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Sovereign

report

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UK emergency budget promises further tax hikes

The UK's general election on 6 May produced an inconclusive result, but after five days of wrangling the Conservatives joined forces with the Liberal Democrats to create the country's first coalition government since the second world war. The most pressing challenge is fiscal – tackling the record £163 billion deficit left behind by Gordon Brown.

There is growing unease that the new government intends to raise so-called non-business capital gains from its current 18% to "similar or close to those applied to income". This could mean that the tax rate people pay on any profit gained from the sale of a second home or shares would jump to either 40% or 50%. George Osborne, the Chancellor, will deliver his first emergency Budget on 22 June. Clearly, anyone with significant UK tax exposures should act now. If you need to protect your interests, or are considering leaving the UK altogether, you should contact our London office at the earliest opportunity.

Han picks Sovereign Asian Art Prize

Our congratulations go to Debbie Han for winning the US$25,000 jury prize at the 2009 Sovereign Asian Art Prize in January for her work *Seated Three Graces* (pictured right). Debbie is the first Korean to win the art prize, which is now in its sixth year. Over HK$2 million was raised during the auction dinner at the Four Seasons Hotel, HK, when the remaining 29 finalists' works were auctioned off with the proceeds being split between the artists and our chosen charities. *Homunculus – Exhibit H,I,J* by Hong Kong artist Angela Su received the highest bid of the night at HK$273,000.

The Schoeni Prize, for the work attracting the most public votes, went to Miguel Payano, an artist of Dominican Republic descent but now resident in China, for his painting *Sha-Boy*. A smaller limited edition print of this work is for sale at a price of US$2,300, with all proceeds going towards our charities. They are sure to be highly sought after collectors items. Please contact Teresa@SovereignArtFoundation.com for details.

The finalists for this year's Sovereign European Art Prize have been selected and can be viewed at www.SovereignArtFoundation.com. The exhibition is being held at the Barbican Centre in London

chairman

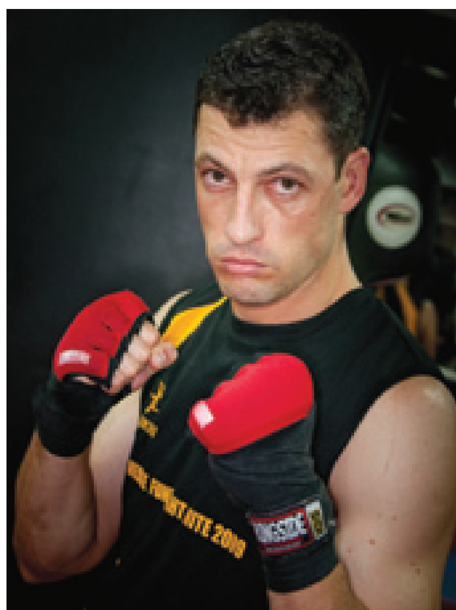
from the 9-20 June. The artworks at the exhibition will this year be sold through a process of sealed bids, with the proceeds going to support the Barbican Centre Trust.

Sovereign opens in the Channel Islands

We are delighted to announce the opening of our new Guernsey operation, located in St Peter Port. Managing director Rob Shipman has relocated from our Gibraltar office to launch the new business, which was licensed by the Guernsey FSC on 4 May 2010. The office will offer a full range of Channel Island products and structures but will specialise in pension-related services including QROPS, QNUPS and EFRBS. Contact details appear on the back page of this edition.

Simon Denton

Simon recently celebrated 20 years with Sovereign. His fellow Group Board Directors marked the occasion with some excellent 20-year old wine. We can report that, like Simon, the wine had shed some of its youthful, fruity character and become smoother and more full-bodied, whilst retaining its instantly recognisable flavour. Congratulations and thanks to Simon.



Seconds out for "Sugarbok"

Our congratulations also go to Jacques "Sugarbok" Scherman (pictured left), managing director of Sovereign Trust (Hong Kong), who pulled on his boxing gloves to help raise HK$665,000 for charity at Hong Kong's Hedge Fund Fight Night last October. After five months of hard training, "Sugarbok" bludgeoned Jacco "The Punching Dutchman" Klip of the Hong Kong Jockey Club to defeat over three, two-minute rounds at the Happy Valley Racecourse. In fairness to Jacques, we should point out that his opponent was not actually a jockey!

