Sovereign

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report

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

27

contents

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UK Offshore Disclosure Facility

UK taxpayers with previously undisclosed tax liabilities from offshore accounts have until 22 June to notify HM Revenue & Customs that they intend to disclose the tax liabilities and must complete disclosure and pay all unpaid tax plus interest and a 10% penalty by 26 November.

As previously reported, the Revenue has used its legal powers to obtain information about holders of offshore accounts from a number of UK banks, and has obtained similar details through the European Savings Directive. This one-off Offshore Disclosure Facility is to encourage those with unpaid tax and duties to pay what they owe. When it has closed, the Revenue will target those with offshore bank accounts and undeclared tax liabilities who have not made a disclosure.

The Offshore Disclosure Facility is open to those who hold or have held, either directly or indirectly, an offshore account that is in any way connected to a loss of UK tax and/or duties. This includes irregularities connected with an offshore trust or company. But anyone making a voluntary disclosure of past tax irregularities, not just those connected with an offshore account can expect similar treatment.

This development was widely anticipated but the time to act is very short. Any reader who remains concerned about their own position should contact Sovereign at uktax@SovereignGroup.com to arrange a low cost consultation that takes account of their particular circumstances.

Sovereign Art Prizes

The 2007 Sovereign European Art Prize was awarded to Damien Cadio whose painting, “Esercito”, most impressed the judging panel led by Sir Peter Blake. The award was presented at a gala dinner held at Bonham’s in London on 15 March. The auction of the remaining 33 works in the final raised a considerable sum for the Sovereign Art Foundation. On behalf of the Foundation and all the people who benefit from its charitable works, a big thank you to everyone who contributed by buying on the night.

The final 30 paintings for the 2007 Sovereign Asian Art Prize have been selected and are now on our website www.SovereignArtFoundation.com, so please take a look. This year’s gala dinner and auction will be held in the ballroom at the Hong Kong Four Seasons Hotel on 21st September. The sponsor, Louis Vuitton, has promised to make it the event of the season. The fact that they own lots of fine vineyards in France and will be bringing along some of their splendid products should guarantee that they make good on this promise. The event is already nearly sold out but a few tickets may still be available. Please contact TPinkstone@SovereignGroup.com for details.

chairman

Planetary Fund wins 5 S&P Fund Stars

Sovereign Asset Management’s top-performing Planetary Fund has been awarded Five S&P Fund Stars by leading rating agency Morningstar. Since its launch in February 2003, Planetary Fund has returned over 232% to investors, equivalent to 33% per annum. This is more than double the return of the MSCI World Index over the same period.

The Planetary Fund is a long-only global stock-picking fund, which focuses on companies’ fundamentals and seeks out under-valued stocks. With no geographical or industry benchmarking, it is a highly diversified fund containing over 230 stocks, which significantly reduces individual stock risk. More details can be obtained from Sovereign Asset Management at sam@SovereignGroup.com or +350 41054.

Sovereign boosts legal team and Dutch office

To meet increased client demand, Sovereign has expanded its in-house legal teams in its Gibraltar, Dubai and Isle of Man offices. These new lawyers will complement the existing teams and will assist any clients who require complex legal structuring.

In the Netherlands, we are delighted to announce that we are merging with our long-term local partner Hyksos Management BV. The expanded firm, to be known as Sovereign Trust (Netherlands) BV, can be contacted on nl@SovereignGroup.com.

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Chairman of The Sovereign Group

27

Netherlands brings in tax reform package

The upper chamber of the Dutch parliament approved, on 28 November 2006, a package of tax reform measures that reduced the corporate income tax rate to 25.5% as of 1 January 2007. The dividend tax rate is also reduced to 15% and the participation exemption requirements are amended.

In 2004 the general corporate tax rate was 34.5% but this was reduced last year to 29.6%. The average corporate tax rate in the European Union (including the new members, which have lower tax rates than the old EU members) is 25.8%. The latest reduction to 25.5% therefore puts the Netherlands in the middle bracket with regard to EU corporate tax rates.

