SOVEREIGN

report

issue thirty-two
april 2009

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Printer Pioneer Printers Limited
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Kung Hei Fat Choi

A little belatedly I wish everyone Kung Hei Fat Choi. This is a year of the Ox. And as 2009 is an odd number, I am reliably informed that it will have a Yin influence such that people born in this year will possess leadership, patience, strength and powers of organisation. Negative traits are stubbornness, narrow mindedness and lack of tact.

I hope that you all have a very happy 2009 despite the present financial conditions. It may not be the most prosperous year but that doesn't prevent it being a good one in other ways.

Sovereign's 20th Anniversary

On 2 March 1989 we incorporated our Gibraltar subsidiary, the oldest company within The Sovereign Group, so this date marks our 20th anniversary. At that time it took around nine months to incorporate a company in Gibraltar and it was virtually impossible to get an international telephone line out of Gibraltar during regular office hours. There was no regulatory licensing and some fairly questionable practitioners were still around.

How things have changed! Gibraltar now has state of the art communications, a privatised and efficient Companies Registry, world-class regulation (Gibraltar was really the first offshore centre to introduce comprehensive licensing and standards) and new property developments have been sparked by high net worth individuals taking advantage of the beneficial personal tax regime.

We will be celebrating our 20th anniversary with a number of special events and hope to see as many clients as possible during the year.

Qualifying Recognised Overseas Pension Schemes (QROPS)

This issue's Profile (page 13) focuses on the potential for long term expatriates to transfer their UK pension abroad to gain more flexibility and control and to reduce tax liabilities. QROPS offer a host of benefits and we hope you will find the analysis useful.

chairman

Bank secrecy and the financial crisis

The tax scandals in Liechtenstein and Switzerland (pages 4 and 6) have led both countries finally to commit to OECD standards on exchange bank information (page 10). As this Report goes to press, Andorra, Austria, Belgium, Luxembourg and Monaco have followed suit in advance of the next G20 summit in London – as have Hong Kong and Singapore (page 7). Taken together, this means that banking secrecy is effectively dead.

We welcome these developments. We believe, as always, that everyone has a right to confidentiality in their personal affairs – but good tax planning should never rely upon it. It is possible to hold investments of every type in structures that are both advantageous and fully compliant. If you think you should review your planning then please contact us.

There is usually a silver lining to every cloud. With asset values at their lowest real level for decades, now may be an excellent time to restructure assets that were previously pregnant with capital gains in order to crystallise losses and shield future growth from capital gains and inheritance taxes. Again, if you think you might benefit from a review of your personal finances and assets, whether we currently manage them or not, please get in touch.

Sovereign Asset Management (SAM)

SAM's new managing director Paul Giles brings a "wealth" of banking and asset management experience to the Group. One of his first initiatives has been to revamp the website and provide a daily online investment broadcast to assist with the current financial crisis. Both can be accessed through www.SovereignGroup.com.

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

Former Deutsche Post chief executive convicted of tax evasion

Klaus Zumwinkel, the former Deutsche Post chief executive whose arrest last February signalled the start of Germany's biggest ever tax investigation, was convicted of tax evasion by a German court on 26 January 2009. The most prominent German taxpayer to be caught up in the tax scandal involving Liechtenstein, he received a €1 million fine and a two-year suspended gaol sentence.

The prosecutor requested leniency because Zumwinkel has paid €3.9 million in back taxes and pleaded guilty at the start of his trial. Under German law, tax evasion can carry a sentence of up to 10 years.

Last year, the German government admitted paying an informant €4.2 million for a CD containing bank data from LGT Group, the biggest bank in the Alpine tax haven of Liechtenstein. It also said the BND, Germany's intelligence service, had been involved. Since the investigation began in February 2008, German prosecutors have recovered over €150 million from German taxpayers seeking to avoid a trial. German authorities claim that up to €4 billion was hidden in Liechtenstein.

LGT, owned by the principality's ruling family, admitted that the data comprised bank information on 1,400 clients. It had been stolen by a former employee, who worked at the bank between April 2001 and November 2001, who had "abused his position of trust to compile information about clients".

The highest proportion of clients, about 600, were resident in Germany but information was also sold to the US, the UK, Australia, Canada and France. The German government said that it was willing to share relevant data on non-German individuals or entities with other governments. Tax authorities in Ireland, Finland, Italy, the Netherlands, Norway, Greece, Sweden, the Czech Republic and Spain all indicated their interest.

Sovereign Comment

This is a high profile case that is being repeated across Europe, the US and elsewhere. Salting funds away in an offshore bank account and not declaring them to home tax authorities is not tax planning. It is illegal and always has been. Sovereign Group views the structuring of compliant solutions as being of the utmost importance, so these types of problems should not affect our client base. As always, professional advice should be sought at the outset. Should you or your clients be worried about your own situation, contact your local Sovereign office for an initial, no obligation, consultation.

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UK Budget to pile more tax on trusts

A proposal hidden in the UK government's pre-budget report, published on 24 November 2008, will see the rate of taxation on trusts increased in 2011.

As a result of the changes, the dividend trust rate will increase from 32.5% to 37.5%, and the trust tax rate is to increase from 40% to 45% effective from 6 April 2011.

The change means that most trusts will be treated for tax purposes as though they were the highest rate taxpayers, notwithstanding the actual amount of trust income or dividends received.

The move will further erode the usefulness of trusts as an estate planning tool. In 2006, the 20% inheritance tax charge was extended to nearly all lifetime gifts into trusts.

Sovereign Comment

This further tightening in the UK tax treatment of trusts shows all too clearly that trusts are no longer suitable for most UK-domiciled clients when considering tax planning options. Increased tax rates and other restrictions have progressively reduced the scope for compliant planning in this area – but all is not lost. There are other ways to mitigate inheritance and other taxes legally, particularly for UK clients who have lived abroad for many years. Contact your local Sovereign office to see if your circumstances provide scope in this area. With an inheritance tax rate of 40%, it is worthwhile considering whatever options are available to you.