Howard Bilton BA(Hons)
Barrister-at-Law (England, Wales & Gibraltar)
Chairman of The Sovereign Group

New UK higher tax rate comes into force

Higher earners in the UK became subject, as of 6 April 2010, to the new 50% tax rate on income over £150,000. Former Chancellor Alistair Darling announced the move in the 2009 Budget – but no party in the 2010 general election made any manifesto pledge to remove it. Dividends received by high earners are subject to tax at a new dividend rate of 42.5%. These rates of tax apply to discretionary trusts, regardless of the level of trust income.

An Emergency Budget, which the Conservatives promised to deliver should they be elected, will go ahead as planned with the backing of the new coalition government on 22 June. It will be a major test for the new Chancellor, George Osborne. The markets will expect a credible plan of how the deficit will be reduced beyond immediate cuts, which both the Conservative and Liberal Democrat parties acknowledged in their coalition agreement. The coalition said the deficit would be reduced mainly through spending cuts, rather than tax rises.

Meanwhile Britain's offshore financial centres (OFCs) must meet clear standards on financial regulation and tax information exchange, according to Michael Foot's independent review on the sector, which was published on 29 October 2009. He did not specify but said London needed to "offer both carrots and sticks" to a group in which some members were performing well but others had "a lot of work to do".

Foot, former managing director of the UK Financial Services Authority, said that while the majority of the OFCs surveyed – Jersey, Guernsey, the Isle of Man, Gibraltar, Bermuda, the Cayman Islands, the British Virgin Islands, Anguilla and the Turks & Caicos Islands – had a "good story to tell", none could afford to be complacent. The 93-page report also said that OFCs must put their public finances on a firmer footing by diversifying their tax bases, making them less vulnerable to events like the current financial crisis. "It's in their own hands," Foot said.

Sovereign Comment
With an Emergency Budget on the way, big changes to the UK's tax system are expected. Much uncertainty remains but a huge hike in capital gains tax to fund a "substantial increase" in the income tax threshold next April, is likely. This will be yet another blow for UK high earners. It remains to be seen whether the increases in personal taxation really do raise that much extra revenue. Our view is that many high earners are considering leaving the UK for warmer climes and more favourable tax regimes. Contact our London office for advice.

europe

Portuguese regime for non-habitual residents

Portugal recently introduced a new regime that provides beneficial tax treatment for qualifying income arising from a Portuguese source for non-habitual residents. The regime was published in September 2009 as part of a package to stimulate growth and aiming to attract high level professionals and investors, but is effective from 1 January 2009.

The qualifying activities for the new regime, established in a separate ruling, included engineers, doctors and dentists, artists and musicians, auditors and consultants of various types. It is interesting to note that sportsmen and women were not included in the list.

The main effect is that as from fiscal year 2010, an individual may benefit from this new regime for ten consecutive (and renewable) years if he or she qualifies as a tax resident in Portugal and has not been taxed as a Portuguese tax resident in any of the five years preceding the year in which residence is established. Under those circumstances any Portuguese source wages and self-employed income would be subject to a flat rate tax of 20%.

Non-Portuguese source income, including pensions, as well as capital gains will be tax exempt in Portugal provided that the income is taxable in a source country with which Portugal has a treaty, or the income is taxable in any other country adhering to the OECD Model. Income earned in territories listed on the Finance Department's list of preferential tax regimes – the so-called "black list" – does not qualify.

US warns of legal action if Swiss renege on UBS deal

The lower house of the Swiss parliament voted, on 8 June 2010, to reject a 2009 agreement with the US that would permit disclosure by Swiss bank UBS of the identities of 4,450 US clients suspected of tax evasion. Lawmakers opposed the deal by 104 votes to 76 and also voted in favour of putting the agreement to a referendum.

Parliamentary approval for the agreement became necessary after a 21 January decision by the Swiss Federal Administrative Court, which ruled that the agreement was insufficient to change the interpretation of "tax fraud and the like" in the Switzerland-US tax treaty. Approval by the parliament would elevate the agreement to the level of a treaty and permit the government to complete the administrative assistance process.

The IRS responded to the news of the vote by saying in a statement: "We have an agreement with the Swiss government. We expect that the Swiss government will continue to honour the terms of the agreement. We continue to monitor the events in Switzerland, and we stand ready to pursue all legal options available to us should the Swiss fail to provide the required information."