Also as of 1 January 2007, the dividend tax rate will be reduced from 25% to 15%. This is especially advantageous for dividend distributions to countries that are not treaty partners of the Netherlands because the maximum rate under many Dutch tax treaties is already 15%. Withholding tax rates are generally lower under tax treaties but taxpayers already enjoying this rate under a tax treaty will no longer have to request a refund.

On 25 July 2006, the European Commission formally requested the Netherlands to end its discrimination in respect of outbound dividends. The Act provides for the similar treatment of Dutch parents and EU parents with effect from 1 January 2007. Dutch subsidiaries are no longer obliged to withhold Dutch dividend tax if the Dutch parent, or parent resident in another EU state, holds at least 5% of the shares in the Dutch subsidiary.

The Act replaces existing rules for the application of the participation exemption with just two requirements, which will apply equally to domestic and foreign subsidiaries. In all cases the parent company must own at least 5% of the nominal paid-up share capital of a subsidiary (although, if a related company has a qualifying participation, the parent may "tag along").

Secondly, the subsidiary must not be regarded as a so-called "low-taxed portfolio investment participation" – if the assets of the subsidiary, directly or indirectly, consist of more than 50% of free portfolio investments, or if the subsidiary is not subject to a tax on profits.

The Act introduces a so-called "group interest box", which will be particularly advantageous for the financing of foreign group activities from the Netherlands. The interest box is optional and allows corporate taxpayers to enjoy an effective tax rate of 5% in respect of any interest received on the balance of loans granted to, and borrowings from group companies.

The Act also introduces a so-called "patent box", which provides for an effective rate of 10% in respect of income (including royalties) in relation to a patent obtained in respect of an intangible asset that is developed by the relevant corporate taxpayer. Both "box" regimes are subject to EU approval but will have retroactive effect to 1 January 2007.

Sovereign Comment

As announced on the Chairman's Page of this issue, our Netherlands office has recently been expanded. They are well placed to advise on all aspects of structuring companies in the Netherlands. Sovereign has also developed considerable expertise in the tax efficient treatment of royalty routing through the Netherlands. For more details on this, please contact your local office or the Netherlands direct.

27 europe

New Luxembourg SPFs

The Luxembourg government launched the "Société de gestion de Patrimoine Familial" (SPF) to replace the 1929 holding company regime. The 1929 regime was terminated on 1 January 2007 after it was found by the European Commission to be in violation of state aid rules for providing "unjustified tax advantages" to those setting up holding structures in Luxembourg.

The SPF, or "Family Wealth Company", has been approved by the Commission and is exempt from corporate income tax, municipal business tax and net-worth tax, and from withholding tax on distributions. Shareholders are restricted to small groups of individual shareholders. They will be prohibited from commercial activity and limited to private wealth management activities, such as the holding of assets. There are about 14,000 existing 1929 Holdings in Luxembourg and those formed before 20 July 2006 will be able to keep their present status until 2010.

Sovereign Comment

Luxembourg is one of several European jurisdictions that have been forced to amend legislation by the European Commission. Sovereign is able to provide clients with a full explanation of how these changes could be applied in individual situations. Also worthy of note is that we have recently seen clients preferring Cyprus-based solutions rather than the more expensive Luxembourg option. Cyprus is an increasingly attractive jurisdiction that has been further boosted by its accession to the EU in May 2004. Details can be obtained by contacting our Cyprus office at cy@SovereignGroup.com.

Portugal cuts offshore tax penalties

The 2007 Budget approved on 29 December 2006, reduced the annual municipal tax (IMI) levied on property owned by companies based in countries classed as tax havens on the Portuguese "black list", from 5% to 1% – this is double the rate applied to non-offshore held property.

The property transfer tax (IMT) payable on initial acquisition by a blacklisted company has also been reduced from 15% to 8%, which is 2% more than the highest rate for non-blacklisted acquisitions.

This may help to revive the property market, which suffered a decline since the laws penalising the use of offshore companies were enacted in 2003. It is also an indication that Portugal no longer considers the use of offshore companies to be the preserve of criminals.

The government has however proposed legislation to impose a duty on all consultants to report "aggressive tax planning". This includes banks and financial institutions, lawyers, economists and auditors.

