see considerable and growing interest in all aspects of hedge fund management. These proposed new regulations illustrate the degree to which the market is less regulated than other investment classes. Efforts made by the SEC to reduce the incidence of hedge fund fraud are positively welcomed, but not at the cost of over regulation. Interest in hedge funds is global in nature and start-up funds are being established all the time. As reported last month, we are in the process of opening an office in the Cayman Islands, which will be well placed to advise on the setting up of such funds.

Antigua takes US to WTO over on-line gaming

The World Trade Organisation (WTO) set up a panel, on 19 July 2006, to examine whether US restrictions on gambling violate international trade agreements. US trade laws banning interstate betting over the internet will be examined by prosecutors who are required to report back to the WTO within 90 days.

The investigation was initiated by Antigua & Barbuda, which claims the US on-line gambling prohibitions are impeding its economy. The dispute stems from a June 2003 WTO complaint that a US ban on Antiguan online gambling was in violation of the General Agreement on Trade in Services (GATS).

Antigua's government has invested heavily in the industry in a bid to lessen its reliance on the tourism sector and, it says, US laws are preventing companies from legally accepting bets from the US. Bilateral talks between the US and Antigua failed to resolve the dispute.

A previous WTO ruling said that some of the US laws were in line with international commerce laws, but others were not. "The US has been busy passing legislation that is directly and unequivocally contrary to the ruling," Antigua told the WTO's dispute settlement body.

Should the WTO find for Antigua, US exports there could face sanctions and higher tariffs. But Antigua's size means these are likely to have little impact.

The WTO decision came two days after US federal authorities charged an internet gambling business based in London and licensed in Antigua with racketeering and wire fraud. The extraterritorial reach of US jurisdiction to regulate and control on-line gaming has serious implications for the industry.

Sovereign comment

We await news on both these developments with interest. In recent years, Sovereign has developed considerable expertise in establishing and managing compliant structures relating to the offshore gaming, particularly in our Gibraltar and Netherlands Antilles offices. Please contact either office for more information.

USA ties benefits to info exchange

Under the new US model tax treaty, due to be published later this year, zero-rated withholding is to be made contingent upon a treaty partner's level of cooperation in exchanging information on civil and criminal tax matters. The US model treaty was last revised in 1996.

Addressing the American Bar Association's Section of Taxation on 5 May, US Treasury international tax counsel Hal Hicks said that, despite its inclusion in recent high-profile treaties, a zero withholding provision would not be a standard component of an updated US model tax treaty.

"Exchange of information on civil and criminal tax issues is key to all treaty negotiations," he said. He expected another tranche of treaties and protocols, including the recently signed Denmark-US protocol, to go before the Senate Foreign Relations Committee in the autumn. Other treaty negotiations currently nearing completion include agreements with Canada, Finland, Germany and Norway.

Sovereign comment

The use of relevant tax treaties is a vital component of sophisticated, compliant tax planning. The developments outlined above highlight the need for up to date information and advice. Please contact your local Sovereign office for any information you may need in this area.

South Africa imposes tax on visiting entertainers and athletes

The South African Revenue Service (SARS) announced that a new withholding tax regime for non-resident entertainers and sportspersons who are not resident in South Africa for income tax purposes would be brought into force as of 1 August 2006.

From this date, event organisers, producers, and others who make payments to foreign entertainers and athletes for performances in South Africa will have to withhold 15% from these payments. Where it is not possible, the foreign entertainer or sportsperson is liable for the payment of the 15% tax.

Previously foreign entertainers and sportspersons were taxed on income derived from their performances in South Africa on a similar basis to South African residents. But SARS said this system had proved to be impractical in light of their very short stays in the country.

asia+ pacific

Reporting requirements have been introduced to ensure that SARS is informed beforehand of performances. A resident who agrees to found, organise, or facilitate a performance for reward, is required to notify SARS of the performance within 14 days of concluding the agreement.

The withholding tax system was announced in the 2005 Budget and included in the Revenue Laws Amendment Act 2005.

SARS said the withholding tax system is not intended to give an unfair advantage to foreign entertainers and sportspersons who are employed for extended periods of time. Foreign entertainers or sportspersons will, therefore, continue to pay tax on the same basis as other employees if they are:

- employed by a resident employer; and
- physically present in the country for more than 183 days in total in a 12-month period that commences or ends in a tax year.

The withholding tax system will be administered by SARS' Non-Resident Entertainers & Sportspersons Team.

Sovereign comment
The incidence of entertainers and sportsmen and women being subject to this type of taxation system in a number of countries worldwide has become more common in recent years. The UK is just one well-known example. As a result, our London and Isle of Man offices have developed considerable expertise advising sports personalities and entertainers around the world on their financial affairs.