HMRC to offer second Offshore Disclosure Facility

HM Revenue & Customs confirmed, on 20 November 2008, that it is to launch a second initiative in 2009 to collect unpaid tax in offshore accounts. The Offshore Disclosure Facility (ODF) will target account holders with money in building societies and any of the 300 UK-based banks that have offshore operations. Last year's ODF focused solely on customers of the five largest High Street banks.

An HMRC spokesman said: "The intention of the new facility will be to provide an opportunity for account holders to inform us of their own accord of any unpaid tax or duties and to settle their debts in a similar way to the original offshore disclosure facility."

HMRC stressed the campaign will not be a tax "amnesty" as all the tax and interest on it will still have to be paid in full. But to encourage people to come forward, fines will probably be capped at 20 to 30% of the tax due. They were capped at 10% under the previous ODF. People who do not come forward will face the threat of prosecution and higher fines.

The Revenue will write to the 300 banks and building societies requesting names and addresses of all their UK resident customers with offshore accounts. It will then write to customers requesting any unpaid tax. The first ODF identified some 400,000 accounts as suspicious. It raised £450 million from 45,000 people but a further 50,000 are still being investigated and some may soon be prosecuted.

"HMRC has made follow-up checks of the disclosures made and has started a programme of checks on those who did not take the opportunity to come forward," a Revenue spokesman said. "In the most serious cases, we are carrying out criminal investigations and we will bring some prosecutions before the courts".

Sovereign Comment

This second proposed campaign is much wider in scope that the earlier version, targeting up to 300 UK-based banks that have offshore operations. The best advice for UK clients with undeclared accounts offshore is to take professional advice at the earliest opportunity. Sovereign's Group Tax Management team in London will be able to help, so please get in touch. Voluntary disclosure is not going to avoid penalties but is preferable to waiting for HMRC to knock on your door.

G20 urges sanctions against non-cooperative jurisdictions

Leaders from 21 nations and four international organisations attended an emergency two-day G20 summit in Washington DC, on 15 November 2008, to address the economic crisis in financial markets.

Presenting a united front, leaders from both developed and developing nations promised to take "whatever further actions are necessary to stabilise the financial system" and vowed to "use fiscal measures to stimulate domestic demand to rapid effect, as appropriate".

They also committed "to protect the integrity of the world's financial markets by bolstering investor and consumer protection, avoiding conflicts of interest, preventing illegal market manipulation, fraudulent activities and abuse, and protecting against illicit finance risks arising from non-cooperative jurisdictions. We will also promote information sharing, including with respect to jurisdictions that have yet to commit to international standards with respect to bank secrecy and transparency."

The G20 nations are to meet again in London on 2 April. In advance of this summit, European leaders meeting in Berlin on 22 February backed oversight of the world's financial markets and products, including hedge funds, and also urged definitive actions against tax havens and uncooperative jurisdictions. "According to objective criteria to be based on ongoing work in relevant international institutions, a list of uncooperative jurisdictions and a toolbox of sanctions must be devised as soon as possible," a statement said.

UK Prime Minister Gordon Brown, who will host the next G20 meeting, raised a similar call for harsher treatment of tax havens in a speech before a joint session of the US Congress on 4 March. Brown urged all governments to put an end to offshore tax havens and opaque banking activities.

"You are also restructuring your banks. So are we," he told Congress. "But how much safer would everybody's savings be if the whole world finally came together to outlaw shadow banking systems and outlaw offshore tax havens?"

"So that the whole of our worldwide banking system serves our prosperity rather than risks it, let us agree in our G20 summit in London in April rules and standards for proper accountability, transparency, and reward that will mean an end to the excesses and will apply to every bank, everywhere, all the time," Brown added.

The G-20 meeting will be the first international meeting to be attended by new US President Barack Obama who, as a Senator, co-sponsored draft legislation known as the "Stop Tax Haven Abuse Act" last year, which was to prohibit offshore tax haven and tax shelter abuses. A revised version of this legislation was introduced into the US Senate on 2 March and a companion bill has also been introduced in the US House of Representatives.

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US firms head for Switzerland

Three US firms announced plans, on 10 December 2008, to relocate their headquarters from Bermuda to Switzerland in a move designed to avoid potential tax consequences arising from the absence of a tax treaty with the US.

Tyco International, the world's largest producer of security systems, said in a statement that US Congress may pass legislation – the so-called "Stop Tax Haven Abuse Act" – that "targets companies that are domiciled in countries like Bermuda", which do not have a tax treaty with the US, and this could threaten government contracts held by Tyco.

Switzerland would enhance Tyco's "ability to maintain a competitive worldwide corporate tax rate and strengthen its presence in Europe," said the statement. The other two firms are oil refinery designer Foster Wheeler and oilfield services provider Weatherford International.

Sovereign Comment

This is another demonstration that Switzerland continues to offer an attractive option to corporates from all over the world that are considering a re-location. In addition, several cantons offer individually-agreed personal tax arrangements for people thinking about living in the country. These vary widely and our Swiss office is able to provide details of the Cantons offering this type of incentive as a way of attracting new residents. Contact details can be found on the back page of this issue.

US targets 52,000 hidden UBS accounts

The US Department of Justice filed, on 19 February 2009, a lawsuit seeking to force UBS to disclose the holders of accounts with about $14.8 billion in assets. It claims 52,000 American customers hid UBS accounts from the authorities in violation of tax laws.

UBS said it would challenge enforcement of the so-called John Doe summons, which seeks details on the accounts of thousands of US citizens at UBS in Switzerland, where such information is protected by financial privacy laws.

The suit came a day after the Swiss bank reached a landmark settlement with the US government in respect of the criminal case. UBS admitted to having enabled clients to evade taxes, agreed to pay $780m in fines and turn over about 250 client names to the US.

The settlement raised question marks over the future of Switzerland's secretive banking industry as international pressure mounts for more transparency. Hans-Rudolf Merz, the country's president, said it was "very clear" that the 250-300 dossiers involved tax fraud but the deal would not compromise the confidentiality of the Swiss banking industry.