Sovereign Comment

These latest changes are a significant reversal to the previous swingeing taxes and may mean that the costs are now more acceptable to those who wish to retain the confidentiality of offshore ownership. Any corporate owners who have "stayed offshore" may feel it is more convenient, but they should consult our Portugal office for a full calculation of the future effects of the changes. Such individual consultations can be arranged speedily and for a modest fee.

OECD financial standards criticised by OFCs

Many OECD member states have regulatory standards no better, and sometimes worse, than many offshore financial centres labelled as tax havens, according to a report published by the Commonwealth Secretariat on 1 May 2007.

Their deficiencies include mechanisms for tax information exchange and for identifying beneficial owners of companies or trusts, says the report, commissioned on behalf of the International Trade & Investment Organisation (ITIO), a group of small countries with international finance centres.

Malcolm Couch, deputy chairman of the ITIO, said small countries had been unfairly stigmatised by larger, more powerful ones. "It's time to stop treating small countries with finance centres as different. Big countries have no moral or legal edge over small ones," he said.

Offshore financial centres have improved their regulatory standards as a result of the OECD's harmful tax competition initiative, launched in 1996. In 2000 it published a "blacklist" of 35 tax haven countries, which obliged offshore centres to make commitments to remove harmful tax practices, improve transparency and exchange information.

This process has led to "considerable rapprochement" between OECD and non-OECD participants, says the report. Both sides have recognised the case for creating "a level playing field", although non-OECD countries still have concerns about distortions caused by the tax treaty network and the OECD's "organisational blindness" about the regimes of its own members.

Many US states, including Delaware and Nevada, do not require companies to provide beneficial ownership information. Many industrialised countries, including the UK, permit the use of bearer shares, which reduce transparency. Switzerland limits exchange of tax information to cases of fraud, while Hong Kong and Singapore limit information exchange to cases where they have a domestic interest.

Small countries should be involved in the creation of new international standards, rather than have these imposed on them by multilateral bodies controlled by large countries, such as the OECD, said Couch. The report also called on large countries to open up access to the international network of double taxation treaties to small countries. It criticised OECD members for offering small countries "tax information exchange agreements" without mutual benefits. It said OECD members wanted to obtain information about taxpayers "at as low a cost and with as little disruption to their competitive positions and existing international arrangements as possible."

Ransford Smith, deputy secretary-general of the Commonwealth Secretariat, said: "To reduce global inequality, international standard setting exercises need to promote a level playing field and fair competition."

usa+caribbean 27

Uruguay passes tax reforms

The Uruguayan Parliament finally approved a tax reform that was first announced in November 2005. The law, which was promulgated on 27 December 2006, includes the introduction of an economic activities income tax to replace the corporate income tax and agricultural income tax.

The new tax will reduce the tax rate on business entities from 30% to 25% and introduce a 7% withholding tax on dividends paid to non-residents and individuals. The income of non-resident entities will be taxed at a 12% rate, with reduced rates of 3%, 5% and 7% applying to certain types of income. The carrying forward of losses will be extended from three to five years and an OECD-based permanent establishment concept and transfer pricing rules will be introduced.

Under the general tax regime, no new SAFIS (Financial Investment Corporations) will be permitted, and existing SAFIS will be required to modify their status by 31 December 2010.

Other measures introduced by the law include a dual-rate personal income tax system, with progressive rates ranging from 10% to 25%, imposed on wages, salaries earned by dependent employees and other personal income derived by independent workers. A flat rate of 12% will apply to income derived from capital (interest, royalties, leasing, etc.), with reduced rates of 3%, 5% and 7% applying to certain types of income.

The new measures will be effective 1 July 2007. For corporations, the changes to income taxation are effective for fiscal years beginning after that date.

Sovereign Comment

Despite the ending of the SAFI regime, Uruguay remains an interesting jurisdiction for complex international tax planning. Readers should bear in mind however that documentation will be in Spanish so translation costs must always be considered. Sovereign recommends that clients seek professional advice as soon as possible when considering using Uruguay in order to balance the advantages against the extra cost involved; our long established office in Montevideo is well placed to provide such assistance.