The agreement must now return to the upper house, which voted to approve it on 3 June, as the two chambers attempt to reconcile their differences. A final vote is expected before the end of the current parliamentary session on 18 June. Should the lower house insist on a referendum process, the agreement would be delayed for at least 100 days, which would breach the August deadline for disclosures to be made under the agreement.

Following the vote, the Swiss Bankers Association (SBA), which supported approval of the agreement, said in a statement: "With today's negative decision the National Council has unfortunately done a disservice to Switzerland's standing as an economic and financial centre. Party-political calculations took priority over the national interest." But the SBA expressed confidence that the agreement would ultimately pass the parliament when it next comes to a vote.

Under the 2009 deal, the US agreed to give up its right to access the identities of all 52,000 US clients of UBS in exchange for getting prompt access to information on key accounts.

Obama signs HIRE-FATCA Bill into law

President Obama signed into law, on 17 March 2010, the Hiring Incentives to Restore Employment (HIRE) Act of 2010, which raises $8.7 billion through new withholding rules and other enforcement measures from the Foreign Account Tax Compliance Act (FATCA) in order to fund $13 billion in tax incentives for companies hiring new workers.

The FACTA provisions of the HIRE Act amend the Internal Revenue Code to revise and add reporting and other requirements relating to income from assets held abroad by requiring foreign financial and non-financial institutions to withhold 30% of payments made to such institutions by US individuals unless such institutions agree to disclose the identity of the individuals and report on their bank transactions. This will be effective for payments made after 31 December 2012, with some exceptions for grandfathered agreements.

Any individual who holds more than $50,000 in a depository or custodial account maintained by a foreign financial institution is required to report on any such account under this legislation. Underpayments of tax attributable to undisclosed foreign financial assets will attract enhanced penalties under the new reporting regime. In addition, the limitation period for assessment of underpayments with respect to assets held outside the US is being extended.

Other provisions require US shareholders of a passive foreign investment company to file annual information returns, and allow the US Treasury to require certain financial institutions to file returns related to withholding on transactions involving foreign persons on magnetic media – currently, electronic filing is required only for taxpayers filing at least 250 returns.

The reach of the legislation goes beyond traditional financial institutions and covers virtually every type of foreign financial institution, including hedge funds, private equity funds and typical offshore securitisation vehicles that hold US assets. Furthermore, the FACTA imposes reporting requirements on owners of foreign trusts and sets out tax penalties for failure to report on transfers to and distributions from such trusts.

FATCA does however omit the language that would have required tax or investment advisors to disclose the identities of any clients that they assist in buying offshore assets, as well as the assets purchased.

Sovereign Comment

Although Sovereign does not have any offices in the US, we nevertheless consider these developments to be of great significance. The predecessor to the HIRE-FATCA Bill was the Qualified Intermediary (QI) scheme that "inspired" the OECD's initiative on tax information exchange and the EU Savings Tax Directive. It is likely that the HIRE-FATCA may be similarly influential on future international policy.

usa+caribbean 35

Cayman introduces investor incentives and raises capital

The Immigration (Amendment) Bill 2010 was passed by the Cayman Islands parliament on 28 April 2010. The new legislation provides 25-year residence to wealthy individuals who invest in businesses on certain conditions.

The Bill enables foreign individuals to apply for a Residential Certificate for Investment. This will cost KYD20,000 (USD24,000) and gives the investor, their spouse and any dependents the right to live in the Cayman Islands without a work permit on certain conditions. Under the law, qualifying investors must have a net worth of at least KYD6 million and must invest at least KYD2.4 million in licensed businesses with workforces comprising at least 50% Caymanians.

Last November, the Cayman Islands raised $312 million in its first-ever placement on international bond markets, as it sought to put its finances in order after a recent budget crisis, while avoiding the introduction of new taxes.

In June, it was revealed that the independent British overseas territory faced a budget deficit of about $100 million and had to secure a $60 million loan. In September, it was forced to ask the British government for permission to borrow $310 million from banks to repair its deficits. At the time the UK refused, advising the island's authorities to impose property or payroll taxes. Newly elected premier, McKeeva Bush, has proposed raising fees on company registrations, mutual fund licences, security investment businesses, work permits and exempted limited partnerships, as well as certain new fees, such as an annual business premises fee that would replace a current stamp duty on commercial leases.