Appeals to Switzerland's top court against the handing over of bank records to the US justice department are still pending, Merz said. It seems, however, that the Swiss government bowed to US pressure and in effect told UBS to settle with the justice department rather than risk an indictment that would not only damage the bank but Switzerland's global financial role and economy.

On 6 November last year, a grand jury in Florida indicted Raoul Weil, chairman of global wealth management at UBS, on one charge of conspiring to help US citizens hide assets from the IRS to maintain a "profitable'" business for the Swiss bank. Weil, who denies being aware of, engaged in or tolerating any illegal conduct in the operation of UBS's US cross-border business, was declared a fugitive from US justice on 13 January.

Hong Kong and Singapore to adopt OECD transparency

Hong Kong and Singapore, in the face of increasing international pressure, have both decided to relax their bank secrecy laws and endorse OECD standards for exchange of information.

Hong Kong Financial Secretary John Tsang, delivering his second budget speech on 25 February 2009, said the government is proposing to legislate by mid-year to amend Hong Kong's existing legislation to accommodate the exchange of tax information provisions contained in the current OECD tax treaty model.

Tsang said: "I believe that the business and professional community generally agrees that Hong Kong should align its arrangements for the exchange of tax information with international standards so that we can enter into such agreements with more economies."

Tsang is also proposing some particular measures to improve Hong Kong's regime as a platform for the growing area of Islamic finance. The proposed measures will include making changes to, or clarification of, the arrangements for stamp duty, profits tax and property tax so as to create a level playing field between conventional products and Islamic financial products.

Meanwhile the Singapore Ministry of Finance announced on 6 March that it had also decided to relax its strict bank secrecy laws and adhere to OECD standards. "The standard is consistent with Singapore's system of banking confidentiality, which does not shelter criminals," the Ministry said.

The ministry is to introduce draft legislative amendments to amend its bank secrecy laws in the middle of 2009, adding that Singapore is prepared to provide further assistance for exchange of information. "Once the legislative amendments are passed in parliament, Singapore is prepared to negotiate and conclude double taxation agreements that will enable us to provide further assistance for exchange of information."

The ministry said: "The decision... is in keeping with Singapore's role as a trusted centre for finance and a responsible jurisdiction, with strong and consistent regulatory policies and a firm commitment to the rule of law."

Lee Kuan Yew, modern Singapore's founding father, told bankers the city-state could not escape the pressure being applied to Switzerland. "We must move with the flow," he said.

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Sovereign Comment
Hong Kong's failure to address the exchange of information article was identified last year as a stumbling block to finalising tax treaties with other countries. Under the promised changes, "information fishing" will not be allowed and there will be confidentiality and privacy safeguards, as allowed under OECD rules. We welcome these moves. The change in laws will help both Hong Kong and Singapore extend their tax treaty networks, which should help facilitate flows of trade and investment between them and the rest of the world.

Dubai International Financial Centre issues SPC regulations

The Special Purpose Company Regulations were enacted, on 7 November 2008 allowing special purpose companies (SPCs) to be formed in the Dubai International Financial Centre (DIFC). The intention is to provide for a company format that will enable the DIFC to compete with key offshore jurisdictions which allow the formation of SPCs.

The new regulations allow companies to create SPCs for facilitating both Islamic and conventional transactions, as well as vessel registrations. Transactions that can be facilitated by the new law include acquisitions and financings.

SPCs can be formed relatively quickly – about three days – and relatively inexpensively. The minimum share capital required is $100 and they enjoy exemptions from some filing and disclosure rules relating to conventional companies in DIFC. The regulations require that SPCs have a registered office in the DIFC and must be administered by a DIFC-registered or approved corporate service provider.

The Gulf Cooperation Council (GCC) has also announced, on 30 December 2008, at a group summit held in Muscat, that it may expedite plans to implement corporate and individual income taxes due to decreased oil and natural gas exports and revenue.

The GCC – comprising Bahrain, Qatar, Kuwait, Oman, Saudi Arabia, and the United Arab Emirates – does not currently levy individual income tax on its citizens; corporate tax rates, except for oil companies, vary depending on the degree of local ownership.

Sovereign Comment
The DIFC has previously stated its intention of supporting the increasing number and growing sophistication of transactions taking place in the financial centre by, among other things, committing to international best practices in the area of securitization and other structured finance transactions. By adopting these regulations, the DIFC appears to have given effect to these commitments and to its aim of wanting to support key players in their sectors of activity. This should further enhance Dubai's reputation as a major regional player in financial markets. Details of all such initiatives are available from our Dubai office.

JITSIC makes tax avoidance a key issue

The Joint International Tax Shelter Information Centre (JITSIC), which met in Kyoto on 25 January 2009, said the impact of the tax avoidance industry on the global economic downturn was one of its key issues.

The JITSIC countries – Australia, Canada, China, Japan, UK and the US – exchange information on abusive tax schemes, their promoters and investors, consistent with the provisions of bilateral tax conventions. It has offices in Washington DC and London.

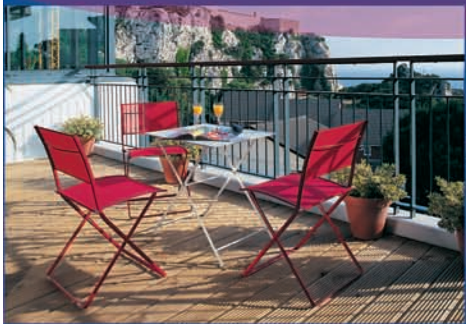
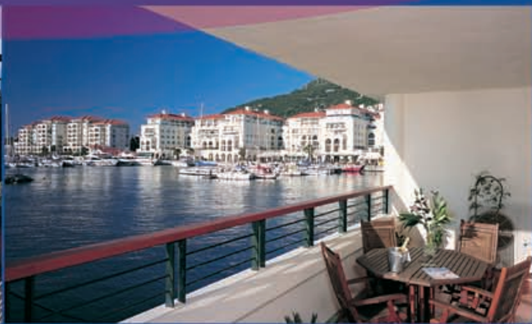
Members agreed to continue joint efforts to curb abusive tax avoidance transactions, arrangements, and schemes and to broaden their activities against cross-border transactions involving tax compliance risk.