Cayman permits Arabic language

The General Registry of the Cayman Islands introduced an Arabic language facility in March to enable registration and other certificates to be issued bearing a company's name in both Arabic and English.

"This customisation of our Registry service for a market of growing importance to us is an indication of our commitment to innovation and quality, and we look forward to catering to Islamic finance structures for the long term," said Deputy Financial Secretary Deborah Drummond.

The Cayman Islands is one of the leading offshore jurisdictions for Islamic finance structures, which have a current estimated market size of between US$250 billion and US$500 billion. In particular, "sukuks" – bond issues that comply with Shari'a law – developed and marketed in the Middle East are predominantly using Cayman Islands-domiciled issuers.

Sovereign Comment

This development in Cayman underscores the increasing importance placed by international finance centres on winning business originating in the Arabic speaking world. It is interesting to note that Company Registrars in a number of jurisdictions are now able to offer such facilities. Readers may recall that for some years this has also been possible in Chinese script in several centres. Sovereign is able to advise both Arabic and Chinese speaking clients as to the possibilities now available in this regard.

South Africa to axe Secondary Tax on Companies

South Africa's 2007 Budget, presented by Finance Minister Trevor Manuel on 21 February 2007, provides for the secondary tax on companies (STC) to be replaced with a 10% withholding tax on dividends.

Initially the STC will be replaced with a dividend tax at company level and the rate will be reduced from 12.5% to 10%, as from 1 October 2007. During 2008, the tax will be converted to a dividend tax on shareholders with administrative enforcement through a withholding tax at company level. The implementation of this phase will depend on the renegotiation of several international tax treaties. There is no mention of the introduction of an imputation system to provide credit for taxes imposed on profits out of which the dividends are declared.

To provide equitable treatment between large institutions and individuals, as well as certainty in distinguishing capital from revenue profits, all shares disposed of after three years will be on capital account and trigger a capital gains tax event. Gains realised on the sale of shares are currently taxed either as ordinary income or capital gains, but the government said the "facts and circumstances" test had become "problematic".

Foreign companies, depending on their legal form, are currently subject to different rates of tax – subsidiaries of foreign companies pay tax at a 29% rate, while a branch of a foreign company will pay tax at a 34% rate. The higher rate will now apply to all foreign companies.

Measures to remedy the potential loss of intellectual property and the impact on the tax base will be introduced to try to prevent certain South African companies from shifting intellectual property offshore as exchange controls are lifted. We will watch this closely as we are involved in some of this work at the moment.

Amendments will also be introduced to combat a perceived loophole where loans are made by emigrating South African residents who then become non-resident immediately after the loan is made. The changes will again have implications for planning outbound clients.

Sovereign Comment

These measures are the latest stage of tax reform announced in South Africa. Clients are encouraged to contact either of our local offices (in Cape Town or Johannesburg) for a more detailed explanation of the changes and how best to structure their affairs as a result.

For those interested in purchasing real estate in the country, professional advice is also recommended at an early stage. Once again, our local team is well qualified in that area.

27 asia+ pacific

Qatar sets out funds rules

The Qatar Financial Centre Regulatory Authority (QFCRA) released a consultation paper and accompanying draft rules on the regulation of collective investment funds operating in or from the Qatar Financial Centre (QFC) on 18 December 2006.

The draft rules provide for the establishment and regulation of funds in the QFC for qualified investors. A regime for retail funds is also being separately developed in conjunction with the development of the wider retail regime in the QFC. In addition, under the proposed regime QFC authorised firms will be able to advise on and market units in recognised foreign funds.

QFCRA chairman and CEO Phillip Thorpe said: "The QFC laws allow for a wide range of collective investment fund activities to be conducted in or from the QFC and makes Qatar a particularly attractive venue for fund managers. Our proposed regime is closely modelled on widely accepted international practices and standards. Our intention is to have a high standard regime in which funds can operate and investors can participate with confidence."

Sovereign Comment

Qatar is the latest Gulf state to seek to exploit the ever-growing interest in fund management across the whole region. It is aiming to compete head on with existing centres such as Cayman and clients should consider this exciting alternative. Our Bahrain office is well placed to advise on all aspects of establishing funds in Qatar.

