Sovereign report

issue thirty-six
november 2010

contents

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Printer Pioneer Printers Limited
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Register An Aircraft.com takes off

Register An Aircraft.com (RANA) is Sovereign's new aviation division based in Gibraltar. RANA will concentrate on the executive jet and turbo prop market and provide a range of aviation related services from aircraft registration, ownership, insurance and assistance with finance arrangements. A general consultancy service is also available. Contact details are found on page 14 or introductions can be made through your local Sovereign office.

Abu Dhabi office opens for business

Vik Pangam has joined the company to head up our newly opened office in Abu Dhabi, which will provide the full range of our services to clients in the largest of the seven Emirates. Contact details appear on page 14 of this report.

Sovereign receives Cayman licence

We have just received news from the regulatory authorities in Cayman that Sovereign has finally received approval for its Cayman Island Corporate Service Provider licence. This will enhance our ability to offer the formation of Cayman Island exempt companies and, importantly, a turnkey mutual fund service.

EU Companies - new disclosure requirements

EU Directive 2003/58/EC came into force in all EU Member States as of 1 January 2007 and is being transposed into various national laws. If they have a website the new law will require all companies incorporated in the EU to state clearly on their homepage both the registered office address and registration number of the company. Sovereign is currently in the process of updating its own websites and any Sovereign clients that have EU companies with websites should take note to do the same.

chairman

Untitled Diptych from the Series "Confessions". David Birkin. 1st Prize Winner, The 2009-10 Sovereign European Art Prize.

Sovereign Art Foundation news

Congratulations to David Birkin whose photographic diptych (see picture left) from his "Confessions" series won this year's Sovereign European Art Prize and the award of €25,000. Fellow British artist Oliver Clegg won the prestigious public vote award.

The 30 finalists for the Sovereign Asian Art Prize have now been selected and their works are on display in the gallery section of the Sovereign Art Foundation website. This year's exhibition will first travel to Singapore where there will be a grand opening party at Artspace @ Helutrans on 22 October. Alongside the 30 Finalists, we will also be showcasing 20 works by Singaporean artists nominated for the prize, which will be sold at a gala dinner in Singapore scheduled to take place at the Sands Casino on 12 December. The works by the 30 Finalists will then return to Hong Kong for exhibition in mid-January, which will culminate in the gala dinner and auction. Dates have yet to be finalised. Full details can be found at www.SovereignArtFoundation.com

'Yeah, I'm the taxman'

In a bid to shame Pakistanis into paying their taxes, the governing body of the upmarket Clifton Cantonment district of Karachi has resorted to transgender tax collectors. The plan is that wealthy individuals will pay up voluntarily in order to avoid a visit by one of the tax authority's transgender representatives. "Neighbours will come out and say, 'oh, what's happening?' and the bad name the person will get, this will maybe convince them to pay taxes. And that's exactly what happens," Aziz Suharwardy, vice president of the board of Clifton Cantonment was quoted as saying. You have been warned.

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

UK MP defends role of offshore finance centres

The UK parliament called, on 22 July 2010, for an "informed, consistent and balanced" debate on the role of offshore centres in the global economy. It welcomed agreement from the UK government that an evidence-based approach should be adopted in future policy making on offshore financial centres, both nationally, and in international fora.

The debate was sponsored by Conservative MP Mark Field, who argued that small international financial centres (IFCs) have endured unwarranted "political attacks and misguided criticism as major governments seek to understand the cause of the global financial crisis". He said that initiatives being driven by the OECD, the G-20, the Financial Action Task Force (FATF), the EU and national governments ran the risk of inaccurately labeling small IFCs as scapegoats for the recent shortcomings in financial markets, and in doing so obscuring the real causes of the financial crisis.

"Small IFCs were not the cause of the global financial crisis. While it is convenient to blame far-off countries for causing the financial crisis, even those who work in the financial markets do not accept that small IFCs were a major cause of the crisis," he said.

Field emphasised the conclusions reached by the Foot Review into the UK's relationship with its Crown Dependencies and Overseas Territories. In particular, he noted that they had a limited impact on the UK's tax base and provided stable, well-regulated and neutral jurisdictions through which to facilitate cross-border business for the benefit of the global economy.

Mark Hoban, Financial Secretary to the UK Treasury, responded by agreeing that the UK was uniquely placed in this debate in having a constitutional relationship, with half of the top 30 IFCs. He recognised the efforts made by small IFCs to date and welcomed further efforts towards progress in this area. He also supported the call for a balanced debate in arguing that it was important that the UK government, the EU and the G-20 proceed on an evidence-based approach.

Sovereign Comment

Sovereign has been warning against the use of non-compliant offshore structures for many years, but it is pleasing to note that the advantages afforded by a well-regulated IFC sector have also been recognised. Readers are referred to the recent UK "emergency" budget discussed below. The Budget highlighted the extent of the current UK deficit – and set out the new coalition government's commitment to a dramatic deficit reduction policy. Tax evasion and related abuse across tax havens are being particularly targeted. We therefore welcome this debate and look forward to some positive conclusions as a result.

36 europe

Spain to probe Swiss accounts

Spanish Finance Minister Elena Salgado said, on 24 June 2010, that tax inspectors were investigating some 3,000 accounts held by Spaniards at HSBC Bank in Switzerland for possible tax fraud. Media reports said the accounts could total more than 6 billion euros ($7.36 billion).

"The account holders have been advised. They have to put the accounts in order with the Treasury and of course they will receive the corresponding sanctions and penalties," Salgado said on television.

Newspaper reports said the accounts being probed are in the Swiss branch of the bank HSBC and that French authorities had tipped off Spain. In January 2009, French officials, on a request from Swiss authorities, seized files stolen by an ex-employee of HSBC that included data on some 127,000 accounts held by people from 180 countries.

An HSBC spokesman in Switzerland said the bank was in the dark about the investigation. "The bank has Spanish clients. But we do not know if these were our stolen data that were given to Spain because we have not received any official confirmation from France or from Spain," he said.

Sovereign Comment

This is another example of a cash-strapped government seeking to maximise its tax take by seeking undeclared funds abroad. Sovereign's position is quite clear. Tax planning that relies on non-disclosure is not tax planning at all; it is just tax evasion. Readers who may be exposed should contact their closest Sovereign office for a no obligation, confidential discussion.

UK announces Capital Gains Tax hike

UK Chancellor George Osborne announced, in the Emergency Budget on 22 June 2010, the introduction of a new 28% rate of capital gains tax (CGT) that will apply to higher rate and certain other taxpayers. But the lifetime limit on gains qualifying for entrepreneurs' relief will increase to £5 million from £2 million. Entrepreneurs' relief results in qualifying gains up to the lifetime limit being taxed at a rate of 10%.

