38

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SOVEREIGN

report

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contents

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chairman

Be prepared for "events"

"Events, dear boy, events", was British prime minister Harold Macmillan's famous riposte when asked what was most likely to blow a government off course. It is a phrase that could apply equally to wealth management in the first half of 2011. In the space of just a few months, we have had the spectre of a default in the Euro zone, the arrest of the head of the IMF, the "Arab Spring", and various natural disasters, not least in Japan. All such events serve to emphasise the importance of robust financial planning. Despite all the recent regulatory attacks on offshore centres, one of their most compelling selling points is financial stability – they are a safe haven in times of trouble. In such times, anyone with substantial personal or business assets should consider setting up a foundation, trust or other structure to protect them, assist in succession planning and, perhaps, achieve tax savings.

Jo'burg office opens

We announced a number of new appointments in our Cape Town office in the last edition. Our Johannesburg office is also now up and running under the able leadership of Noelle McKean. Noelle's contact details may be found on page 14.

Far East expansion

Frederik van Schalkwyk has moved from Hong Kong to head up our Shanghai office and will shortly be joined by Tony Huang. At the time of writing, we are also in final negotiations to acquire a full service accountancy practice in Shanghai, with a representative office in Beijing. This will enable us to provide a full range of initial and ongoing services to companies seeking to enter the China market.

In Singapore, our office continues to expand and again we are in final negotiations to purchase a fully licensed Singapore company. More on this will appear in the next addition. In Hong Kong, we have appointed several new consultants including John McGale, a New Zealand-qualified trust and company expert lawyer, Yuseff Murphy who moved from our Abu Dhabi office, and Clifton Tang.

The Sovereign Art Foundation

At the legendary "Judgment of Paris" in 1976, Californian red and white wines beat the best of France in a blind tasting. It was possibly the biggest surprise in the history of wine tasting and was the subject of a recent Hollywood film, *Bottleshock*. The Sovereign Art Foundation (SAF) recently hosted the "Judgment of Hong Kong", where the best of France was this time challenged by wines from Portugal. An impressive judging panel chaired by Simon Tam, Hong Kong's foremost wine critic, blind tasted 13 wines, all from 2007. This time the French wines shaved it, but some of the Portuguese wines rated very highly. For a full list of the wines and the scores see the press release on SAF's website at www.SovereignArtFoundation.com/wine.

SAF also exhibited at ARTHK11, the leading showcase for international modern and contemporary art in Asia. Vincent Fantauzzo, directed the younger (and a few older) visitors to create a hugely impressive graffiti wall. Laura Spector and Chadwick Gray demonstrated their body painting art. Our stand was by far the best attended in the show and helped us to showcase SAF's work in using art as therapy and rehabilitation for disadvantaged children in Cambodia, India and elsewhere in the region. Our thanks to everyone who contributed. Images from the event can be found on SAF's website.

And finally... all hail to spaghetti

In July, an Austrian man named Niko Alm finally convinced the authorities, after a three-year battle, to let him wear a colander on his head in his driving licence photograph. He argued that wearing the kitchen utensil was an essential part of his "Pastafarian" faith. Alm is a follower of the Church of the Flying Spaghetti Monster, which was set up in 2005 to mock American schools that teach the theory of creation known as intelligent design, rather than natural selection. The Church claims the world was created by the Flying Spaghetti Monster (FSM) and is not perfect because the FSM was inebriated at the time. Sovereign has no comment other than to say spaghetti is not recommended for those on a low-carb diet.

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

ECJ Advocate General declares Gibraltar tax regime "not unlawful"

European Court Advocate General Niilo Jaaskinen, in a legal opinion published on 7 April 2011, stated that Gibraltar should be regarded as a territory in its own right for purposes of its tax regime and therefore its low corporate tax regime could not be classified as discriminatory state aid.

Back in 2002, the UK notified the European Commission of Gibraltar's proposed reform of corporate tax. In the event, this reform that did not enter into force because Gibraltar instead opted for a different system of corporate tax but, in 2004, the Commission decided that the proposals constituted a scheme of State Aid that was incompatible with the internal market and should not be implemented.

europe

38

In *Government of Gibraltar and UK v Commission*, the General Court held, in December 2008, that the reference framework for assessing the reform's regional selectivity had to correspond exclusively to Gibraltar's, and not the UK's, territorial limits. It further held that the Commission had not followed a correct method of analysis. The Commission and Spain appealed to the European Court of Justice (ECJ).