China unifies corporate tax rates

The Unified Enterprise Income Tax Law, to unify the corporate tax rate at 25% for domestic and foreign investment enterprises (FIEs) and make other important changes to China's corporate tax regime, was finally approved by the National People's Congress of the People's Republic of China on 16 March.

The effective date of the new EIT law is 1 January 2008, at which time the former foreign-investment and domestic-investment enterprise income tax laws – the FEIT law and the old EIT law – will be officially repealed.

Both domestic and foreign investment enterprises are currently subject to a statutory rate of 33%, but there are preferential tax rates of 24% and 15% for FIEs in some special regions, and reduced tax rates of 27% and 18% for domestic investment enterprises with profits that fall below a specific threshold. The varying tax rates had led to big gaps between the nominal and actual tax rates.

The unified EIT would revise the existing preferential tax policies such that, in addition to a new unified tax rate of 25% on all enterprises in China and regardless of the source of the capital, there would be preferential tax rates of 20% for qualified enterprises with profits that fall below a specific threshold, and 15% for some high- and new technology enterprises.

The fixed-period tax reduction and exemption policies for manufacturing FIEs and the 50% tax reduction for export-dominated manufacturing enterprises would be eliminated. But to mitigate the impact of the higher tax burden on FIEs under the unified EIT, enterprises that currently receive those tax benefits would benefit from a five-year transition period, during which their benefits would continue.

The new law, which passed with a 98% majority, is regarded a progressive move. Domestic firms, on average, have paid an effective tax levy of 24%; double that of their foreign counterparts, since the introduction of a dual tax regime in 1994.

"The corporate tax reform marks the maturity and standardisation of China's economic system," Jin Renqing, China's finance minister, told government press agency Xinhua. The law also granted the State Council the right to alter the tax code without requiring the vote of the NPC, which meets only once a year.

Gibraltar gives evidence to ECJ on proposed tax regime

Gibraltar Chief Minister Peter Caruana travelled to Luxembourg on 14 March 2007 to give oral evidence to the European Court of Justice in support of Gibraltar's challenge to the European Commission's 2004 decision that, under EU law, Gibraltar is not permitted to have a tax regime different to the UK's.

The two issues identified for adjudication by the ECJ are whether a new corporate tax regime proposed by Gibraltar to replace the existing exempt company regime is in compliance with EU state aid rules and whether Gibraltar, which is regarded as part of the UK for purposes of some aspects of EU membership, is to be permitted to have a tax regime separate from that of the UK.

The ECJ has already received full written submissions from both sides, and the oral hearing is expected to be the final stage of the litigation. The Commission's intervention led Gibraltar to postpone several planned tax changes and to scrap plans to move to a zero-tax regime in place of the exempt company regime that is being phased out after being found to violate EU state aid rules.

Gibraltar had hoped the ECJ would hand down its decision in time for the new regime to be incorporated in the 2007-2008 fiscal year that begins in July, but an unexpected intervention by Spain extended the oral hearings and may also lengthen the deliberations of the court. The Spanish government is concerned about the possible effect of any court ruling on tax regimes already operating in areas such as the Basque region of Northern Spain.

The Gibraltar government believes its case has been strengthened by a decision handed down by the ECJ last year, which confirmed Portugal's right to make separate tax arrangements for the Azores without infringing EU state aid rules.

Sovereign Comment

As this edition of Sovereign Report goes to press, we await the pending ECJ decision with keen interest. As soon as the result is known, we shall advise those readers who have signed up for our email service and, of course, full details will be published in future editions of this Report. Gibraltar's finance industry has made great strides in recent years to exploit its unique position vis-à-vis the other British offshore centres (Channel Islands and the Isle of Man). Unlike those islands, Gibraltar is a member of the EU although it is not included in the Customs Union, hence the absence in Gibraltar of VAT. As a world leader in the offshore gaming industry as well as being able to passport banking, insurance and other services across the EU, this pending decision has significant implications.

27 legal

UK banks ordered to hand over offshore client details

Four UK High Street banks – understood to be HSBC, HBOS, Royal Bank of Scotland and Lloyds TSB – are to be forced to hand over details of their clients' offshore bank accounts after Revenue & Customs won consent from the Special Commissioner on 1 February 2007.