Dubai introduces Investment Trusts

The Investment Trust Law, which provides an additional structure for persons setting up collective investment funds within the Dubai International Financial Centre (DIFC), was enacted on 1 August 2006. Rules to permit the operation of Real Estate Investment Trusts (REITS) were also introduced.

Investment trusts, also known as closed-end mutual funds, are companies that use the pooled funds of small investors to invest in other companies. Previously, public funds could only be structured as an investment company or an investment partnership. Private domestic funds can also now be structured as an investment trust.

David Knott, Dubai Financial Services Authority chief executive, said: "This new Investment Trust Law provides additional flexibility and choice for the structuring of managed funds within the DIFC. Investment trust vehicles play an important role in capital markets and will contribute to product innovation within the DIFC."

Dubai passed the Collective Investment Law, which sets out the framework for regulating funds and permits the operation of various types and categories of collective investment funds in the DIFC, on 18 April.

Sovereign comment
We have commented in previous issues on the tremendous growth seen in Dubai's financial services sector in recent years. This story emphasises once again the interest in the UAE for these type of investment vehicles. Our Managing Director in Dubai, John Hanafin, has considerable experience in this area.

China and Hong Kong agree cross-border enforcement of judgments

The Arrangement between Hong Kong and China for reciprocal enforcement of certain civil court judgments was finally signed on 14 July. It will only apply in commercial cases where there is a pre-existing written exclusive jurisdiction agreement. Legislative changes are required in Hong Kong and the Mainland for implementation.

The Arrangement is limited to judgments relating to agreements between creditors and debtors "in written form... in which a people's court of the Mainland or a court of the HKSAR is expressly designated as the court having sole jurisdiction for resolving any dispute which has arisen or may arise in respect of a particular legal relationship."

It also only applies to "civil and commercial contracts between the parties concerned, excluding any employment contracts and contracts to which [an individual] acting for personal consumption, family or other non-commercial purposes is a party."

The limitation period for applying to enforce is very short – one year if either the judgment creditor or the judgment debtor is an individual, and six months in the case of disputes between companies – and certain important categories of dispute fall outside the scope of this Arrangement.

In Hong Kong, the only court with jurisdiction to deal with enforcement or recognition applications is the High Court. In the Mainland, jurisdiction lies with the courts of the respondent's domicile or ordinary residence, as well as with the courts of any place where the respondent has property. An applicant must elect to file in only one such court.

A commencement date has yet to be announced. The Arrangement is non-retrospective and whether it will apply to judgments on or after the commencement date or only to agreements entered into after the commencement date has not been clarified.

Sovereign comment
This Arrangement will be of benefit to cross-border business and to the international community as a whole. Contracting parties will have the freedom to choose between arbitration or litigation, in either Mainland China or Hong Kong, with the outcome enforceable in both jurisdictions.

Cadbury Schweppes wins partial victory in CFC appeal

The establishment by a parent company of a subsidiary in a low-tax jurisdiction is not an abuse of freedom of establishment, said the Advocate-General of the European Court of Justice in the *Cadbury Schweppes* case.

Publishing his opinion on 2 May 2006, Philippe Leger said that the UK's controlled foreign corporation (CFC) rules were in breach of the EU principle of freedom of establishment when they sought to tax the income of subsidiaries set up in low tax jurisdictions. But, he added, the UK could apply its controlled-foreign corporation rules to "wholly artificial arrangements the purpose of which is to circumvent national law".

In *Cadbury Schweppes v Commissioners of Inland Revenue,* the UK drinks and confectionery group had set up two companies in the International Financial Services Centre in Dublin (IFSC) to raise finance for subsidiaries in rest of Cadbury Schweppes. The IFSC provides favourable tax treatment for group treasury companies.

On the basis of its controlled-foreign-corporation (CFC) rules, the UK issued Cadbury Schweppes with a tax bill of almost £9 million on the profits of Cadbury Schweppes Treasury International, one of the IFSC companies, for the year to the end of 1996. Cadbury Schweppes appealed to the UK Special Commissioners, claiming that the UK's CFC rules breached the EC Treaty rules on freedom of movement.

The UK's CFC rules seek to tax the profits of a foreign subsidiary controlled by a UK tax resident where the tax rate in the country where the subsidiary has been set up is much lower than the UK rate. Control is taken to mean a stake of 50% or more.

The Advocate-General proposed that evidence of legitimate operations might come in the form of "the degree of physical presence of the subsidiary in the host State; secondly, the genuine nature of the activity provided by the subsidiary and, finally, the economic value of that activity to the parent company and the entire group."