For gains not covered by entrepreneurs' relief, individuals will continue to pay CGT at 18% where their total taxable income and gains are below the upper limit of the income tax basic rate band (£37,400 for 2010/11). Gains will be calculated as before, net of available capital losses and the annual exemption. The new 28% rate applies to gains above that limit. Trustees and personal representatives of deceased persons will pay CGT at a flat rate of 28% as will all individuals who pay the remittance basis charge, regardless of the level of their taxable income or gains. This will apply to disposals on and after 23 June 2010.

As a result, the UK has leapt from 16th to 7th in terms of local CGT rates, against other countries in Europe. According to a guide to CGT on residential property by online publication Global Property Guide, the UK is still more than five percentage points below the rate of CGT levied in France, the highest in Europe. But it is only two percentage points behind the 30% levied in Russia, Sweden, the Netherlands and Norway. Previously, the UK was behind the 20% levied by the likes of Serbia and Cyprus.

The Chancellor announced reductions in both the main rate and small companies' rate of corporation tax. The current main rate of corporation tax of 28% will be reduced to 24% over the course of four years. The main rate will be reduced to 27% in 2011/12, reducing by a further 1% per annum, to 26% in 2012/13, 25% in 2013/14 and 24% in 2014/15.

The government also confirmed that from 6 April 2011 it will end the effective requirement to convert an individual's pension fund to an income at the age of 75. Interim changes have come into effect for all those about to turn 75: the stricter minimum and maximum limits on income withdrawal will be deferred to age 77 instead of the current age 75. New rules will be finalised next year.

Guernsey and Isle of Man announce switch to automatic EU information exchange

Guernsey Chief Minister Lyndon Trott told the States assembly, on 28 July 2010, that Guernsey plans to move to automatic exchange of information under the EU Savings Tax Directive (EUSD) in place of the equivalent measures that it has operated since the Directive came in to force.

His statement, which followed consideration of consultation carried out by the Fiscal and Economic Policy Group, said Guernsey would give financial institutions a six-month window – from 1 January to 1 July 2011 – for moving to automatic exchange of information.

Trott said: "This transition period is to provide the maximum flexibility to our industry in making their necessary adjustments to their payment systems." A report will be submitted to the States in the early autumn to confirm arrangements for the move.

The Isle of Man parliament earlier endorsed, on 17 June 2010, the commitment made in June 2009 by then Treasury Minister Allan Bell to move fully to automatic exchange of information under the EUSD from 1 July 2011. As a result, the withholding tax option currently available to customers having accounts with Isle of Man banks by virtue of the transitional arrangements in the EUSD will be withdrawn.

Bell said this was "further evidence that the Isle of Man is prepared to align its policies with international benchmark standards, which signals to our trading partners and investors alike that we can be relied upon and that our name is associated with probity and foresight."

Preparation for the change has moved forward with the passing of enabling legislation. Liaison work will continue with the island's banks to ensure that the change is brought in smoothly and effectively.

Jersey responded to the Isle of Man's June 2009 commitment by stating that it had always been the intention of the EU that the option to withhold tax on interest paid to EU savers instead of the exchanging of information on account holders' interest would only be available to jurisdictions during a transitional phase. It said Jersey Finance would be consulting within the Industry on the timing of this change while monitoring developments in other jurisdictions.

europe

Swiss government completes processing of UBS accounts

The Swiss government announced, on 26 August 2010, that it had completed processing the 4,450 undisclosed UBS accounts that it was obliged to disclose under the terms of last year's bilateral agreement with the US. The IRS, the US tax authority, confirmed that it had received account information on over 2,000 of those accounts.

The agreement of 19 August 2009 stipulated that Switzerland would establish a special task force that would enable the Swiss Federal Tax Administration (SFTA) to render final decisions on all 4,450 accounts by 26 August. The issuance of a final decision by the SFTA triggers a 30-day period during which an affected individual may appeal the decision to the Swiss Federal Administrative Court. The agreement did not set a time limit for the resolution of the appeals process.

The Swiss government said: "Talks are being held between the contracting parties regarding the final stage of the agreement's implementation. Both parties are optimistic that the US authorities will receive most of the agreed account information within a reasonable period of time and that the US authorities will definitively withdraw the civil action brought against UBS."

It also hoped that the transfer of the UBS client data would be largely concluded by autumn 2010. The IRS similarly stated, "Based on information received to date and assurances by the Swiss Government, we anticipate being in a position to withdraw the John Doe summons this fall."

The bilateral agreement was reached after the IRS and the Department of Justice sought a John Doe summons against UBS in the US District Court for the Southern District of Florida in 2008. In conjunction with the agreement, the US issued a treaty request to Switzerland for information on some UBS accounts held by US clients.

The John Doe summons is still outstanding regarding UBS accounts covered by the US treaty request, but under the agreement, the summons would be withdrawn for those accounts as long as UBS has complied with the requirement to turn over account information to the SFTA.

In January, the Swiss Federal Administrative Court nearly scuppered the deal by ruling that the criteria used to determine what information would be shared went further than Swiss law and the existing US tax treaty permitted. As a result, the Swiss government was forced to seek approval of the agreement in parliament. After several failed attempts to win approval without requiring that the agreement be subject to a referendum, the parliament gave its approval on 17 June.

Liechtenstein passes LDF law and cuts corporate tax rate

The Liechtenstein Parliament passed, on 7 July 2010, the Law on Administrative Assistance in Tax Matters. Under the Memorandum of Understanding signed by the Liechtenstein and UK governments in August 2009, Liechtenstein had agreed to introduce the legislation no later than 12 months after the date of signing.

Under the law, Liechtenstein banks, financial advisors, trustees and other asset custodians will have three months in which to notify any of their clients who they suspect could have tax reporting obligations elsewhere that they have 18 months in which to provide evidence of tax compliance. The three-month period begins on the date the financial institution identifies a client. Advisors are required to "cease providing relevant services" to any clients who refuse to comply with this request, or face possible sanctions.

The legislation is a central plank of the tax "amnesty" programme agreed with the UK and known as the Liechtenstein Disclosure Facility (LDF), which runs through to March 2015. UK taxpayers with undeclared offshore assets can disclose them through a Liechtenstein entity in exchange for reduced penalties.

On 5 May, Liechtenstein also approved plans for creating a new Tax Act, designed to modernise the existing Tax Act of 1961 and bring it into compliance with European law. A flat corporate tax rate of 12.5% was among the key elements of the package, which takes effect on 1 January 2011. Currently the top corporate rate is 20%.