Sovereign Comment

Cayman has always benefited from its pre-eminent position in Caribbean financial services. The demand by international investors and the success of this fund raising bond programme is testament to its status and bodes well for the future.

HKSE listing for BVI companies

The Hong Kong Stock Exchange announced, on 15 December 2009, that it would allow companies incorporated in the British Virgin Islands to list in Hong Kong. The move will simplify the listing process and provides a cost-efficient exit strategy for investors in BVI-incorporated companies.

Several other major exchanges worldwide, including NASDAQ and NYSE in the US, AIM in London and SGX in Singapore, already permit BVI companies to list. By jurisdiction, BVI companies provide the second largest source of foreign investment in China, at US$5.8 billion in the year to June 2009.

BVI Financial Services Commission managing director Robert Mathavious said: "This is long something that the BVI authorities and industry practitioners have hoped would be possible. It emphasises the quality of BVI companies and extends their value to users."

The BVI House of Assembly passed the Securities and Investment Business Act (SIBA) during the week commencing 12 April 2010. SIBA and related secondary legislation, which is designed to update investment business regulation, is expected to come into force soon. Existing funds will benefit from transitional provisions which mean that certain provisions of SIBA will not apply for a period following the commencement date.

The FSC also announced, on 5 January, the establishment of a focus group to review and revise existing IP laws. This is to make "recommendations for legislative revision that are in concert with recent developments in the field and industry".

Hong Kong and Singapore enable exchange of tax information

The Inland Revenue (Disclosure of Information) Rules were finally approved by the Legislative Council on 3 March 2010. They came into effect, together with the Inland Revenue (Amendment) Ordinance 2010, which enables Hong Kong to adopt the more liberal 2004 version of OECD Exchange of Information article in its tax treaties, on 12 March.

Previously, the Inland Revenue Department (IRD) could only collect taxpayers' information for domestic tax purposes, a provision that conflicted with OECD's 2004 Model, which provides that the lack of a domestic tax interest does not constitute a valid reason for refusing to collect and supply the information requested by the other contracting party. The Hong Kong government said it would adopt the "most prudent" version of the standard to protect the privacy of firms and individuals, and ensure confidentiality. Relevant tax jurisdictions would need to prove their request was necessary or relevant to avoid "fishing expeditions", and must treat the information as confidential under their domestic laws.

With the new exchange of information regime, Hong Kong has proceeded to expand its treaty network, including signing new comprehensive tax treaties with Brunei, the Netherlands and Indonesia, and concluding negotiations with Japan and Switzerland. Previously, Hong Kong had concluded only five treaties.

Meanwhile the Singapore government enacted the Income Tax (Amendment) (Exchange of Information) Act on 22 January, enabling it to implement the OECD Standard on exchange of information with treaty countries upon request. Previously Singapore's banking and trust confidentiality laws would only permit information to be obtained for the purposes of investigating or prosecuting a tax offence only where there was a domestic interest.

On 13 November 2009, Singapore qualified for removal from the OECD "grey" list after signing its 12th bilateral information-sharing agreement. Singapore now expects to hold exploratory talks with the US regarding a comprehensive tax treaty, which may lead to a breakthrough in the 22-year deadlock between the two countries. Last July, John Harrington, international tax counsel for the US Treasury department, said that historically, there had been three issues on which the US could not compromise in tax treaty negotiations. "The country had to be willing to exchange information, had to be willing to agree on a comprehensive limitation on benefits provision, and can't insist on tax sparing," he said.

Sovereign Comment

This story provides further evidence that Hong Kong is prepared to take whatever steps are necessary to maintain its increasing role in the international tax planning arena. We welcome any moves that lead to the adoption of further tax treaties, particularly as it is clear that China is leading the table of major world economies as we move out of recession. The inclusion of Singapore on the OECD white list is also to be welcomed; these further developments should allow her to continue to develop a full range of financial services and products. In recognition of Singapore's growing international importance, Sovereign is expanding its operation there.

asia+ pacific

UAE relaxes foreign ownership rules

The Abu Dhabi government announced, on 23 March 2010, that a proposed new companies law would allow majority, but not full, foreign ownership in "some sectors". The Ministry of Economy is preparing the final draft of the law ahead of its relay to the Federal National Council later this year.

"The new companies law will give some relaxation to foreign ownership," said Mohammad Omar Abdullah, undersecretary of the Department of Economic Development. "But it will not be to the extent of 100%." Sectors to be excluded from the new legislation will be those of "strategic" value, such as oil and gas.