If the ECJ follows Advocate-General Leger's opinion that the UK's CFC rules breach the EC Treaty, the case will have an impact in other EU member states other than the UK. A final decision is expected in the autumn.

Sovereign comment

This case is of very considerable importance and developments should be monitored closely. Further editions will bring readers updated news on this and other European cases. In the last Sovereign Report 24, we commented again on another UK case *Wood & another v Holden (Inspector of Taxes)* that deals specifically with corporate residence. Both cases highlight the vital need to consider corporate residence, management and control, as well as traditional CFC rules. When considering the establishment of cross border structures, professional advice is more important than ever.

Agassi loses UK tax match in final set

Andre Agassi, the US tennis player, has finally lost a protracted tax dispute with HM Revenue & Customs over sponsorship revenue he earned while working in the UK. Six years after he began litigation, the Law Lords ruled by four to one in favour of the Revenue.

The ruling overturns a Court of Appeal decision of 19 November 2004 and means all non-residents must pay UK tax on endorsement or sponsorship deals for the portion of the year that they work here. This includes payments from foreign companies to foreigners where the money never enters the UK.

Agassi was originally assessed for £27,500 for back taxes for fiscal 1998-1999. Agassi claimed that, since both himself and the sponsors were based outside the UK, and he was in the country only temporarily to play in tennis tournaments, he was not liable to pay tax on the endorsements.

Initially, the Special Commissioners, ruled in favour of the Revenue. Agassi also then lost in the High Court, but won in the Court of Appeal.

Ruling that Agassi could not escape liability because the income was collected by a company outside the UK, Lord Scott said: "I am impressed by the Revenue's point that, if Mr. Agassi is right, the ease with which the tax liability... could be avoided simply by ensuring that the potentially taxable payments were made by foreign entities with no residence or trading presence in this country would render payment of the tax to all intents voluntary. That cannot, in my opinion, have been Parliament's intention."

Sovereign comment

The reversal by the Law Lords is clearly of importance to anyone seeking to avoid the imposition of UK taxation by way of routing payments via a foreign company (offshore or otherwise). There have been an increasing number of cases where sports or entertainment events have not taken place because of the tax implications. Once again, clients must take appropriate advice before entering into such contracts.

UK Revenue wins offshore accounts

Barclays Bank will be forced to hand over details of thousands of its customers' offshore accounts after the Her Majesty's Revenue & Customs (HMRC) won a landmark legal case that it believes could yield £1.5bn in unpaid tax.

The Special Commissioner's granted the Revenue powers, which are expected to affect all banks, to force disclosure of British residents' accounts overseas. The Revenue said suspicions had been aroused when 688 Barclays' customers paid tax credits directly into offshore bank accounts.

The Special Commissioner dismissed Barclays' claim that this would amount to "a fishing trip" contravening its customers' human rights, and ruled there were grounds to investigate widespread tax evasion.

Barclays said it did not intend to appeal and would hand over details of customers' offshore bank accounts by 24 June.

It followed an earlier ruling by the Special Commissioners, by which the Revenue won the power to require financial institutions to hand over customers' credit card details to help them track undeclared income from offshore savings accounts.

Sovereign comment

At all times, Sovereign stresses the importance attached to ensuring that any offshore structuring for its clients is legitimate and compliant. Simply holding bank accounts offshore in the hope that the tax man will not find out is hardly tax planning. The full implications of this item remain to be seen.

UK Finance Act 2006 receives Royal Assent

The Finance (No.2) Bill 2006 received Royal Assent on 19 July, and passed into law as Finance Act 2006. As of 6 April 2006, most trusts whose value is over the IHT threshold (currently £285,000) will be subject to the discretionary trust IHT regime, such that: lifetime transfers into any trust, new or existing, over the IHT threshold will trigger an IHT charge at 20%; trusts will be subject to an IHT charge every 10 years – currently 6% of the value of the trust assets over the IHT threshold; and, when capital leaves a trust, there will an IHT charge – currently a maximum of 6%.

A number of amendments were made to the proposed new rules for accumulation & maintenance (A&M) trusts and interest in possession (IIP) trusts as the Bill went through Parliament.

The existing tax treatment for trusts in existence on Budget Day (22 March 2006) remains during the existing life tenant's life. If an existing life tenant dies, or otherwise ends their interest, in favour of another life tenant before 6 April 2008, then the existing tax treatment will continue during the life of the successor life tenant. If a surviving spouse takes an interest on the life tenant's death, then the spouse exemption will apply and the existing tax treatment will continue during the surviving spouse's life. At the end of the existing or successor life interest, if the trust continues it will be taxed as a discretionary settlement.