Prime Minister Klaus Tschütscher said: "The new Tax Act is an important step toward enhancing the attractiveness of our location. Through rapid implementation of this tax reform, we will give more transparency to our citizens and a framework for sustainable growth to our business location."

Panama aims for OECD "White List" by early 2011

The Panamanian Finance Ministry announced, on 12 August 2010, that Panama should be promoted to the OECD "white list" of jurisdictions that have substantially implemented the internationally agreed tax standard by the beginning of 2011.

Panamanian Deputy Economy Minister Frank De Lima said he was optimistic that Panama's efforts to sign income tax treaties with 10 countries and its upcoming treaty negotiations would be enough to attain white list status.

Panama has signed income tax treaties with Barbados and Mexico and has agreed to the text of tax treaties with eight other countries – Belgium, France, Italy, Luxembourg, the Netherlands, Portugal, Qatar and Spain. De Lima said that negotiations for tax treaties with South Korea and Singapore were scheduled to start. When concluded, these would bring the number of agreements to 12, fulfilling the OECD's criteria for placement on the white list.

On 3 June, the OECD announced that it had moved Brazil and Indonesia to the "White List" category of jurisdictions that have substantially implemented the internationally agreed tax standard. Dominica, Grenada and St Lucia were also promoted on 19 May.

Jeffrey Owens, director of the OECD's Centre for Tax Policy & Administration, said: "We continue to see a great deal of progress in the Caribbean as jurisdictions move to sign agreements. With Dominica, Grenada and St Lucia now reaching this benchmark, most of the Caribbean jurisdictions have implemented their commitment to signing exchange of information agreements.

"We will be working with the remaining Caribbean jurisdictions – Belize, Costa Rica, Guatemala, Montserrat and Panama – to encourage them to follow this trend, providing them with whatever assistance is needed. The real test will come with the peer review process, when the Forum can evaluate the quality of these agreements and the extent of the implementation of the standards in practice."

Countries that remain on the OECD's "Grey List" of jurisdictions that have committed to, but not yet substantially implemented, the internationally agreed tax standard are: Belize, Brunei, Cook Islands, Costa Rica, Guatemala, Liberia, Marshall Islands, Montserrat, Nauru, Niue, Panama, Philippines, Uruguay and Vanuatu.

Sovereign Comment
It is good to note that only a handful of jurisdictions have not yet implemented the international agreements in full. It means, however, that the forthcoming peer review process has become even more important. Over the next couple of years, the Global Forum will report on the practical implementation of the several hundred agreements that have been signed in order that the majority of jurisdictions now appear on the so-called "white list". All jurisdictions involved should therefore consider this whole process to be "work in progress".

36 usa + caribbean

Brazil expands tax haven list

4 June 2010, the Brazilian government issued Normative Instruction 1,037 of the Receita Federal do Brasil that expands the 2002 list of jurisdictions considered as "tax havens" for Brazilian tax purposes from 53 to 65 and introduces a new list of regimes designated as "privileged tax regimes".

Article 1 of the ruling identified those countries that do not impose income tax or where the maximum income tax rate is lower than 20% (favoured tax jurisdictions), as well as those whose laws impose restrictions on the disclosure of the shareholding or ownership of the investment (secrecy jurisdictions).

In Article 2, the list of "regimes fiscais privilegiados" comprises: limited liability companies incorporated in the US in which the equity interest is held by non-residents not subject to US federal income tax; Sociedades Financieiras de Inversiones in Uruguay; Entidad de Tenencia de Valores Extranjeros in Spain; International Trading Companies (ITCs) and International Holding Companies (IHC) in Malta; ITCs in Iceland; offshore KFT companies in Hungary; and holding companies incorporated in the Netherlands, Luxembourg and Denmark. Both Luxembourg and Malta were removed from the tax haven list but now appear on the new privileged tax regime list.

Switzerland and the Netherlands requested the government to reconsider their inclusion on the list of tax havens. On 24 June the Receita Federal published a new regulation that temporarily suspended Switzerland and the Netherlands from inclusion on the lists.

Uruguay to lift bank secrecy to facilitate OECD standards

The Uruguayan government announced, on 24 May 2010, that it intends to eliminate bank secrecy for tax purposes and to tax the global investment income of individuals residing in Uruguay. A bill containing the changes to the tax system is to be remitted to parliament and, if approved, would become effective 1 January 2011.

Under the current system, tax authorities cannot access the bank accounts of a taxpayer and the taxpayer is not obligated to reveal its bank accounts. The refusal to show details and movements of accounts therefore represents the legitimate exercise of a taxpayer's right. The proposed legislation would enable the tax authorities to request a court to lift bank secrecy to "verify the veracity" of a taxpayer's declaration.

In April 2009 Uruguay pledged to sign 12 tax information exchange agreements (TIEAs) to meet the OECD requirement. The Bill sets out the judicial procedure to enable the exchange of tax information with countries with which Uruguay has executed TIEAs. Uruguay will not disclose information to foreign tax authorities with which it has not signed TIEAs. To date it has signed 11 such agreements.

Previously all international criminal cooperation treaties executed by Uruguay have excluded tax crimes. The country only cooperated with tax crime investigations if the case involved tax fraud and the tax fraud was carried out to conceal money deriving from another crime that was covered by a treaty.

The government also announced changes to the personal income tax (impuesto a la renta de las personas fisicas, or IRPF) which would be a significant break with its tradition of taxing only income generated in Uruguay. Currently, foreign-source income is not subject to IRPF. Under the reform, interest on deposits and placements in foreign banks and other non-resident entities and on dividends from foreign companies will be subject to IRPF at a rate of 12% when the owner is a Uruguayan tax resident.

SA to introduce new regional holding company regime

South African Finance Minister Pravin Gordhan tabled in the National Assembly, on 24 August 2010, the Taxation Laws Amendment Bills (TLAB), which include a new regional holding company regime – or headquarter company regime – to encourage foreign investment into South Africa as a gateway for investment into the rest of Africa. The concept, intended to rival Mauritius, was first proposed in the February budget.

Under the proposals, headquarter companies would not be subject to the existing secondary tax on companies (STC) in respect of dividends remitted to foreign investors or the 10% dividend withholding tax regime that is expected to replace it. Headquarter companies would also not be subject to the controlled foreign company regime and South Africa's thin capitalisation rules are to be amended so that they do not apply to loans made by foreign investors to a headquarter company, where such funds are in return advanced by the headquarter company to its foreign subsidiaries. Finally, there would be a potential relaxation of exchange controls provided that certain requirements are met.