Under current regulations, business owners from all nationalities outside the GCC must have a local majority partner. Exceptions apply in certain free zones where 100% foreign ownership is allowed."

Mohammad Al Qamzi, chief executive of the Abu Dhabi government's Higher Corporation for Specialised Economic Zones said the federal law would probably serve as a "guideline," allowing for flexible implementation at the local level according to each emirate's needs.

The law is aimed at increasing international investment, for which the UAE announced an annual growth target of 9%. Last August, a presidential decree eliminated the Dh150,000 minimum capital requirement to register a limited liability company, bringing the UAE in line with five other Arab countries that have dropped similar requirements since 2004.

India to negotiate tax treaties with non-sovereign territories

India's Central Board of Direct Taxes issued, on 20 April 2010, a notification recognising Hong Kong as a "specified territory" for purposes of section 90 of India's Income Tax Act 1961 (ITA), which clears the way for the two sides to enter into a tax treaty. The notification was published in India's official gazette on 21 April.

India's 2009 Finance Act included a little noticed clause authorising the government to enter into tax treaties with non-sovereign territories – such as Hong Kong or the Cayman Islands. The ITA previously permitted the negotiation of tax treaties only with sovereign countries. The amending provision came into effect as of 1 October 2009.

India also recognised nine other jurisdictions – Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Macau and the Netherlands Antilles – as specified territories on 13 April.

The absence of tax treaties with Hong Kong and the Cayman Islands led to controversy in the ongoing tax dispute over the acquisition by Vodafone, the mobile phones giant, of Hutchison Essar, the fourth-largest Indian operator in 2007. The sale created a capital gains tax liability of US$1.7 billion in India, but Vodafone challenged its legal basis in the Supreme Court on the basis that the underlying contracts were subject to the jurisdictions of Hong Kong and the Cayman Islands, with which India had no tax agreements.

"Now the central government can initiate and negotiate agreements for exchange of information for the prevention of evasion or avoidance of income tax and assistance in collection of income tax with these nine specified territories," an official statement said. The government has ordered re-negotiation of all India's 77 existing tax treaties to include provisions for exchange of, and assistance in, the collection of tax information.

UK Court of Appeal remits pilot residence case

The Court of Appeal found, on 1 November 2009, that the Special Commissioner had misdirected herself in law in the case of *Lyle Dicker Grace v Revenue & Customs Commissioners*. It allowed the appeal by Grace, but only so that the issue of residence could be remitted to the First-tier Tribunal for reconsideration.

Grace was a pilot domiciled in South Africa but who had been living in the UK for some time. He had come to the UK in 1986 to qualify as a commercial pilot and was then employed by British Caledonian. In 1997 his marriage was dissolved and he returned to South Africa, setting up home in Cape Town while continuing his employment with the airline. He retained his house near Gatwick Airport, which he used in order to rest before or after carrying out his flying duties.

Grace said that in August 1997 he left the country to live outside the UK permanently and thereafter was not resident in the UK. He had moved the centre of his life to South Africa and he had kept his visits to the UK to a minimum. In the following three years he spent 41, 71 and 70 days in the UK, ignoring days of arrival and departure. HMRC argued that he had not really left the UK. There had been no distinct break and so he remained as a resident.

The Special Commissioner originally decided that he was not resident in the UK but, on appeal, the High Court disagreed. The judge said that Grace's presence in the UK to perform duties under a permanent contract of employment was not casual or transitory and his presence simply could not be described as a temporary purpose. The Special Commissioner should not have concluded that because Grace had a permanent dwelling and a settled place of abode in South Africa, he could not have had one in the UK. Grace appealed.

The Court of Appeal did not feel that a finding of UK residence was the only possible conclusion based on the facts found by the Special Commissioner. It said: "It would be wrong to treat the appellant's presence for the purposes of his employment as a factor which necessarily shows his residence. It may well be a strong pointer in that direction but... I do not think it would be right to regard Mr Grace's residence in this country in order to perform the duties of his employment as a trump card which of itself concludes the issue in favour of residence."

Sovereign Comment

Please refer to the *Gaines-Cooper* story on the Profile section later in this edition. These cases are just two high profile examples of the increased efforts by HMRC to crack down on offshore taxpayers. The rules are becoming more complex and, of course, the size of the current UK budget deficit means that this pressure is unlikely to ease any time soon. More than ever before, it is vital for those already claiming non-UK residence – or those who may be considering such a move as way to escape the new 50% higher tax rate – to seek professional advice at the earliest possible opportunity.