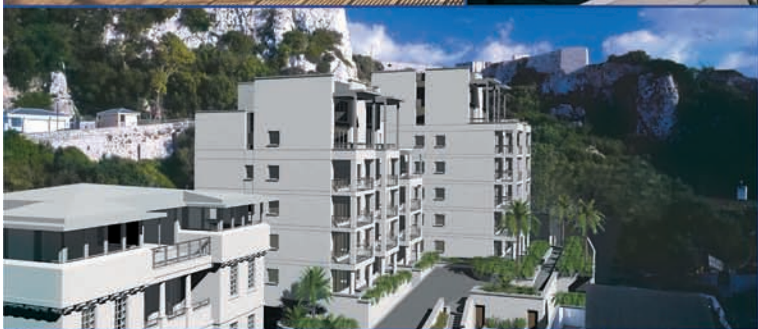
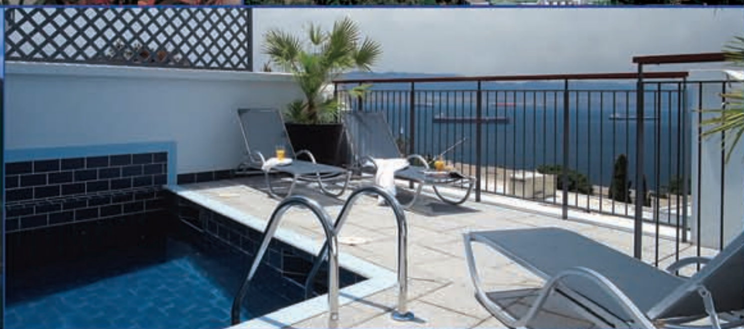
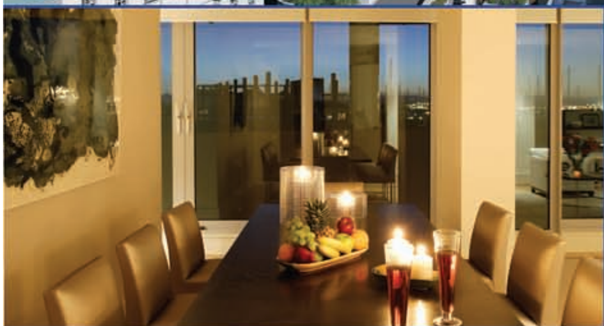
Use of offshore arrangements to avoid tax will come under close scrutiny and there will be a fresh focus on the ways in which some high wealth income taxpayers artificially minimise their tax liabilities.

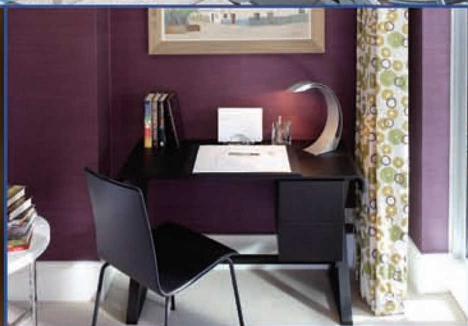
The focus of member country activities will also include collaboration on tax administration issues arising from the global economic environment and financial crisis, as well as approaches and activities to improve transfer pricing compliance.

Dave Hartnett, the UK Revenue's Permanent Secretary for Tax said: "JITSIC is adapting fast to global economic circumstances by concentrating on the effects of the world economic down turn to ensure that member states will not be unfairly denied vital tax revenues."

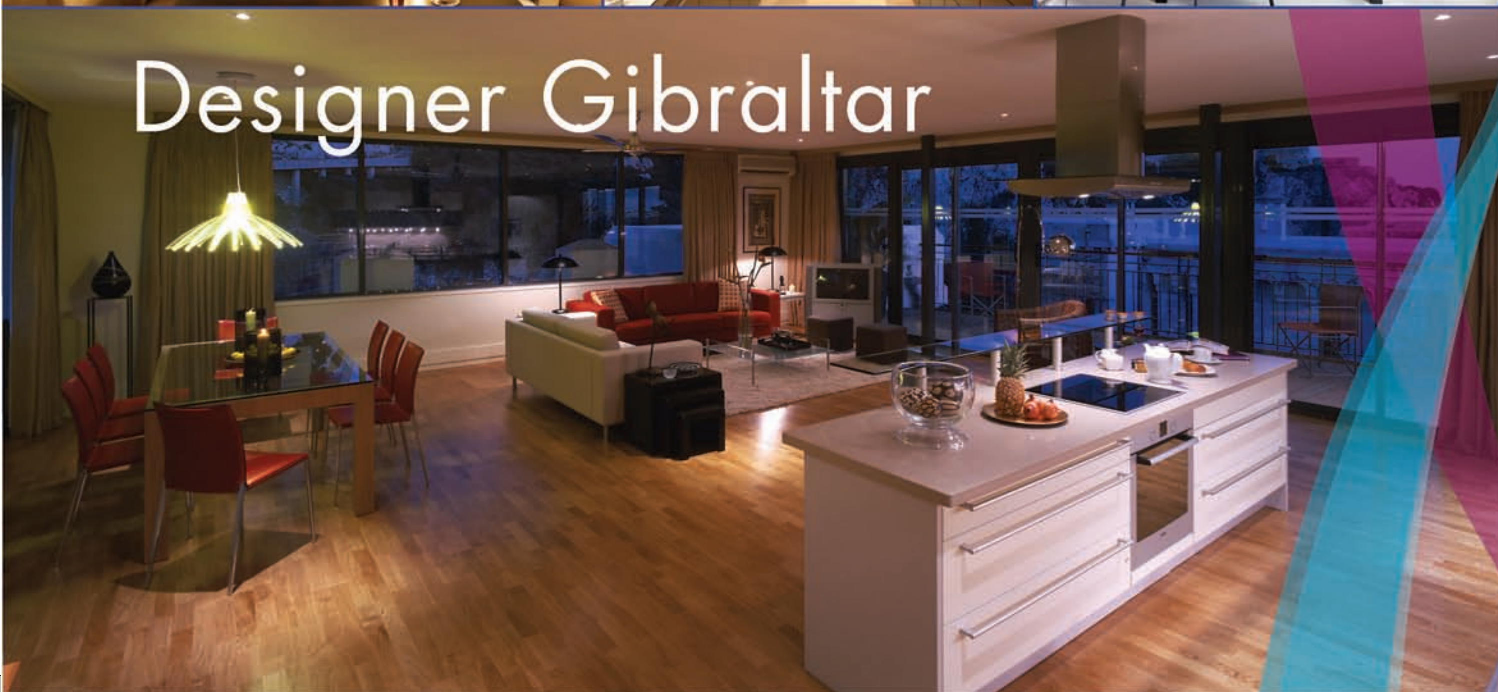
Non-domiciles Delight...