In order for a South African resident company to qualify as a regional holding company, it will have to meet certain criteria such as that each investor is required to have a minimum 20% shareholding in the company and that at least 80% of the funds invested by the company are required to be invested in foreign subsidiaries in which the company has a shareholding of at least 20%.

Changes to transfer pricing will also be introduced from 1 October 2011. Section 31 of the South African Income Tax Act will be amended to widen its application such that the South African Revenue will no longer be restricted to adjusting a particular price on a particular cross-border transaction. Instead, it will determine an overall tax result, as per the general anti-avoidance provision.

Sovereign Comment

The regime is expected to come into effect on 1 January 2011. It is yet to be seen whether these measures will be enough to attract foreign investors wishing to invest in Africa away from the established investment regime in Mauritius. Sovereign has offices in both Cape Town and Johannesburg; contact either office for the latest information on what promises to be an exciting new holding company regime that could benefit investors from across the region.

Grounded actor Paul Hogan strikes tax deal in Australia

Actor Paul Hogan struck a deal with the Australian Taxation Office (ATO), on 3 September 2010, which allowed him to return home to his family in Los Angeles. He had been barred from leaving Australia for nearly two weeks after the ATO served him with a departure-prohibition order while he was in the country to attend his 101-year-old mother's funeral.

The star of the "Crocodile Dundee" movies, 70, has been in a dispute with the tax office for five years and is under investigation as part of Australia's biggest probe into offshore tax evasion, Operation Wickenby. The ATO refused to comment on reports that it was seeking tax on AUD38 million of allegedly undeclared income from Hogan, saying it did not give details of individual taxpayers. He has never been charged with tax evasion.

The tax office claims he put tens of millions of dollars in film royalties in offshore tax havens, a claim that he has denied. The Australian government considers Hogan to have been an Australian resident for tax purposes from 1987 to 2005 even though he lived in the US from 1995 to 2002. Hogan now lives permanently in the US.

"Mr Hogan is pleased to announce that the parties have reached agreement on terms (which include the provision of security) which will allow Mr Hogan to return to his family," said the actor's lawyer in a statement. "While the Commissioner and Mr Hogan remain in dispute on more general taxation issues, Mr Hogan continues to protest his innocence and denies any wrongdoing."

Hogan fought to block the release of private records relating to the case, but Australia's High Court ruled on 16 June that they should be made public. The Australian Crime Commission (ACC) wanted access to them in order to finalise its case against Hogan, film producer John Cornell and their accountant.

Sovereign Comment

Paul Hogan is the latest in a line of high profile public figures to be caught up in such investigations around the world. As recent cases elsewhere, especially in Europe, have demonstrated, residency issues and the related personal taxation are complex areas. The importance of obtaining professional advice at the earliest possible opportunity cannot be stressed too highly.

Singapore launches "Angel" investor scheme

SPRING, a Singaporean development agency for growing innovative companies and fostering small and medium sized enterprises in the country, launched the Angel Investors Tax Deduction (AITD) scheme on 29 June 2010. It was first announced in the budget earlier this year.

The AITD is a tax incentive that aims to stimulate business angel investments into Singapore-based start-ups, and to encourage more angel investors to add value to these start-ups. It will be effective for qualifying investments made from 1 March 2010 to 31 March 2015, both dates inclusive.

Under the scheme, an approved angel investor who commits a minimum of SGD100,000 (USD71,500) of equity investment in a qualifying start-up within a given year will enjoy a tax deduction, at the end of a two-year holding period, based on 50% of his investment costs, subject to a cap of SGD500,000 of investments in each year of assessment.

For angel investors to qualify for the tax incentive, the individual must make the investment as an individual. Investment made via corporations, trusts, institutionalised funds and other investment vehicles are not eligible. Suitable investors have been able to apply for eligibility under the AITD since 1 July. SPRING aims to catalyse some SGD600 million worth of angel investments in Singapore over the next five years through the means of the AITD.

Court rejects use of reserved powers against will of settlor

The Cayman Islands Court of Appeal held, in an unreported judgment given on 9 September 2009, that the court does not have jurisdiction to appoint a receiver, at the behest of a judgment creditor, by way of equitable execution over a settlor's power of revocation of a trust.

In *TMSF v Merrill Lynch Bank and Trust Company (Cayman) Ltd and Others*, the case involved two Cayman trusts settled in 1999 by Mr. Demirel, a Turkish citizen, over which he had reserved powers of revocation. A revocable trust is one in which assets are owned by the trustee, but the settlor reserves a power of revocation and therefore effectively maintains control over the property.

The appellant, TMSF, was a Turkish government entity responsible for protecting the interests of investors. In proceedings in Turkey. TMSF had been awarded judgment against Demirel for US$30 million, reflecting the value of the assets in the Cayman trusts plus interest and costs. Demirel was subsequently made bankrupt. TMSF issued proceedings in Cayman seeking to have receivers appointed over the defendant's powers to revoke the trusts by way of equitable execution.

At first instance in the Cayman Grand Court, Chief Justice Smellie agreed to appoint receivers over future distributions made to the defendant and, were Demirel ever to revoke the trusts, the property would pass to the receivers. But he refused to appoint receivers over the powers of revocation on the basis that they did not constitute "property". TMSF appealed.

Dismissing the appeal, the Court of Appeal concluded that the power of revocation given to Demirel was unfettered; he could exercise it as and when he chose without anyone else's consent and without regard to the interests of anyone else. Citing the law of bankruptcy, where specific legislation had been required to make a general power of appointment available to a trustee in bankruptcy, it concluded that legislation would also be required to allow equitable execution over a power of revocation and that it would not be open to the court to take such a step.

Sovereign Comment

Importantly, in both instances, the trusts were found to be valid and duly constituted notwithstanding the reservation of the power to revoke. The case therefore illustrates the value of offshore trusts, even revocable trusts, for asset protection purposes, and goes some considerable way to responding to those who may attempt to attack offshore trusts with reserved powers as shams.

36 legal

Gaines-Cooper gains appeal

Robert Gaines Cooper, the Seychelles-based British businessman at the centre of a long-running dispute with HM Customs & Revenue, was granted permission by the Supreme Court, on 26 July 2010 to appeal the decision of the Court of Appeal in February to disallow his claim for a judicial review.

This marks the latest stage in the war of attrition between Gaines-Cooper and HMRC and will be the final stage unless the European courts can be persuaded to become involved. The entrepreneur left Britain in 1976 but is being pursued for tax backdated to 1982 under an interpretation of UK tax law that could also be applied to other non-residents.

The taxpayer, who has homes both in the UK and the Seychelles, had been contending in separate strands that he was non-domiciled and non-resident in the UK. At the first stage, the Special Commissioners found against him. The High Court found against him on appeal in relation to domicile.