ECJ rules that France can control inheritance of IP

The European Court of Justice ruled, on 15 April 2010, that EU member states are entitled to apply forced heirship rules to the benefits of the resale of artist's work after their death. The judgment said that it was not appropriate for a question about a resale right to interfere with national laws of succession.

In *Gala-Salvador Dalí and Visual Entidad de Gestión de Artistas Plásticos* (C-518/08), the artist Salvador Dalí had left his intellectual property rights to the Spanish state in his will when he died in 1989. He had five heirs who inherited the rest of his estate. But French forced heirship rules stipulate that only heirs can benefit from the resale of an artist's work after their death and a collections agency in France passed the resale income to Dalí's heirs. Spain sued and the case was referred to the ECJ.

A 2001 EU Directive states that a royalty payment is due to the original creator of a work if it is resold after the original sale. The right lasts the author's lifetime and for 70 years after death and was intended to redress the balance between the economic situation of authors of graphic and plastic works of art and that of other creators who benefit from successive exploitations of their works.

The Court said that it was important that the law in EU member states was harmonised because if it were not in force in one country art sales would flock to that country at the expense of others. But it said that that harmonisation did not extend to the issue of who can inherit the benefits of the resale right.

It further said that it was not appropriate for a question about a resale right to interfere with national laws of succession. "It is permissible for Member States to make their own legislative choice in determining the categories of persons capable of benefiting from the resale right after the death of the author of a work of art," it stated. The Court said that it was up to the French court that referred the issue to decide whether French or Spanish law should apply to the dispute.

UK High Court upholds retrospective tax

The UK High Court upheld, on 27 January 2010, the right of HM Revenue & Customs to seek £100 million in income taxes from 2,500 users of an offshore tax avoidance scheme. It also ruled that the backdating of demands was "in the relevant circumstances proportionate" and did not breach human rights.

In *R (on the application of Huitson) v HMRC*, Robert Huitson was a UK-resident, self-employed IT contractor who, before 2008, belonged to a scheme whereby his services to UK clients were supplied through an Isle of Man intermediary. Double taxation relief under the UK-Isle of Man tax treaty ensured that no UK income tax liability arose. The judge said that the overall effect had been to reduce Huitson's tax rate to just 3.5%.

The UK Finance Act 2008 subsequently prevented this type of scheme from working, with retrospective effect. Huitson issued an application for judicial review, arguing that HMRC's retrospective imposition of the law breached the 1998 Human Rights Act. He emphasised that HMRC had failed to take any action against the scheme before the law was changed, despite being well aware of it.

Mr Justice Parker rejected this, upholding the 2008 Finance Act, which let the Revenue close the loophole retrospectively. He noted that the Revenue had warned the users of the scheme that it might be challenged, and said the government was entitled to change tax law retrospectively to quash artificial arrangements.

EU to review Jersey, Isle of Man "zero-10" regimes

The "zero-10" corporate tax regimes of Jersey and the Isle of Man are to be reviewed by the EU Code of Conduct Group in September, according to a report in the Jersey Evening Post on 1 June 2010. It said "the news slipped out because Guernsey is celebrating avoiding the assessment by committing early to a 10% corporate tax rate across the board."

Jersey Chief Minister Terry Le Sueur confirmed that there would be an assessment of the corporate tax system by the EU in September. He said: "Jersey is going to have its tax system assessed and as far as I am concerned that is fine because it actually gives us greater clarity."

Guernsey has not, in fact, formally committed to replacing its zero-10 regime with a flat 10% rate, but a spokesman said: "Guernsey has committed to a review of its corporate tax regime under a presumption of a headline general rate of 10%. How the general rate will apply is still under consideration and will clearly be informed by the results of our public consultation to be published in the next few weeks."

Guernsey Chief Minister Lyndon Trott noted, in a recent public statement in response to media enquires, that the Code of Conduct Group had "decided not to review Guernsey's tax regime at this time".

Last October, Jersey, Guernsey and the Isle of Man were informed, at a meeting with the then UK Financial Secretary Stephen Timms, that their zero-10 tax regimes might not be compliant with the EU's Code of Conduct for Business Taxation.