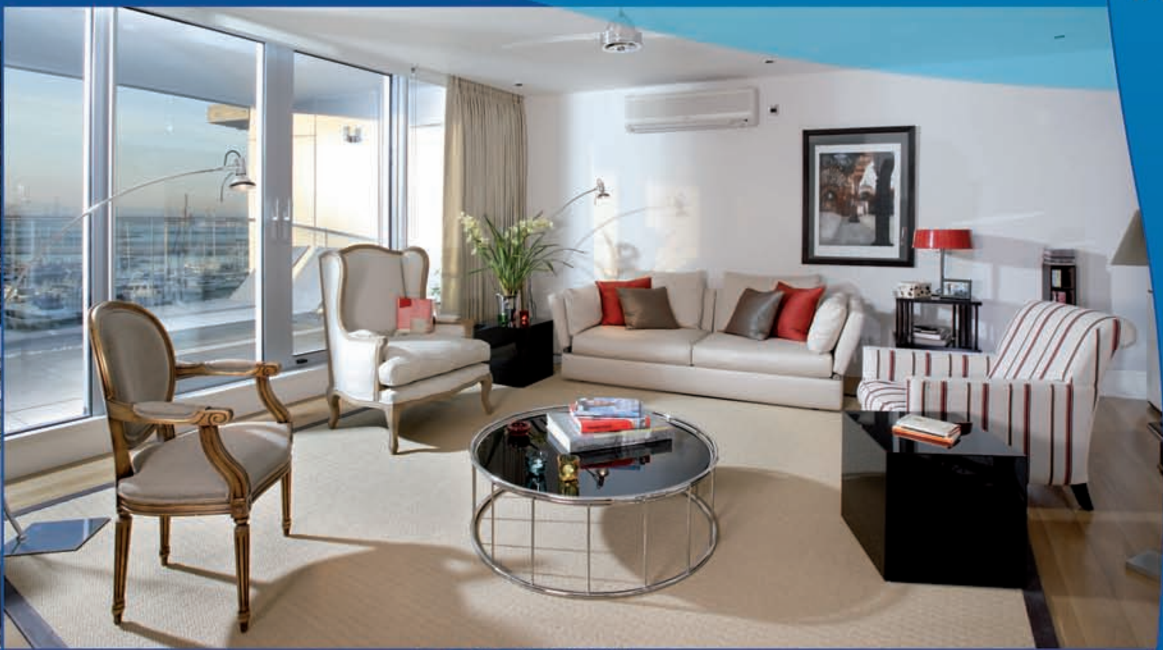




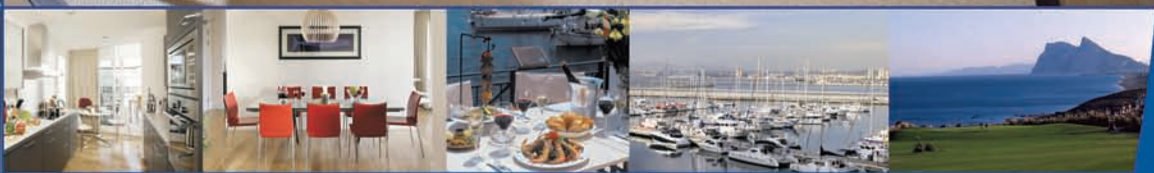


Designer Gibraltar



...Sunshine Attached





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Bank secrecy jurisdictions pledge to cooperate on tax data exchange

A raft of financial secrecy jurisdictions – Switzerland, Liechtenstein, Austria, Luxembourg, Belgium, Andorra and Monaco – have bowed to international pressure and pledged to cooperate with foreign tax authorities by sharing tax information. Hong Kong and Singapore have made similar commitments (page 7).

The concessions preceded the G20 summit on 2 April at which leaders are expected to discuss ways to combat offshore tax evasion. The OECD has been preparing a new blacklist of uncooperative tax havens in the run-up to the summit. The OECD's current list names only Andorra, Monaco, and Liechtenstein; the new list will reportedly name over 30 jurisdictions.

The Swiss government announced 13 March that it will adopt the OECD standard on administrative assistance in tax matters, which will permit the exchange of information with other countries in individual cases when a specific and justified request has been made. Finance Minister Hans-Rudolf Merz said: "It's not an open-door policy. It's a relaxation to facilitate the contact between the two countries."

Liechtenstein agreed to ease its strict bank secrecy law by committing to OECD standards on 12 March. It will now sign bilateral tax information exchange agreements (TIEAs) with individual states similar to one it signed with the US in December. The principality is also offering to sign agreements that go beyond the OECD standards provided that clients of its banks holding secret accounts can be allowed to bring their money onshore and meet their tax obligations in an orderly manner.

Austria and Luxembourg announced on 13 March that they are to implement OECD standards for information sharing. The Austrian government said it will now exchange information when there is "compelling suspicion" documented by foreign tax authorities and the Luxembourg government agreed to "exchange information on request in specific cases and on the basis of concrete proof" provided by foreign tax authorities.