The surviving case relates to the interpretation of HMRC's published guidance in booklet IR20. Gaines-Cooper claims that since leaving the UK he has obeyed the rule that gives non-resident status and tax benefits to anyone who spends no more than 90 days a year in the country. The Court of Appeal ruled in February that HMRC was justified in denying Gaines-Cooper non-resident tax status and pursuing him for backdated tax because he retained significant ties to the UK and was still officially resident.

See *In the Press* on page 12.

HMRC wins *Smallwood* trust case in Court of Appeal

The UK Court of Appeal held, on 8 July 2010, that the UK/Mauritius tax treaty did not provide protection from a UK capital gains tax (CGT) charge arising on the disposal of shares by an offshore trust that had UK resident trustees for part of the year, because the trust was effectively managed and controlled in the UK.

In *Revenue & Customs Commissioners v Smallwood & Another,* Trevor Smallwood, a UK resident individual, settled shares into a trust. A Mauritian corporate trustee was appointed in December 2000 and the trust sold the shares in January 2001. The Mauritian trustee then resigned in March 2001 and Smallwood and his wife Caroline, who were both UK residents, were appointed as trustees.

HMRC argued that the Smallwood's were liable to UK CGT on the gain under section 86 of the Taxation of Chargeable Gains Act 1992. The Smallwood's appealed, contending that Article 13(4) of the UK/Mauritius treaty provided that capital gains were only taxable in the contracting state where the person disposing of the asset was resident.

The Special Commissioners decided, in February 2008, that the residence tiebreaker in Article 4(3) of the treaty was based on place of effective management (POEM). They found that, although trustee meetings took place in Mauritius, the top level management of the trust was carried out by UK tax advisors in the UK. The trust was therefore UK resident and Article 13(4) did not provide any protection from UK tax. The Smallwood's appealed.

Upholding their challenge, the High Court held, in April 2009, that as the trust was clearly resident in Mauritius at the date of disposal, there was no need to consider the treaty tiebreaker. HMRC appealed.

The Court of Appeal ruled that this "snapshot" approach was not correct. Two of the three judges held that it was the POEM of the trustees as a continuing body, rather than at the time of the disposal, that was relevant. Based on the facts they concluded that the POEM, and therefore the residence of the trust, was in the UK. Hence the trust was liable to UK tax in respect of the gain on the disposal of the shares.

Untaxed UAE company eligible for Indian treaty benefits

The Mumbai Income Tax Appellate Tribunal ruled, in a decision of 25 November 2009 but made public recently, that a company based in the United Arab Emirates, and which was not subject to tax in the UAE, was still eligible to enjoy the benefits under the India-UAE tax treaty.

In *Hindustan Petroleum Corporation Ltd v ACIT,* the assessee HPC, a company incorporated in India engaged in refining oil and marketing petroleum products, had entered into an aviation services agreement with Caltex Al Khalij LLC, a company incorporated in the UAE, for it to provide technical and commercial services for a fixed annual fee. HPC sought authorisation from the tax officer to remit the fees without withholding any income tax.

HPC argued that Caltex was a resident of UAE and thus the fee was not subject to tax in the absence of Caltex having a permanent establishment in India. There was no separate article in the tax treaty governing fees for technical services, and therefore the fee had to be classified as business profits.

HPC submitted an alternative contention that at best the fee could be considered a royalty, and thus the withholding, if any, would be limited to 10% under the tax treaty.

The tax officer rejected these arguments. Caltex did not pay any tax in the UAE and thus was not eligible to claim the benefits of the tax treaty. The fee was therefore subject to withholding tax in India as per the provisions of the Income Tax Act, 1961. HPC appealed.

The tribunal overruled the tax officer. If the right to tax UAE residents in specified circumstances vested only with the UAE under the tax treaty, that right, whether exercised or not, remained the exclusive right of the UAE. There was no precedent that the UAE would have to actually exercise that right before India would grant the benefits of the tax treaty, the tribunal said.

There was no doubt that Caltex was resident in the UAE, and thus the application of the tax treaty could not be denied solely on the grounds that Caltex did not pay any tax in the UAE. Judicial forums had to interpret the provisions of a tax treaty as they existed even if they resulted in double non-taxation.

Sovereign Comment

This is very good news. UAE resident companies are able to claim advantages of the UAE / India tax treaty without actually having to pay tax in the UAE. This clarifies serious misinterpretations of the treaty to date. Therefore, a company incorporated in UAE, doing business in India can successfully apply the treaty and pay less withholding tax in India on royalties, dividends and interest paid from India to the UAE.

HMRC wins CGT avoidance case

The UK Upper Tribunal found, on 18 May 2010, that avoiding capital gains tax (CGT) had been one of the main purposes of an arrangement for the disposal of shares for loan notes. It therefore upheld the decision of HMRC that no deferral relief was due and CGT was payable on the sale.

In *Coll & Another v HMRC*, Mr and Mrs Coll had owned the entire share capital of Grosvenor Nursing Agency. In 1997 they sold their shares to Nestor Healthcare Group plc, each receiving £1.25 million in loan notes, which were to be redeemed in the sums of £500,000 in October 1998 and £750,000 in March 1999.

The key issue was whether there was a scheme in existence at the date of the sale. The taxpayer argued that Mr Coll's original intention was to become resident in Ireland because of the state of his marriage, but he had been reconciled with Mrs Coll by 18 November 1997, only two days before the sale was completed. In the event, the Colls put their UK home up for sale in January 1998 and took up residence in Belgium in September 1998.

The First-Tier Tribunal found that although the intention to reside in Belgium did not exist in November 1997, there had still been an intention of taking up residence somewhere other than the UK. It held that no deferral relief was due and CGT was payable on the sale.

In their appeal to the Upper Tribunal, the Colls claimed that the move to Belgium was a separate transaction taken independently some months after the sale and was therefore irrelevant in deciding whether a scheme existed in November 1997. The Upper Tribunal disagreed. If looking for confirmation of an intention to become non-resident, it was justifiable to take into account later events that served to confirm that intention.

Mrs Coll further argued was that she had never intended to leave the UK before the sale and was not therefore party to any scheme. The Upper Tribunal did not agree, holding that the legislation stated that the deferral relief should not apply to any issue in the exchange unless the conditions set out were satisfied. This pointed to all the shareholders being treated in the same way.

ECJ finds Spain violates EU Law

The European Court of Justice held, on 3 June 2010, that the different treatment of domestic and foreign shareholders under Spain's participation exemption regime violates article 56 of the EC Treaty on the free movement of capital.