Under the new law, beneficial tax treatment is available for trusts created on death or by will for children, provided that they will become absolutely entitled at no more than 18 years old. Existing A&M trusts will continue with the existing IHT treatment until 5 April 2008 and can be amended before 5 April 2008 such that the beneficiaries become absolutely entitled at 18. If no change is made and the trust is worded so that the beneficiaries become absolutely entitled at an age more than 18 then, from 6 April 2008, the trust will be taxed as a discretionary settlement.

Special rules apply if the beneficiary becomes absolutely entitled up to 25, which are similar to the discretionary trust regime but with some variations. Again, no extra tax will be due on the death of the settlor. If an age later than 25 is specified, no extra tax will be due on death but the trust will be taxed as a discretionary trust from the date of death.

Sovereign comment

The Finance Act will affect many existing trusts established for UK clients. Advice should be sought if you or your clients have set up a trust during your lifetime, or are the trustee or beneficiary of a trust. Making gifts into trust, business property relief and life insurance arrangements remain important IHT planning tools. Highly advantageous IHT rules are also still available for individuals who are non-domiciled in the UK.

fiscal 25

Manx tax regime gains approval

Both the Income Tax (Amendment) Act 2006 and the Income Tax (Corporate Taxpayers) Act 2006, introducing the new "zero-ten" tax regime for companies, received Royal Assent on 11 July.

The "zero-ten" tax regime for companies is now in force and has effect from 6 April 2006; that is, for the 2006/07 and subsequent years of assessment. The distributable profits charge and the corporate charge are also in force from 6 April 2006. An accounting period basis of tax assessment for companies will be introduced with effect from 6 April 2007.

Meanwhile Guernsey's parliament has followed suit by passing, on 28 June 2006, a set of proposed fiscal changes that includes a "zero-ten" corporate tax regime and the capping of personal tax at £250,000. Wealth taxes such as inheritance tax and capital gains tax will not be introduced. The proposals are intended to maintain competitiveness with similar jurisdictions and meet international obligations, particularly the EU's Code of Conduct on harmful business taxation. Legislation will be required to give effect to the proposals.

Sovereign comment

These are very interesting developments and the larger Channel Island, Jersey, is also expected to introduce similar legislation. Of the four British overseas territories in Europe the Isle of Man is the only one that operates a VAT regime. This opens up a number of interesting planning opportunities when used with other companies, particularly those established in EU countries. Our Isle of Man office has undertaken considerable research on the new arrangements and may be contacted for further information.

Belgium clarifies Hong Kong tax treaty application

Belgian Finance Minister Didier Reynders confirmed that dividends from a Hong Kong subsidiary are not excluded from the Belgian participation exemption on the basis of the subjective taxation conditions and that the legal owner of the participation is to be considered the beneficial owner of the dividends received.

He was responding to parliamentary questions on the applicability of the 2003 Belgium-Hong Kong income tax treaty in respect of an administrative circular, issued by the Belgian tax authorities on 31 March 2005.

In the circular, the Belgian tax authorities confirmed that the Hong Kong corporate tax regime, based on the territorial principle, was not considered "substantially more advantageous" than the tax system in Belgium, and that the Hong Kong offshore regime did not deviate from Hong Kong's common tax regime.

The Belgian participation exemption test requires that a shareholder holds at least 10% of the capital of the subsidiary for at least one year, or holds a participation worth at least Euros1.2 million on the distribution date. The tax code provides that dividends will not qualify for exemption if received from a company that is not subject to corporate tax, or from a company resident in a jurisdiction whose normal tax regime is "substantially more advantageous" than that in Belgium.

The 2005 circular letter was unclear as to whether Hong Kong-source dividends would qualify, but Reynders confirmed that dividends from a Hong Kong subsidiary would not be excluded from the Belgian participation exemption on the basis of the subjective taxation conditions.

Questioned on the interposition of a Hong Kong company between a Belgian subsidiary and a foreign parent company, and the subsequent qualification of the Hong Kong company as the beneficial owner, Reynders said the legal owner of the participation was to be considered the beneficial owner of the dividends received. But a person that acted as a representative on behalf of the legal owner of the participation would not be regarded as the beneficial owner and, therefore, would not be entitled to treaty benefits.

OECD Global Forum on Taxation

The OECD Global Forum on Taxation issued on 29 May a progress report, entitled *Tax Co-operation: Towards a Level Playing Field,* to review the legal and administrative tax systems in the 82 participating OECD and non-OECD countries.