The Belgian government said on 12 March that it will begin exchanging information on interest payments made to individuals under the EU Savings Tax Directive next year. Austria, Belgium and Luxembourg were all permitted to impose a withholding tax on interest income rather than exchange information during the directive's transitional period.

Andorra's head of government Albert Pintat signed an agreement in Paris on 10 March pledging to repeal the principality's bank secrecy laws by November 2009 and to enter into TIEAs. The Andorran government is now working with the OECD to put in place a framework for exchanging tax information.

The government of Monaco announced on 14 March that it, too, was ready to make access to information on foreign account holders in Monaco available to foreign tax authorities. Access has previously been limited to judicial investigations authorised by a judge. A spokesman said that the move coincided with promises made in 2008 by Prince Albert II to implement greater transparency once larger countries such as Austria, Luxembourg, and Switzerland did so. Monaco "won't remain outside the general movement toward transparency" as defined by OECD standards, the government said in a statement.

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fiscal

British couple wins CGT refund from Spain

In February, a Spanish Court ratified the decision of the European Commission that the differential between the rates levied by the Spanish tax authorities on non-residents and residents in respect of capital gains from the sale of a property was a direct contravention of European Union legislation.

Alan and Margaret Roy, a British couple, acquired a Spanish property in 2001 for a total cost of €150,000 that they then sold in 2004 for €160,000, which crystallized a gain of €10,000. They were charged the Spanish non-residents' tax rate of 35% on the gain instead of the Spanish flat rate of 15%.

The Roy family took their action to the European Commission, which ruled last year that the disparity between the rates contravened European Union legislation. A Spanish Court has now upheld the Roys' claim for a 20% rebate, plus interest — thereby avoiding a hearing at European Courts of Justice.

The case opens the way for claims by an estimated to 10,000 Britons, plus thousands more in other European countries, who sold a property in between about July 2004 and December 2006. Spanish courts are considering the cases of about 260 Britons and another 340 have registered their details. But under Spanish law there is a limited window for registering claims, so those who sold properties before November 2004, and after the rules changed at the start of 2007, will not qualify.

Cyprus is Europe's most attractive tax regime, survey finds

Cyprus, Ireland and Switzerland are the top three countries in a league table of European tax systems, compiled by KPMG International, in which major business organisations across Europe assessed the attractiveness of their domestic tax regimes.

All three countries were rated highly for their combination of consistency in interpreting tax legislation, stability in resisting frequent changes to tax laws and comparatively low tax rate. The three least attractive countries were the Czech Republic, Romania and Greece. All three had high volumes of complex legislation, with frequent changes.

At a European level the most unattractive area was the volume of tax legislation, with a net attractiveness score of just 28%. Relations with tax authorities were generally positive, with an average of 60% across Europe saying that this was an attractive part of their regime.

The countries with the highest scores in this area were Ireland, Switzerland, Estonia, Finland, Denmark, Slovenia and Lithuania. Those with the poorest were Germany, Spain, Italy, the Czech Republic and Greece

The survey was compiled from more than 400 interviews of tax professionals in multinational companies across Europe. The survey also showed that being in a country with an unattractive tax regime is not simply an inconvenience for business. Almost 70% of respondents who thought their country's tax regime was unattractive also believed that this put their companies at a competitive disadvantage.

Europe tightens VAT net on luxury yacht owners

The European Union, at the request of the Dutch and French authorities, has launched a crackdown on VAT strategies promoted by various advisors to yacht owners.

The Dutch Ministry of finance announced, on 19 November 2008, that the EU initiative – known as Fiscalis Multilateral Control 21 – has resulted in €31 million of additional VAT assessments in The Netherlands alone.

The initiative examined the whole supply chain from yacht builders, dealers and intermediaries to the end user. Tax authorities and customs services from 11 EU member states cooperated in random checks on 322 yacht owners, which led to inquiries into 225 transactions with a joint value of more than €1 billion.

Prosecutions have not, as yet, resulted but additional VAT assessments have been raised in all EU member countries, in particular The Netherlands, France and the UK. The largest single assessment on a yacht exceeded €10 million.

The EU has employed new tactics to trace vessels. Marcel Homan, a spokesman for the Dutch Ministry of Finance, said: “Investigators used ‘yacht spotter’ sites on the internet to find out where vessels were located. They also recovered information on the identity of owners from sailing regattas where vanity often overrules discretion and owner’s enter yachts under their own name.”

All private yachts, both sailing and motor vessels, owned or used by EU residents or domiciles must be VAT paid if they are used in EU territorial waters. Non-EU residents may own and use a private yacht without paying VAT on a temporary import basis for up to 18 months.

The rules on charter boats are less clear and have been exploited by a variety of schemes that enable individuals to incur little or no VAT on purchase, particularly at the top end of the market. These broadly fall into two categories – cross-border leasing and artificial chartering – and involve a contrived commercial arrangement, generally through an offshore company, while the vessel operates predominantly for recreational use by the purchaser.

The VAT treatment of pleasure yachts is dealt with on a case-by-case basis and is influenced by factors such as: the place where the yacht is acquired; whether it is a new or second-hand build; its tax history; and its make, build and price.

The EU says the investigation is to be continued due to the extent of the abuse uncovered. Extra attention, it warns, is to be paid to the correct VAT status of recently purchased yachts.

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Sovereign Comment

“It is essential that expert advice is obtained prior to tackling the payment of VAT on the purchase of a pleasure yacht, to ensure both the adoption of a tailor-made approach that is as cost-effective and efficient as possible, and conformity with all relative rules and regulations on the matter,” said Gabriel Gonzalez, manager of Gibraltar-based RegisterAYacht.com.

Swiss Canton ends tax breaks for wealthy foreigners

The Swiss canton of Zurich voted, on 8 February 2009, to abolish tax breaks that had been available to rich foreign residents.

The canton, which includes the exclusive "Gold Coast" along Lake Zurich, voted by a majority of 52.9% to do away with the privileges. The decision will apply only to cantonal and community taxes, not to federal taxes, and will require officials in Zurich to adjust their laws.