Revenue officials will now search the records of an estimated 100,000 customers for information on UK-domiciled individuals who have not declared income on money kept in offshore centres such as the Channel Islands. The move is expected to yield £275 million in unpaid tax.

Special commissioner John Avery Jones said: "In my view, the information that the Revenue has already obtained raises serious questions that merit investigation and cannot be investigated by any other means." Barclays was the subject of a similar ruling in April last year, which Revenue & Customs estimated would yield £1.5 billion on unpaid tax.

Although it has been legal to hold money offshore since the relaxation of exchange controls in 1979, it is illegal to conceal the interest earned. But the ruling is thought unlikely to force the disclosure of secret bank accounts in Switzerland and some other offshore jurisdictions. To reduce the burden on its investigators, Revenue & Customs is encouraging individuals with undeclared offshore accounts to take advantage of a partial amnesty, which offers reduced penalties of 10% of the maximum for a limited period.

Sovereign Comment

This development links to the Offshore Disclosure arrangements separately announced which are detailed on the Chairman's Page in this Report. It is interesting to note the discrepancy between the estimated yield in unpaid tax where the earlier figure for just one bank is far higher than that under this second stage for another four institutions.

Sovereign has been advising clients for many years against the setting up of bank accounts or company structures that are not fully tax compliant. However, if any of our readers are concerned that they may be affected by these developments, they are encouraged to urgently contact any of our offices. We have also established a special e-mail address for this purpose – uktax@SovereignGroup.com.

HMRC reaffirms "91-day" test

HM Revenue & Customs has confirmed it has not changed its rules relating to the time UK non-residents can spend in the UK, following the controversial *Gaines-Cooper* tax case.

The Special Commissioners decided last year that Robert Gaines-Cooper, a Seychelles-based multi-millionaire, was domiciled in England, and therefore came under the UK's tax jurisdiction, despite his claims that he spent less than 91 days in the UK.

HMRC stated that, based on a "wide range of evidence" Gaines-Cooper had been continuously resident in the UK, and therefore the 91-day rule did not apply to him. "Where an individual has lived in the UK, the question of whether he has left the UK has to be decided first," said the HMRC.

Sovereign Comment

The *Gaines-Cooper* case could have had significant implications to individuals residing abroad who visit the UK for short periods on a regular basis. The calculation referred to above deals with the treatment of days of arrival and departure in the UK. HMRC has traditionally ignored both days in its assessment of days spent in the UK. As an example, someone arriving on a Monday in London and leaving on a Wednesday would be considered to have spent only one day – Tuesday – in the UK. The implications of any change to this treatment are of course obvious. Despite this reassurance from HMRC, we recommend that anyone concerned about his or her particular circumstances obtain specific advice. Sovereign's London office would be happy to help.

UK Budget clarifies tax charge on overseas property purchase

The UK Budget of 21 March removed one area of concern for the many thousands of British purchasers of second homes abroad. In his final Budget, Chancellor Gordon Brown confirmed that individuals who buy a property abroad through their company will not face a benefit-in-kind tax charge for any private use of it. This means that UK residents who have bought and live in overseas properties in this way can relax after many years of uncertainty on whether they would be liable to tax.

If your employer provides you with accommodation abroad, this will still be taxed as a benefit in kind because you have not contributed to the purchase of the property yourself. But company directors who buy overseas homes using their own money should now be exempt from the charge. The new rules will also be retrospective, meaning that those who have paid a benefit-in-kind tax charge will be able to claim their money back.

For the hundreds of thousands of investors across the EU who will be looking to buy second or even third homes in the sun this year, purchasing property abroad is still something to be considered very carefully. It should be remembered that most countries including Spain, Portugal, Italy and France operate completely different legal and taxation systems. Issues such as capital gains, wealth and inheritance taxes need to be examined, as well as any local income tax due on rent received.

In some cases, for example Spain, the tax authorities will levy income tax to non-resident owners on "assumed" rent, even if the property remains unoccupied.