The Forum was set up to include 33 jurisdictions that the OECD originally classified as tax havens under its Harmful Tax Practices initiative but which then made commitments on transparency and information exchange. It enables them to work together with OECD members to ensure common standards on transparency and information exchange for tax purposes so as to permit fair competition between all countries.

Of 82 countries reviewed in the 2006 Report, all but 12 now have exchange of information arrangements that permit them to exchange information for both civil and criminal tax purposes in the form of double tax treaties or Tax Information Exchange Agreements (TIEAs). The exceptions are: Andorra, Anguilla, Cook Islands, Gibraltar, Guatemala, Liechtenstein, Nauru, Niue, Panama, Samoa, Turks & Caicos Islands and Vanuatu.

Only Cyprus, Hong Kong, Malaysia, Philippines and Singapore reported being unable to respond to a request for information in cases where they have no domestic tax interest. Only Andorra, Cook Islands, Samoa and Switzerland still apply the principle of dual criminality to all information exchange relationships.

All countries except Guatemala and Nauru reported having legal mechanisms in place to permit the exchange of information in criminal tax matters. But in a number of countries, the report said, the exchange mechanisms based on either mutual legal assistance treaties or domestic law are very restrictive. As a result, countries, such as Panama, are rarely, if ever, able to exchange information in criminal tax matters. All countries that are able to exchange information, report having safeguards in place to protect the confidentiality of any information exchanged.

In respect of bank information, authorities in 77 countries have access to information held by banks or financial institutions for at least some tax information exchange purposes. Only Guatemala, Nauru and Panama indicated an inability to access information. Another 17 countries permit access to bank information solely for exchange of information in criminal tax matters. Of these Andorra, Austria, Cook Islands, Luxembourg, Samoa, San Marino, Saint Lucia, Saint Vincent & the Grenadines and Switzerland apply the principle of dual criminality. In the Cook Islands, Niue and Vanuatu the provision of information is at the discretion of the attorney general.

In respect of access to ownership, identity and accounting information, 78 countries – including all OECD members - have powers to obtain information kept by a person under record keeping obligations in response to a request for exchange of information in tax matters. In addition, 71 countries also have powers to obtain information from persons not required to keep such information. But Anguilla, Montserrat, Panama and Turks & Caicos Islands have very limited powers to obtain information for criminal tax matters.

In respect of the availability of ownership, identity and accounting information for companies, 77 countries require companies to report legal ownership information to government authorities, or to hold such information. More stringent ownership reporting requirements exist in certain countries.

Bearer shares can still be issued in 48 countries. Of these, 39 have adopted mechanisms to identify the legal owners of bearer shares in some or all cases. Ten of these countries also require bearer shares to be immobilised or held by an approved custodian, while the remaining 29 rely mainly on anti-money laundering rules, investigative mechanisms or a requirement for the holders of shares to notify the company of their interest.

All but five countries – Aruba, Guatemala, Hong Kong, Macao and Singapore – indicated that applicable anti-money laundering legislation would normally require corporate service providers or other service providers to identify the beneficial owners of their client companies.

In 75 countries, all domestic companies are required to keep accounting records. No such requirements exist for international business companies in Belize, Brunei and Samoa, or for limited liability companies in Anguilla, Montserrat and Saint Kitts & Nevis. In the Bahamas, only public companies are required to keep accounting records. Mandatory accounting records retention periods of five years or more exist in 63 countries.

Of the 54 countries that have trust laws, information on settlors and beneficiaries of domestic trusts is required to be held under the laws of 47 countries. For 36 of these, this also applies to a domestic trustee of a foreign trust. In 45 countries, trusts are required to maintain accounting records. Of the 28 countries without a trust law, 18 indicated that their residents might act as trustees of a foreign trust. With the exception of Luxembourg, all require resident trustees to identify settlors and beneficiaries of foreign trusts.

The Report said that both OECD and non-OECD countries have made considerable progress towards implementing standards for transparency and effective exchange of information. But it recognises that further progress is required in certain countries to address:

- constraints placed on international co-operation to counter criminal tax abuses;
- those instances where a domestic tax interest is needed to obtain and provide information in response to a specific request for information related to a tax matter;
- strict limits on access to bank information for tax purposes;
- the need for competent authorities to have appropriate powers to obtain information for civil and criminal tax purposes;
- lack of access to beneficial ownership information and the permissibility of bearer shares;
- the need for the keeping of accounting records for international company regimes.

Countries are encouraged to review their current polices and to report the outcome of their review at the next Global Forum meeting. Over the next year, said the Report, the most crucial issue would be whether further progress was made in the TIEA negotiations with non-OECD Participating Partners. Over 40 such negotiations were currently under way and due to be completed before the end of the year.

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Printer Pioneer Printers Limited
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25

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