Zurich is the first canton to eliminate the flat – or lump-sum – tax, which is individually negotiated by the taxpayer and applies provided that the taxpayer does not work in Switzerland. Zurich's government and parliament opposed the change, warning it could prompt an exodus.

In Zurich, 137 people qualified for special tax rules at the end of 2006, the last year for which information is available. Singers Tina Turner, Shania Twain and James Blunt, Russian oligarch Viktor Vekselberg, German milk mogul Theo Müller, and several motor racing drivers – including Lewis Hamilton and Kimi Raikonnen – maintain residences in the canton.

Switzerland has long attracted some of the world's richest people. Most of the country's 26 cantons offer highly beneficial flat taxes to wealthy foreigners and as many as 4,100 wealthy foreigners are understood to benefit.

The campaign to end the tax benefit was spearheaded by the Alternative List (AL), a left-wing party active in the cantons of Zurich, Schaffhausen and Aargau. AL said it wanted to abolish "tax privileges for foreign millionaires".

Switzerland-UK tax treaty protocol comes into force

The protocol to the 1977 Switzerland-UK tax treaty, signed in London on 26 June 2007, came into force on 22 December 2008.

The most important amendment is the full exemption from tax at source on dividends paid to a company with a substantial shareholding in the company paying the dividends, or to a pension scheme.

Full exemption from tax at source will apply to dividend payments between companies where one company holds at least 10% of the capital of the company paying the dividends. Dividend payments to pension schemes will also be exempt from tax. For all other dividend payments the state in which they arise retains a withholding tax rate of 15%.

In accordance with Switzerland's commitments to the OECD and European Union, the protocol also amends the exchange of information article. It provides that, in future, information will be exchanged in cases of tax fraud and in cases involving holding companies.

The provisions of the protocol apply to Swiss taxes from 1 January 2009 and to UK taxes from 1 April 2009 for corporation tax and from 6 April 2009 for income tax.

The entitlement to tax credits in relation to dividends paid by companies resident in the UK to residents in Switzerland will be terminated for dividends paid on or after 6 April 2009.

Gibraltar wins crucial European tax challenge

The European Court of Justice, on 18 December 2008, overturned the European Commission's 2004 decision that Gibraltar's proposals to reform its corporate tax system amounted to a scheme of State Aid that was incompatible with the common market and therefore could not be implemented.

The Commission's decision was based on the false proposition that Gibraltar was merely a region of the UK – and not therefore entitled to have its own tax system different to that of the UK. Had Gibraltar lost the case, it would logically have had to adopt the UK's company tax system and company tax rates, effectively closing down its finance centre.

The uncertainty surrounding Gibraltar's future dates back to August 2002, when the UK notified the Commission of Gibraltar's proposed reform of corporate tax. This included the repeal of the existing "discriminatory" tax system and the imposition of three taxes applicable to all Gibraltar companies – comprising a registration fee, a payroll tax and a business property occupation tax (BPOT) – with a cap of 15% of profits.

In 2004, following a formal investigation procedure, the Commission deemed that the proposed reform was "regionally selective" because it provided for a system under which companies in Gibraltar would be taxed, in general, at a lower rate than those in the UK. The Gibraltar and UK governments sought an annulment in the ECJ's Court of First Instance.

The ECJ concluded, according to the conditions laid down in the judgment of September 2006 on the Azores' tax regime *(Portugal v Commission)*, that the reference framework for assessing whether the tax reform was regionally selective corresponded exclusively to the geographical limits of the territory of Gibraltar. No comparison could therefore be made between the tax systems applicable to companies in Gibraltar and in the UK.

The ECJ therefore annulled the Commission's decision in its entirety. The ruling is expected bring more certainty to the Gibraltar economy and finance centre on the basis that the proposed new "low tax" regime can now be implemented in place of the previous exempt company regime, which was closed for new business on 30 June 2006.

Sovereign Comment

This was of course an excellent result for Gibraltar. For some time in the period leading to the announcement the finance centre had become increasingly confident that the decision would be favourable, due in part to the successful outcome of the Azores case some time ago. The government has announced its intention to introduce a 10% corporate tax rate from 2010. We await further details as this edition goes to press. More information can be obtained from our Gibraltar office at gib@SovereignGroup.com

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ECJ rules on charity gifts

The European Court of Justice held, on 27 January 2009, that German legislation that only allowed such deductions for charities based in Germany was contrary to the principle of free movement of capital. Taxpayers should be able to deduct gifts to charities established in other European member states.

In Case C-318/07, a German donor, Hein Persche, made an in-kind donation of bedclothes and other equipment to a Portuguese care home. As donations to charities, including in-kind donations, are tax deductible for individual donations in Germany, Persche deducted the donation on his income tax return in Germany in 2003. The deduction was rejected on the grounds that only donations to German resident public benefit organisations may benefit from tax incentives.

A referral from the German Federal Court of Finances Bundesfinanzhof was lodged on 11 July 2007 asking for a preliminary ruling by the ECJ in this regard according to Article 234 EC Treaty.

The Court held the restriction in German tax law was not justified. When a public-benefit organisation based in the other Member State pursues objectives that would be recognised as public-benefit causes in the country of the donor, there is no justification for a different tax treatment for the donor.

Sovereign Comment

As most national tax laws do not treat donations to resident and foreign public benefit organisations on an equal basis, they could therefore be in conflict with the EC Treaty and the European Commission may now ask other EU countries to review their legislation in this respect.

HMRC wins residence appeal in Grace case

The UK High Court, on 11 November 2008, overturned the decision of the Special Commissioner by finding that a non-domiciled, non-UK citizen who regularly came to and stayed in the UK while pursuing his career as an airline pilot was resident in the UK for tax purposes.

In *HMRC v Grace,* Mr Grace was an airline pilot with homes in the UK and South Africa, who was not a UK resident for tax purposes. When the UK revenue determined in June 2004 that he had been ordinarily resident in the UK for the six years from 1997/98 to 2002/2003 inclusive, he appealed to the Special Commissioner. Grace claimed that he had departed from the UK in August 1997 to live outside the UK permanently.