The regimes impose a zero rate on corporate income, with the exception of financial service companies, which are assessed a 10% tax rate. They came into effect on the Isle of Man in 2006, Guernsey 2008 and Jersey 2009.

Timms told the chief ministers of the three jurisdictions that the EU Code Group had specifically considered the zero-10 regime, with some members suggesting that it did not comport with the Code of Conduct. But rather than launching a formal complaint, the EU simply stated that the regime "does not meet the spirit" of the Code.

Sovereign Comment

These are interesting developments that could lead to changes in the zero-10 tax regimes in these territories. If nothing else, this story demonstrates that the financial crisis we have experienced in the last couple of years implies that even previously agreed arrangements may now be scrutinised and changed where necessary. Readers will recall that the Gibraltar government's planned implementation of a flat 10% corporate tax rate takes effect from January 2011. It may be that the Channel Islands and Isle of Man will be obliged to follow Gibraltar's lead.

fiscal

OECD launches peer reviews

The OECD Global Forum on Transparency and Exchange of Information launched, on 18 March 2010, a peer review programme as a first step in a three-year process, approved in February, in response to the call by G20 leaders at their Pittsburgh Summit in September 2009 for improved tax transparency and exchange of information.

The reviews will be carried out in two stages: firstly, an assessment of the legislative and regulatory framework; and, secondly, assessment of the effective implementation in practice. The review reports will be published when approved by the Global Forum, which is next due to meet in Singapore at the end of September 2010.

The first tranche of 15 jurisdictions comprises: Australia, Barbados, Bermuda, Botswana, Canada, Cayman Islands, Denmark, Germany, India, Ireland, Jamaica, Jersey, Mauritius, Monaco, Norway, Panama, Qatar and Trinidad & Tobago.

Mike Rawstron, chair of the Global Forum, said: "There has been a lot of progress over the past 18 months, but with these reviews we are putting international tax co-operation under a magnifying glass. The peer review process will identify jurisdictions that are not implementing the standards. These will be provided with guidance on the changes required and a deadline to report back on the improvements they have made".

Netherlands simplifies participation exemption rules

The Dutch government adopted, on 22 December 2009, a Bill to amend the legislation on the participation exemption to reintroduce the "Motive Test" and simplify the regime, which is currently perceived as unclear and difficult to apply to international structures. It entered into force on 1 January 2010.

Before 2007 the motive of the taxpayer for holding shares in a foreign subsidiary was used to determine whether or not the participation exemption applied. But, as of 1 January 2007, the government changed the rules by introducing an Asset Test and a Tax Burden Test.

Under the latest changes, the Motive Test is reintroduced such that the participation exemption is applicable if the participation is at least 5% shareholding in the subsidiary and the shareholding is not held as "portfolio investment". If the shares are held in the course of the taxpayer's ordinary business, the participation exemption will apply without recourse to further tests. As a safety net provision, the Asset Test and Tax Burden Test will be maintained for those companies that fail this non-portfolio investment test. The existing requirements of the Tax Burden Test are also be relaxed with the abolition of the requirement to recalculate the taxable basis based on Dutch standards.

The Dutch Patent Box regime for income on qualifying intangible assets is also improved and renamed the Innovation Box. The most important changes are that income from qualifying intangible assets will be taxed at an effective tax rate of 5% – it was 10% under the Patent Box regime – and there is no limit on income that can be allocated to the Innovation Box. Furthermore, if the R&D activities report a taxable loss, this loss could be credited against the regular tax rate of 25.5%.

Sovereign Comment

Together with its extensive tax treaty network, the Dutch participation exemption rules are one of the most important reasons why the country remains attractive for foreign investors. Any clarification to the rules is to be welcomed. Our Dutch office is always willing to discuss the changes and the wider benefits of Dutch holding companies – and indeed trading structures, such as those relating to royalty routing.

Residence and Ordinary Residence in the UK

Two decisions have recently been issued by the UK courts regarding UK tax residence which will have implications for certain international assignees inbound to and outbound from the UK. The first – *the Gaines-Cooper case* – concerns the circumstances in which an individual ceases to be UK tax resident, while the second – *the Tuczka case* – involved a non-UK national and considered when someone becomes ordinarily resident in the UK.

In *Gaines-Cooper*, the UK Court of Appeal rejected, on 16 February 2010, a British taxpayer's claim that he did not owe taxes because he was a non-resident, landing him with a £30 million tax bill for the years 1993 to 2004.