In his opinion, Advocate General Jaaskinen proposed that the ECJ should dismiss both appeals. In respect of the territorial selectivity of Gibraltar's proposed tax reform, he upheld the General Court's conclusion that the territory of Gibraltar constituted the territorial reference framework to be used for assessing the selectivity of the intended reform.

With regard to the issue of the material selectivity of Gibraltar's intended measure, Jaaskinen considered that the State Aid rules could not be diverted from their objective in order to be used to combat tax competition between Member States. "Where a tax measure is of a general character, it constitutes an adjustment to general fiscal policy and not state aid," he said.

Although the Advocate General's advice is not binding, it is followed in about 80% of cases when the final verdict is given by the full court. A final decision by the ECJ is expected later this year.

Sovereign Comment

This is another important decision that, although widely expected, was hugely welcomed in Gibraltar. Gibraltar's new corporate tax regime came into force on 1 January this year so it is early days, but our colleagues in Gibraltar report that they have seen a marked increase in the level of enquiries this year for companies. Gibraltar is a full member of the EU but there is no VAT (although registration by local companies in other EU countries is possible). Now that there is certainty concerning the corporation tax situation, clients and their advisors should take another look at the Rock when considering where to incorporate.

Jersey and Isle of Man commit to zero-ten

Jersey and the Isle of Man announced, on 15 February 2011, that they would retain their controversial zero-ten corporation tax regimes under which most foreign-owned companies pay no tax on their profits. The system has come under fire from the European Union.

In late 2010, a critical review by the EU Code of Conduct Group and High Level Working Party concluded that zero-ten "gave rise to harmful effects" because it was combined with special anti-avoidance rules imposed by the Crown Dependencies – Jersey's "deemed distribution rules" and the Isle of Man's "attribution regime for individuals".

Under these rules, resident shareholders of a resident company pay personal income tax on undistributed company profits. The EU regards this as a device used by the Crown Dependencies to tax locally-owned businesses while exempting foreign-owned ones.

Jersey and the Isle of Man have therefore decided to drop their special anti-avoidance provisions, starting in 2012. Guernsey's response is not yet clear. It has previously indicated its willingness to abolish the zero-ten system in favour of a flat rate of corporation tax.

French government scraps holiday home tax plan

The French government announced, on 20 June 2011, that it was shelving a plan to impose a new tax on holiday homes of non-residents that would have hit French expatriate and foreign property owners under a wider fiscal reform.

The proposed measure would have applied to some 360,000 properties belonging to foreigners or French people living abroad, out of a total 3.2 million secondary residences in France, and could have raised 176 million euros in taxes in 2012, or around 490 euros per residence.

But President Nicolas Sarkozy and Budget Minister Francois Baroin, under pressure from senators representing French expatriates, agreed to omit the measure from the tax reform package sent to the French parliament.

The reform bill will not abolish France's annual wealth tax – "l'impôt de solidarité sur la fortune" (ISF) – outright; instead the starting threshold for the tax is to be raised from 800,000 euro to 1.3 million euro. For families with assets above that level, tax will be imposed at 0.25% a year. Where assets exceed 3 million euro, the rate will rise to 0.5%. Existing rates currently vary between 0.55 and 1.8%. The bouclier fiscale ("tax shield"), which previously limited total household tax payments to 50% of income, will now be eliminated.

Sovereign Comment

Any expatriate who has purchased property in France will attest that it is not always a stress free process. The French government's plans to introduce the "holiday home" levy only added to these concerns. Property purchase in a second country, wherever it may be, should never be undertaken lightly. France would not have been the first country to impose taxes or other restrictions on second home owners; indeed there are places, such as Spain, where such discrimination still exists. Advising clients on the correct structure to use when contemplating property purchase has always been core to Sovereign's business, so contact your local office if you are considering such an investment anywhere in the world.

Italy vetoes EU compromise on Savings Tax Directive

The EU Council of Finance Ministers (ECOFIN) held, at a meeting on 16 May 2011, an “orientation debate” on the European Commission's proposed amendments to the EU Savings Taxation Directive.

The amendments are intended to stop tax-payers using trusts and other non-bank intermediaries to circumvent the provisions of the existing Directive. They also extend the Directive – adopted in its current form in 2005 – to cover certain types of non-interest income.

This extension of the directive's scope has been the subject of much negotiation among member states, but the Hungarian presidency of the EU considered that member states were so close to agreement that they could start negotiations with third-party jurisdictions – Liechtenstein, Switzerland, Monaco, San Marino and Andorra – for treaties with the EU that would practically impose similar provisions.