In January 2008, the Special Commissioner came to the conclusion that from 1 September 1997 Grace had ceased to be resident and ordinarily resident in the UK. He took into consideration the evidence, especially having regard to the taxpayer's past and present habits of life, the reasons for his visits to the UK, the temporary nature of his ties with the UK, the more permanent nature of his ties with South Africa, and the distinct break made in 1997.

The High Court disagreed. Residence, it said, connotes a degree of permanence and continuity or expectation of continuity, and short but regular visits to a place might also amount to residence, particularly if connected to the performance of obligations. A person might have more than one residence at a time. In this case, the taxpayer was regularly present in the UK so that he could discharge his duties under his contract of employment and the purpose for his being in the UK was neither casual nor transitory.

Sovereign Comment

This follows the October 2008 *Gaines-Cooper* decision previously reported in the Sovereign Report and proves once again that the residency and implied taxation rules are far from straightforward. We have extensive experience in these situations so, if these issues concern you, contact our Group Tax Manager at our London office.

QROPS – The Exportable Pension

Anyone reading the international expatriate press may have come across a curious five-letter acronym – QROPS. If you are one of the estimated 5.5 million British nationals that live overseas then it is a term with which you should become familiar. So what is it?

Under UK legislation effective from April 2006, expatriates or UK residents who have either moved or plan to move overseas may transfer their existing UK pension to an approved offshore scheme. In doing this, it is possible to avoid many restrictions that would typically be imposed on the pension fund if it remained in the UK and, simultaneously, achieve considerable tax savings when the pension is drawn-down.

Transfers must be made to a Qualifying Recognised Overseas Pension Scheme (QROPS) that is approved by HM Revenue & Customs (HMRC). The most advantageous QROPS have been established in jurisdictions such as Gibraltar, Guernsey, Isle of Man and Jersey where clients can be assured that the pension trustees are well regulated and which offer the greatest tax advantages.

Under UK pension rules, any part of the fund remaining when the pension holder reaches the age of 75 must be used to purchase an annuity. At present, annuities are providing historically low returns to the detriment of the pension holder's income and, on the death of the pension holder, the annuity ceases – leaving nothing to pass on to the holder's heirs. With a QROPS, however, there is no annuity requirement so that the fund can be invested more effectively and the remaining value can be passed on to heirs upon death.

Depending on where the QROPS is based, a member may also benefit from: no or reduced inheritance tax if they die in drawdown – the monthly pension benefit is paid from the fund directly to the heirs of the pension holder, an approach now referred to as "unsecured income"; reduced income tax on the fund profits; and a higher tax-free cash sum.

Under UK rules a pension fund must be invested in a relatively narrow band of investments. A QROPS can hold a much wider range of investments, including residential property, within the first five years and almost all restrictions are removed thereafter.

Cases should be examined on an individual basis but there are a number of basic conditions that must be fulfilled for a transfer to a QROPS to be considered advisable:

- the pension holder must either have lived, or intend to live, outside the UK for at least five complete UK tax years;
- generally, 75% of a UK pension has to be paid out in regular monthly payments when the pension holder has reached 50 years of age, but 25% can be withdrawn as a lump sum at any time. If the lump sum has already been withdrawn then no further lump sum amounts can be withdrawn without tax penalty.

UK rules impose a statutory lifetime allowance relating to the amount payable from UK registered pension schemes that will be treated as tax-privileged. For the tax year 2008/9 this allowance is £1.65 million and will rise in stages to £1.8 million by 2010/11.

"Offshore pensions are more flexible and less heavily taxed than the UK equivalent"

Transferring benefits to a QROPS is known as a "crystallization event" and the value of pension rights transferred in excess of the lifetime allowance will be taxed at a 25% rate.

QROPS, like other financial products, are not all the same and the advice received may also vary. Here are some general comments on what to look for.

Firstly, check that any non-UK pension option you may be considering is indeed recognised as a QROPS by HMRC. Most recognised international schemes choose to be listed on HMRC's own website, which means they will have been subjected to a rigorous background check. The list is updated every month.

Secondly, check whether the scheme advisors are actively promoting in-house investment funds for the underlying pension or whether you are permitted to select your own investment manager. Some pension companies impose their own restrictions for their own reasons. These are best avoided.

When transferring to a QROPS, it is important to remember that your pension is designed to provide retirement income. The UK revenue authorities take a dim view of "cashing in" – that is using the transfer to a QROPS simply as a way of encashing the pension proceeds for current expenditure. This was not the government's intention and it is possible that this may be explicitly prohibited in the future. Having said this, under QROPS rules, pensions can start being paid from the age of 50. People in defined benefit pensions should also be very cautious about cashing in their entitlement for a cash lump sum. The amount being offered may look tempting, but the cost of buying the same income elsewhere may be significantly higher.

An independent pension review is recommended to take account of an individual's own circumstances prior to transfer. This evaluation is a triangular process involving the tax rules in the UK, the country where the QROPS scheme is based and the country where the pension holder plans to live. In these days of economic uncertainty it is also vital to consider the investment options very carefully and to seek professional advice where required.

Be realistic on timing. The administrators of the international scheme may require up to three months to complete the transfer to the new arrangement. Any necessary costs should be agreed in advance. And finally, it should be noted that a subsequent withdrawal from a QROPS is usually permitted, but questions of how this can be arranged and any likely withdrawal costs should be determined at the outset. Once again this will depend on individual circumstances.

Anyone planning to retire abroad or move overseas for at least five years should look very closely at QROPS. There are also many thousands of foreign workers who have spent part of their career in the UK and have accumulated UK-registered pension benefits. Offshore pensions are more flexible and less heavily taxed than the UK equivalent so why would anyone not want to transfer? Those people who have already moved abroad but left their pensions in the UK should revisit their arrangements.

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Printer Pioneer Printers Limited
www.pioneerprinter.com

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