Spanish legislation currently provides that dividends paid by a Spanish company are exempt from tax if the recipient of the dividend is a Spanish company holding 5% or more of the capital of the paying company. But if the recipient is a non-resident company, the shareholding threshold for the exemption is higher – the minimum holding percentage was reduced from 20% to 15% in 2007, and then to 10% in 2009.

In *European Commission v Kingdom of Spain* (C-487/08), the Spanish government argued that the legislation did not violate EU law because resident and non-resident companies were not comparable and the task of relieving any double taxation should fall on the country of residence of the company receiving the dividends.

The ECJ rejected this argument and held that the difference in treatment was sufficient to discourage non-resident companies from investing in Spain. It found that the unfavourable treatment of dividends distributed to non-resident companies could be attributed to Spain's exercise of its tax powers. Because the Spanish government did not present any public interest evidence to justify the unequal treatment, the Commission's complaint in respect of the Spanish legislation was justified.

Gibraltar government sets out tax regime overhaul

The Gibraltar government published, on 16 June 2010, a pre-legislative briefing paper setting out the text of a new, amended and consolidated Income Tax Act, which lays the foundations for the reduction of company tax in Gibraltar from 22% to 10% as from 1 January 2011, to coincide with the definitive abolition of the historical tax exempt company regime.

"The legislation ends all distinction between 'onshore' and 'offshore' business," said a government statement. "Together with the tax information exchange agreements being entered into by the government and Gibraltar's full integration in the EU and compliance with EU financial services regulation, money laundering and cooperation rules, the new Tax Act completes Gibraltar's 14-year transition from tax haven to mainstream European financial services centre."

"Only by creating a climate of compliance can low company tax and further lowering of personal taxes be assured. The new Act therefore introduces tough anti-avoidance measures and default financial and legal penalties to help ensure that all pay the taxes that are due – thus making the low rate possible for everyone."

Following a consultation with the finance industry, revised proposals were published by the government on 2 September. It is expected that the resulting Bill will undergo and complete its passage through Parliament during the autumn. The new legislation is based closely on the old Income Tax Act, with major amendments to bring about the changes being introduced. For ease of use the new legislation will take the form of a new, consolidated Act.

Chief Minister Peter Caruana said: "Previously tax exempt banks, insurance, investment, gaming and other companies will begin to pay profit tax in Gibraltar for the first time on the same basis as all other companies. These companies are vital to our economy and to the social prosperity of all of us in Gibraltar.

"The climate of compliance sought to be created by the new Act is also intended to enable the government to continue and proceed further with its long established programme of tax cutting for individuals as well. Low tax must come hand in hand with an end to our historically benign tax administration and enforcement system."

Sovereign Comment

This is excellent news. Following the publication of their draft proposals, several very positive revisions have been adopted and it is to be hoped that the new Act is passed during the autumn. Our Gibraltar office has seen an upsurge in enquiries in recent months, as the proposed amendments have become public knowledge. As a full member of the European Union, the jurisdiction is well placed to compete with Malta and Cyprus. We will publish further details in future issues.

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Italy seizes motor boss yacht

Italian police seized the £17 million yacht of former Formula One boss Flavio Briatore on 20 May 2010. The yacht was impounded pending further investigations into its tax status. It was alleged Briatore owed up to £3.5 million in unpaid taxes.

Armed officers from Italy's tax police boarded the 62-metre yacht, Force Blue, near Genoa on the Italian Riviera. Guardia di Finanza investigators said they suspected that the Cayman Islands-registered vessel, was supposed to be available for charter at a cost of €245,000 a week but was largely used by Briatore. They also alleged that the crew of the converted ice breaker broke the law when they refuelled in European Union waters without paying VAT, which could amount to €800,000.

Briatore was quoted in the Italian media as saying he was confident the matter would be quickly resolved. His lawyers deny wrongdoing and have challenged the sequestration in court. A spokesman for the Guardia di Finanza tax police said that three similar cases of super-yacht tax evasion were under investigation.

Sovereign Comment

Gabriel Gonzalez of Sovereign's marine division, Register A Yacht.com said: "If a chartering arrangement is to be entered into, then the parties must be clearly identified and evidence should be available to show that chartering is really being undertaken. A similarly transparent approach should also be taken in relation to VAT obligations".

EU tax commissioner visits Hong Kong and Macau

EU Tax Commissioner Algirdas Šemeta visited the two special administrative regions (SAR) of the People's Republic of China (PRC) – Hong Kong and Macau – on 30 and 31 August 2010 respectively, to discuss strengthening ties in tax and customs matters.

In Hong Kong, Šemeta met with Secretary for Financial Services and the Treasury, Professor K.C. Chan, and Customs Commissioner Richard Yuen. He emphasised the improved dialogue, cooperation and convergence with the SAR on issues relating to good governance in tax matters. In line with its stated tax policy of promoting internationally recognised good governance principles, the EU aims at improving the degree of transparency and the exchange of information with Hong Kong.