Sovereign Comment

Intelligent use of company structures to own property can, in many cases, reduce or even eliminate such taxes, but every case is different and sound advice should be sought at the earliest opportunity. The costs involved in setting up and maintaining a property owning company must be balanced against the likely savings. Even when a company structure is not advisable, it may still be possible to reduce the tax burden by reviewing the ownership itself – including two or more names on the title deed, for example, if more than one person is purchasing the property.

Sovereign has developed considerable expertise in this area over many years. Our recommendation is that the way you choose to hold any overseas property is as important a decision as finding the right property in the first place. The ownership structure should certainly be considered before any money is handed over to developers or real estate agents. Anyone contemplating an investment in overseas property should seek advice from us as soon as possible.

27 fiscal

ECJ ruling in *Denkavit* case

In a landmark judgment, the European Court of Justice (ECJ) ruled that it was illegal for EU member states to charge withholding tax on dividends paid to foreign companies if the countries' own companies receive the same payments tax-free.

The ruling, handed down on 14 December 2006, paves the way for European pension funds to claim back taxes charged illegally by many EU states on foreign dividends. Claims by UK funds alone could be worth "hundreds of millions of pounds".

The case concerned Denkavit, a Dutch company that successfully sued the French government for charging withholding tax on dividends paid from its French subsidiary back to the Dutch parent.

The ECJ agreed with Denkavit that this was illegal under EU law because France did not levy the same tax on payments from French subsidiaries to French parent companies. As a result Denkavit, and a host of other European companies, will now be able to reclaim the illegal taxes.

Last year, PricewaterhouseCoopers launched a series of claims with the European Commission against various EU member states on the same issue. The Commission has not yet ruled but the *Denkavit* judgment should give a significant boost to the existing cases.

Spain's tax treaty with Emirates comes into force

The tax treaty signed between Spain and the United Arab Emirates (UAE) in Abu Dhabi on 5 March 2006, was brought into force on 2 April 2007. The treaty has added significance because the UAE was included on Spain's "blacklist" of countries or territories regarded as tax havens. Countries that agree a tax treaty which includes an exchange of information clause are de-listed.

Residence for the purposes of the treaty applies to individuals that have their domicile in the UAE and are nationals of the UAE, or companies that are incorporated in the UAE and have their place of effective management in the UAE. Subject to tax treaties, there are no withholding taxes in the UAE and there is no capital gains tax.

For cross border investments, the use of the Spanish holding company (ETVE) to invest abroad may provide a tax efficient structure because the ETVE will benefit from the wide number of tax treaties signed by Spain and dividends distributed by the ETVE to its UAE shareholders, both companies or individuals, will not be subject to withholding tax.

Investments by a Spanish company in a UAE subsidiary will automatically fulfil the "subject-to-tax test" in respect of the participation exemption for dividends or capital gains on Spanish corporate income tax.

Article 25 of the treaty includes an exchange of information clause similar to those included in the treaty recently signed with Malta and the amended treaty with Switzerland.

Sovereign Comment

This is an interesting development given Spain's traditional hostility to jurisdictions that it considers to be "tax havens". This treaty therefore demonstrates the importance to Spain of increased business links with the Gulf region. The UAE is one of the fastest growing economies in the world and the construction boom, particularly in Dubai, is of significant interest to European investors. The exciting significance of this treaty is that Dubai companies could now be used as tax efficient vehicles for inward investment into Spain. Our Dubai office would be delighted to discuss setting up such companies. It is interesting to note that, on 8 May, the Netherlands also signed a tax treaty with the UAE.

Using your Intellectual Property (IP) to reduce tax

Intellectual Property (IP) has long been at the core of much of our client's wealth and many of their most important transactions. This is not surprising – intellectual capital is the wealth-creating asset of the future. Patents, trademarks, copyright, knowledge, secrets, brands are among the most important advances in wealth creation.

It is vital to identify and realise the value of intangible assets and IP. Every business has valuable IP, even if it is only the name under which it trades. The contents of a Coca Cola bottle, for instance, are worth little without the Coca Cola label attached to it. Anything that differentiates a business – names, products, systems – is IP and should be protected by being registered.