The case involved judicial review of an earlier decision that the position of HM Revenue & Customs (HMRC) was contrary to its own guidance given in booklet IR20. British businessman Robert Gaines-Cooper had argued that he did not owe taxes in the UK because he has been a resident of the Seychelles since 1976. He justified his position by a rule that defines a non-resident as one who spends less than 91 days per year in the UK.

The Court of Appeal confirmed that HMRC was indeed bound by the terms of IR20. But it accepted that an implied condition in IR20 was that, in order for the individual in question to be treated as non-resident, they had to have made a distinct break with the UK by severing all social and family ties with the UK. As Gaines-Cooper was deemed not to have done so, he was to be treated as resident in the UK even after his ostensible departure in 1976.

Justice Alan Moses said that the correct interpretation of tax residency status turned on whether England had remained the taxpayer's "centre of gravity of his life and interests," according to the report. The 91-day rule could not establish non-residency status, rather it was "important only to establish whether non-resident status, once acquired, has been lost".

The Court found that Gaines-Cooper, who was born in the UK, never meaningfully cut ties with the UK. He maintained a large house in the UK, which the Court called his "chief residence" and was home to his second wife and son, as well his collections of art and guns. Furthermore, his son attended an English school, his will was drawn up under English law and he attended regularly at Ascot racecourse.

On the basis of these connections, the Court found that Gaines-Cooper had failed to show the required distinct break and that his complaints of unfair treatment by HMRC were based on an "impossible construction" of the law. The fact that Gaines-Cooper had not been in the country for more than 91 days in any one year since 1976 made no difference to his status, the Court said.

The Court said HMRC's interpretation of tax residency was correct, adding that there were "ample grounds on which to conclude that he had been resident and ordinarily resident in the UK throughout (the period)". HMRC is "fully entitled to look for a clear break – or a clean break – with this country before affording non-resident status," the Court concluded.

"The fact that Gaines-Cooper had not been in the country for more than 91 days in any one year since 1976 made no difference to his status"

Gaines-Cooper plans to appeal the case to the Supreme Court. His counsel said that HMRC was reinterpreting its own guidance, turning it "from a sensible, practical, guide into something meaningless and, which is worse, a devious trap".

Last year HMRC replaced the IR20 guidance on residency with a new booklet called HMRC6. This emphases the importance of "pattern of lifestyle" in determining UK residency, stating that "just because you leave the UK to live or work abroad, does not necessarily prove that you are no longer resident here".

The second case, *Tuczka v HMRC*, was a decision of the First-Tier Tribunal that seems to have overturned the common understanding that individuals who come to the UK with the intention of remaining for less than three years are treated as "not ordinarily resident" in the UK such that their income from non-UK sources is only taxed in the UK if remitted to the UK. Uncertainty arises when individuals who originally intended to remain in the UK for less than three years remain for longer. The question then arises when do – or did – they become ordinarily resident?

Andreas Tuczka, an Austrian corporate financier, claimed to have no intention of remaining in the UK for three years. He arrived in the UK in July 1997, but was held to be ordinarily resident for the years 1998/1999, 1999/ 2000, and 2000/2001. In reaching this decision, one factor that was considered was that Tuczka purchased a flat and lived there with his future wife who was in the UK on a training contract that would last for more than three years.

In the words of the judge: "One factor in considering this question is Dr Tuczka's decision to purchase the Notting Hill flat. In our view this is not determinative of the question; it is an added factor demonstrating that his purpose in living in London for the time being was settled. Even without the purchase of the flat, we consider that the evidence shows Dr Tuczka to have become ordinarily resident during 1998-99. He chose to remain in London for a settled purpose, namely his employment, and adopted a pattern of living which in fact continued until 2002 (and, with certain changes, subsequently)."

In other words, individuals should not assume that they will automatically be regarded as not ordinarily resident for three years if they do not leave the UK before their third anniversary of arrival. If they become "settled", they may become ordinarily resident at an earlier date.

Taken together, the two rulings suggest that HMRC is targeting people who use residence and domicile rules to reduce their tax bills. Last year, it established a new team – the High Net Worth Unit – specifically to investigate the lifestyles of wealthy individuals in the UK. The government is also consulting on whether there should be a statutory definition of residence and, in broad terms, whether the test should be an objective one or not.

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