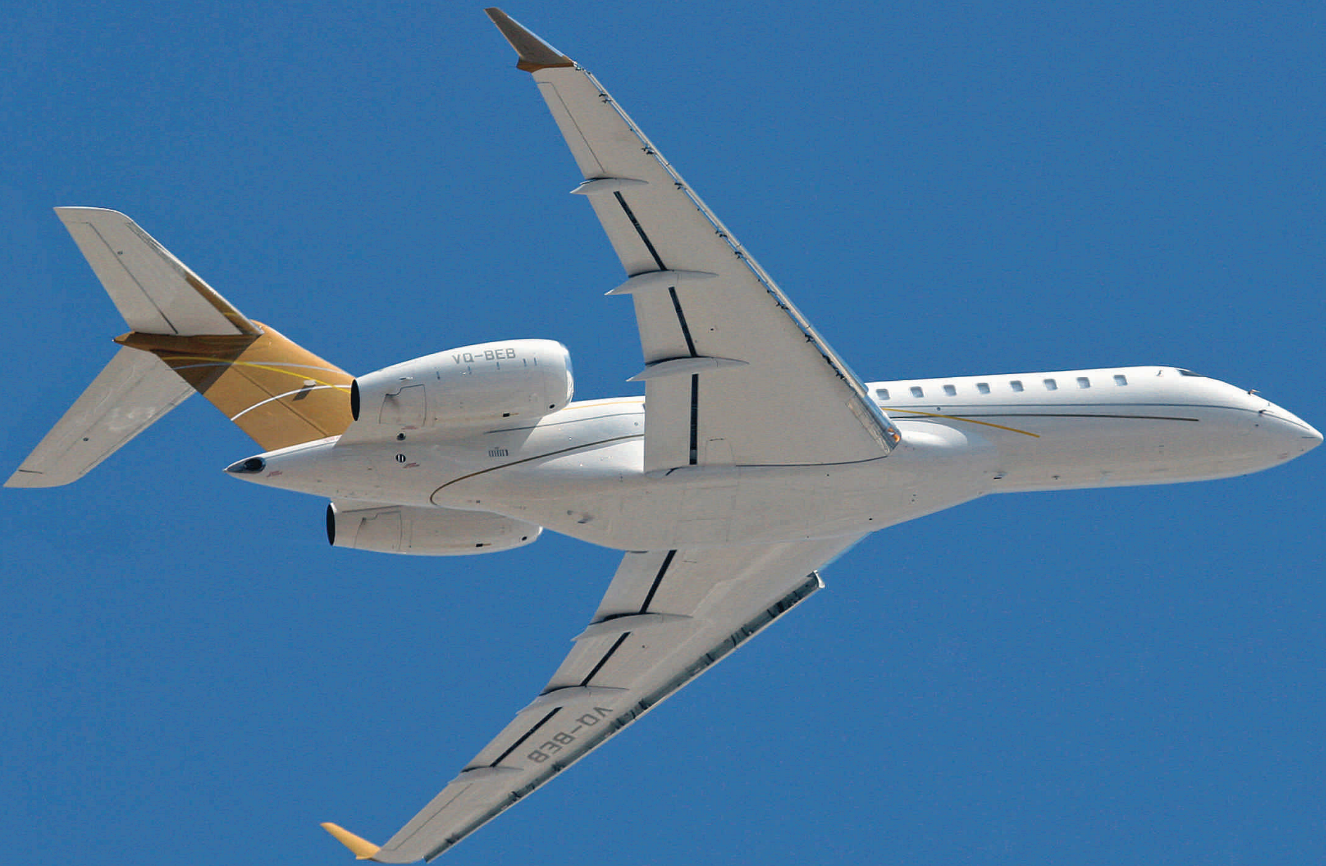
Already adopted by 25 out the 27 EU Member States, automatic exchange of information on savings tax is currently being trialed on a voluntary basis with Hong Kong. The ultimate aim of the EU is to promote the application of measures equivalent to those applied within the EU.

The Hong Kong government signed comprehensive double taxation and fiscal evasion treaties with Liechtenstein on 13 August, Ireland on 22 June and the UK on 21 June. These followed the signing of treaties with Austria, Kuwait and Hungary in May and brought the ongoing total of such treaties to 14. Previously Hong Kong had signed comprehensive treaties with Brunei, the Netherlands, Indonesia, Belgium, Thailand, Mainland China, Luxembourg and Vietnam.

On 27 May, Hong Kong signed a Third Protocol to the 1996 comprehensive tax treaty with mainland China to amend the information exchange article by removing the requirement for there to be a domestic tax interest.

Sovereign Comment

The new treaties will provide investors with greater certainty as to their tax liabilities in connection with cross-border investments in Hong Kong and vice versa. As Hong Kong now has more than 12 such treaties, it can refute any suggestion that it is a non-cooperative jurisdiction in terms of the OECD standards on tax information exchange.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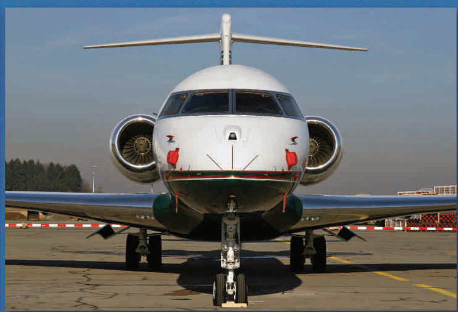

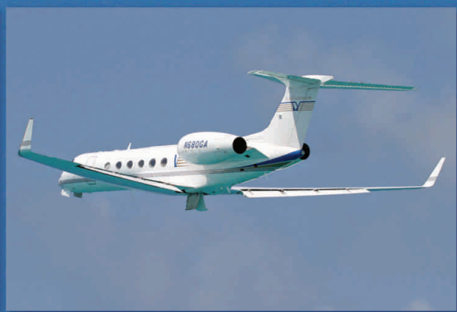

> There never has been a rule that says that the number of days spent in the UK is the absolute test of residency.

in the press:

The long arm of the British taxman

This article by The Sovereign Group chairman Howard Bilton first appeared in the Personal Finance section of The Daily Telegraph.

For many British expats who have been banking abroad and assuming that their savings are safe from the long arm of Her Majesty's Revenue, things have just become very much more complicated. A recent tax case has made it clear that if you are a UK national abroad, but have maintained connections with the UK, you are at risk from the UK taxman, who will be happy to charge you 50% tax on your world income.

This case involved British businessman Robert Gaines-Cooper. He argued that he did not owe taxes in the UK because he has been a resident of the Seychelles since 1976. He pointed to the rule in HMRC's own leaflet IR20 that defines a non-resident as one who spends less than 91 days per year in the UK.

The Court of Appeal rejected this claim on the basis that taxpayers must show a "distinct break" from social and family ties to the home country, and that spending all but 91 days outside the country is necessary, but not sufficient to establish non-resident status. It then handed him a £30 million tax bill for the years 1993 to 2004 for his trouble.

Frighteningly, this was not down to a change in the rules. There never has been a rule that says that the number of days spent in the UK is the absolute test of residency, although many expats remain under the impression that this is the single criterion by which they have to abide.

The decision could affect thousands of British expats who have lived abroad for many years, but who still spend time in the UK. All may be at risk from an increasingly aggressive HMRC, whipped into a frenzy by a government desperate for more tax to cut an increasing national deficit.

Most countries operate similar systems. If you spend a certain number of days in the country, you must necessarily be resident, even if already tax resident elsewhere as well. But even if you don't spend the requisite number of days, you may still be resident if the country in question is at the centre of your economic or social life, or is the place of closest connection. It's this latter point that has often been missed.

The court confirmed that HMRC was bound by the terms of IR20, but there was an implied condition – that to be treated as non-resident, there must be a distinct break with the UK, and a severing of all social and family ties. Mr Gaines-Cooper had a house in Henley where his wife and son lived, and where he kept a valuable collection of art and guns. His son was at school in the UK. He had a UK mobile phone, his will was drawn up under English law, and he regularly attended Ascot racecourse.

In the court's view, therefore, he could correctly be treated as resident in the UK, even after his ostensible departure in 1976. And with the exception, perhaps, of the regular attendances at Ascot, many UK nationals are in the same situation as Mr Gaines-Cooper.

The court deemed 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", and that the 91-day rule could not establish non-resident status on its own – rather it was "important only to establish whether non-resident status, once acquired, has been lost". In other words, if you spend more than 91 days in the UK, then you are definitely resident. If you spend less than 91 days in the UK, you may not be resident, but you must look at other factors too.