In today's market the ability to understand and analyse IP strategies has never been more important. The general rule is "trademark it or lose it", and all trademarks should be held in a separate company so that the value of the IP is protected against any untoward events in normal trading activities. As soon as the IP is held in a separate company, it can be licensed back to the operating companies – and this also provides tremendous tax planning opportunities.

Licensing Structure

The starting point would be to transfer or sell the IP to an offshore company. This could be incorporated in any zero tax jurisdiction and would be set up to operate free of tax. The IP could then be licensed out to each onshore operating company, charging a royalty sufficient to reduce or even eliminate the onshore profits and take them offshore. Royalties are an expense and thus will come off the top line and reduce taxable profit.

Onshore jurisdictions will generally withhold tax at source on outbound royalties unless there is provision under a relevant double tax treaty to allow them to flow through free, or at a reduced rate, of tax. It will therefore be necessary to use a treaty to reduce or eliminate any tax that would generally be withheld. Typically this is achieved by the offshore entity licensing the IP to a Dutch company, which would in turn sub-license the IP to the various operating companies worldwide. Royalties could then be paid across using the Netherlands' comprehensive tax treaty network.

The Netherlands taxes profits at rates of 20% to 35%, but the only profit made by the Dutch company would be the margin between the royalties it received under sub-licence agreements from the various operating companies, and the amount which it had contracted to pay out to the offshore entity under the master licence agreement. Typically this margin might amount to 7% of the total royalties, resulting in an effective rate of tax of about 2%.

Royalty Collection

Many tax treaties now include "anti-treaty shopping" provisions to prevent non-residents taking advantage of a treaty to reduce their withholding taxes artificially. The rationale is that the reduced withholding taxes under a treaty should not be enjoyed unless the beneficial owners of the recipient company are residents of one of the treaty partners.

For this reason, Sovereign has a Dutch subsidiary which is majority owned by residents of the Netherlands – our staff in the Netherlands office. It can therefore collect the royalties on behalf of the offshore entity and access the treaty benefits. As a third-party it can also by-pass transfer pricing rules which dictate that companies under common ownership should trade with each other at "arms length" – the market price. This service would also save the expense of setting up and running a Dutch company.

"Royalties are an expense and thus will come off the top line and reduce taxable profits."

Licence Agreements

A master licence agreement would be required between the offshore entity and the Dutch company, and further licence agreements would be needed for the Dutch company to sub-licence the various operating companies in different countries. The form of these agreements is crucial. Sovereign has tax specialists practised at drafting such agreements so as to ensure they stand up to scrutiny by revenue authorities worldwide.

Anti-avoidance Laws

Finally, the licensing structure must take account of any "anti-avoidance" laws that might apply in the countries of residence of each substantial shareholder. Generally speaking all onshore countries have put in place attribution laws that cause profits to be treated as though are received by shareholders in proportion to their shareholding, irrespective of whether they are actually received or not. Such legislation is designed specifically to undermine this type of offshore scheme and remove the tax advantage, but Sovereign can execute strategies to circumvent it legitimately and in a fully compliant manner.

How we do this will depend upon each shareholder's country of residence and the percentage of shares they own in the structure. Typically it will involve a shareholder setting up a personal holding structure, often an insurance product, that will enable them to roll up their share of the profits free of tax, reinvest those profits free of tax and ultimately, should they choose, move their residence to a more favourable jurisdiction where the profits may be received at a reduced or zero rate of tax. Again, we have considerable expertise in this area.

Shareholders with minority interests may be reluctant to incur such costs. Other shareholders may not be subject to anti-avoidance legislation or may be reluctant, for reasons of their own, to use offshore structures. This need not affect the overall strategy. Should they want to hold their shares personally, they would incur no disadvantage other than the opportunity to defer their personal taxes. The fact that the company can defer corporate tax, however, will benefit its shareholders as a whole because it will have more money available for reinvestment and to fund it's own cash flow.

The costs of this exercise will vary considerably from case to case, but will rarely be consequential in comparison to the tax savings that can be made.

information

For more information on the services provided by The Sovereign Group, please visit our website: **www.SovereignGroup.com** or contact your most convenient Sovereign office listed below.

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27

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