Mr Gaines-Cooper has been granted leave to appeal to the Supreme Court. His counsel told the BBC that HMRC was "playing games" with his client, and mischievously reinterpreting its own guidance, turning it "from a sensible, practical, guide into something meaningless and, which is worse, a devious trap".

HMRC may (for that read "will") now look to crack down on more UK expats. It has launched a sustained attack on people who have used residence and domicile rules to reduce their tax bills. Last year, a new HMRC team was established, known as the high-net-worth unit, to investigate the lifestyles of some of the UK's richest individuals, including expats. It follows the enactment of the £30,000 non-domicile levy, the introduction of the 50% top income tax rate, and the super-tax on the City of London bonus pool.

HMRC said: "We are looking at residency and domicile more carefully... HMRC is committed to ensuring that all those who are resident in the UK pay the tax that is due, and this judgment will aid that effort."

The IR20 guidance on residency was replaced last year with a new booklet called HMRC6. This emphasises the importance of pattern of lifestyle in determining UK residency, and states that just because you leave the UK to live or work abroad, you are not necessarily a non-UK resident for tax purposes.

So what to do? If you think that you may be affected, then you can change your lifestyle to remove the tax danger. But for many that will neither be either feasible or desirable: selling your UK home and taking your children out of their school may well be a very unattractive option.

The alternative is to plan, so that if you are caught out, your exposure to UK tax will be limited. Without proper planning you may have to pay UK tax at up to 50% on every bit of your world income – an economic disaster for many living abroad. At the very least, you should thoroughly review your arrangements which were probably made on the assumption that you were not UK tax resident. That assumption may be incorrect. Or at least, HMRC may not agree.

Pensions – why the present economic crisis means you might need to consider your options

The most fundamental problem currently facing Europe is the budget deficits that in certain countries, particularly Greece and Spain, are threatening to destabilise the euro zone. All European countries are looking to reduce their deficits. For the foreseeable future, national administrations will be looking to cut costs wherever possible.

Large scale infrastructure such as new roads and airports may be symbols of national pride but, when the going gets tough, are relatively easy to postpone or cut. But governments in Europe know that this isn't the whole story. In order to bring about a future of more balanced government debt compared to revenue, much more fundamental – and politically controversial – change will be required. But what will this mean for the ordinary citizen?

Essentially there are two ways that the financial crisis is going to affect each and every resident of those countries where substantial deficit reduction programmes are a necessity. Firstly, government spending cuts will mean a reduction in benefits for many. Less generous allowances and tax breaks are going to be made available – there have been recent announcements in both Spain and the UK, and more is certain to follow across Europe.

Secondly – although this is really only the other side of the same coin – taxes will almost certainly have to increase for most citizens. Rising taxes are never popular but, when combined – as they will be this time – with serious reductions in public spending, we can expect to witness serious public commotion in coming months when the harsh reality begins to bite. Politicians across Europe are going to need nerves of steel as they confront an increasingly uneasy electorate.

Another tactic already announced or being actively considered in some countries – the UK, Spain, Greece and, as we are seeing so dramatically, France – is to increase the official retirement age. This has long been debated as a necessary response to shifting demographics and ageing populations, but governments are now being forced to act far sooner than had been predicted. This will be deeply unsettling for the millions of people who will suddenly find their long-term plans disrupted, but is there anything that individuals do about it?

In a word – pensions. For all those fortunate enough to have made some provision for their future financial security, now might be a good time to review those arrangements to ensure that you are maximising the opportunities. Given the present state of the stock markets and their recent history, you must ask yourself if your future material comfort is still as assured as it was on the day that you first made your plans.

Anyone who regularly reads the personal finance columns of newspapers or expat publications cannot but help coming across advertorials and other promotions of pension-related products with highly complex and improbable-sounding acronyms such as QROPS, and more recently QNUPS and EFRBS. Arranging one's financial future can sometimes seem to be very complicated. Do not despair.

> **“Politicians across Europe are going to need nerves of steel as they confront an increasingly uneasy electorate.”**

For people whose pension is entirely dependent on their home country government, it is of course critical that the global effort to reduce public deficits is successful so that future pension payments and benefits can be protected. For others, greater reliance will be placed on alternative arrangements – perhaps one of those fast disappearing, gold-plated “final salary schemes”, assuming that the company in question has a fully funded or at least well-managed scheme.

Increasingly though, many who worked in the UK throughout, or at least for a good part of, their careers will have been paying into private pension schemes that are still based there. This is where QROPS come in. Put simply, non-UK residents with a UK pension can transfer it to a suitable scheme elsewhere – provided the UK authorities have approved such an overseas scheme in advance. A QROPS (Qualifying Recognised Overseas Pension Scheme) allows for a more flexible investment approach to be adopted and also offers other benefits such as avoiding the need to purchase an annuity at a specified time.

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QNUPS (Qualifying Non-UK Pension Scheme) is another pension-related arrangement, only introduced in February of this year, which can be used, for example, by British expatriates now considering returning to the UK. It creates significant opportunities for British expatriates to save local taxes in the country in which they are tax resident, as well as UK inheritance tax (IHT).

EFRBS (Employer-Financed Retirement Benefit Schemes) offer a flexible “unapproved” pension scheme that is particularly suitable for UK resident employees who are not domiciled in the UK, or who are UK domiciled but likely to leave the UK before retirement, or have substantial remuneration to justify high levels of pension contributions.

In the case of QROPS, and to an extent QNUPS, these are British government initiatives to ensure that the UK meets its obligations under EU rules to allow pensions to have freedom of movement in the same way as goods, services and people. At the same time, the government is determined to ensure that individuals who benefit from UK tax breaks when making pension contributions in the UK use these pension pots to provide for their future – even if that future is away from the UK.

We should all be concerned about pensions, whether they are “state” pensions, private arrangements or perhaps a combination that includes one of the confusing acronyms above. The way that governments tackle the present financial problems – and the results of these actions – are going to be of fundamental importance. And not just in terms of roads, airport terminals or hospitals that don't get built. So stay abreast of the news and, if you have any cause for concern, seek professional advice at the earliest opportunity.

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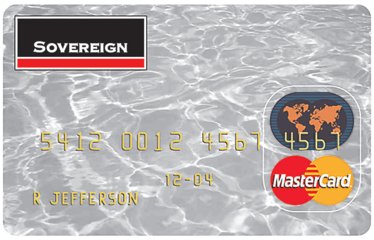

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Printer Pioneer Printers Limited
www.pioneerprinter.com

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