Ecofin's previous attempt to reach agreement, in January this year, ended in deadlock when two member states – Austria and Luxembourg – insisted on retaining their transitional right to impose withholding taxes on interest payments, instead of automatically reporting them to savers' home countries, unless third-party jurisdictions followed suit. In principle both countries are required to abandon their withholding tax options by 2014.

In the event, it was Italy that refused to support a compromise in the absence of sanctions for states and operators that "systematically" violate the existing rules. Italian Finance Minister Giulio Tremonti said the Directive was a “toothless instrument” that was legally worthless since it did not allow for sanctions against those failing to comply.

Italy consequently refused to make the slightest concession until the Commission "undertakes to apply sanctions against non-compliant countries and operators" in the framework of the review of imple-mentation of the EU legislation. The Commission was to present a report in June, confirmed Taxation Commissioner Algirdas Semeta, who wants "to use it as an instrument of surveillance".

In the meantime, the Hungarian EU Presidency said it would still "try to see" how it could take the issue forward.

Sovereign Comment

The second stage of the EU’s Savings Tax Directive always promised to be troublesome in its implementation – and so it is proving. Competing interests continue to result in difficulties bringing in the full reporting rules demanded by the Directive’s promoters – witness Austria and Luxembourg seeking to retain their right to withhold tax. What is clear is that simply leaving personal bank accounts in place in the hope that the taxman won’t find out is not tax planning. It’s illegal and very dangerous. Sovereign is well placed to advise clients seeking to comply with any new legislation and as individual circumstances vary widely, a no obligation consultation should be arranged as soon as possible.

Portugal hikes tax on “blacklisted” companies

The municipal tax rate (IMI) payable on Portuguese property was increased, as part of the 2011 State Budget approved on 23 March 2011, from 1% to 5%, in respect of companies registered in blacklisted (offshore) territories.

The increased rate, which is applied to the Tax Department’s valuation of the property, could result in a substantially increased IMI tax, which will be payable in 2012. For instance, a property whose rateable value is 250,000 euros will be invoiced 12,500 euros property tax per year.

It is also a legal requirement for “blacklisted” companies to declare a presumed income of 1/15th of the rateable value, via a yearly tax return in Portugal and tax departments have begun to demand backdated tax returns for the presumed income of some companies.

The simplest and cheapest way to avoid this higher tax rate is to move the company as soon as possible to an acceptable jurisdiction, such as Delaware or Malta. In this way the municipal tax (IMI) is reduced from 5% to a maximum of 0.8%, depending on the local authority. Changes must be completed by the 31 December 2011.

Sovereign Comment

Clients whose companies are managed by the Sovereign Group should contact this office for more information. Once a com-pany has re-domiciled the Portuguese tax department must be informed of the change within 15 days or a fine of 200 euros may be imposed. The Land Registry and Companies Register in Lisbon must also be informed. Our office in Lagoa can take care of all these changes for both Sovereign managed companies and those managed by others.

Guernsey consults on proposed Foundations Law

The government of Guernsey launched, on 11 April 2011, a consultation on its draft Foundations (Guernsey) Law. The consultation includes consideration of the foundation structure, initial capital requirements, the extent of founder powers, fiduciary duties and taxation.

“The introduction of foundations will provide another tool for practitioners to meet the needs of clients. In particular, we expect the foundation structure will be attractive to clients based in civil law jurisdictions in Europe and also further afield in the emerging markets of China, Russia and Latin America where the trust concept is less familiar,” said Peter Niven, chief executive of Guernsey Finance.

The introduction of foundations was first proposed in a review of Trust Law in Guernsey, which was approved by the States of Guernsey, the island’s parliament, in December 2006. The Commerce Department will finalise the legislation and report to the States no later than September. If approved, the Law could be enacted by early 2012.

Sovereign Comment

This is an interesting development. Guernsey is playing “catch up” with neighbouring Jersey, which introduced its own foundations legislation in 2009 and both jurisdictions may steer business away from Liechtenstein and Panama, where foundations are long established. We will monitor the progress of this legislation; updates will be published in future editions.

US reportedly abandons talks for a "global resolution" with banks

The US was understood to have rejected a multibillion-dollar "global resolution" that would have enabled several Swiss and European banks to join a common settlement and avoid potential US prosecution for helping wealthy US citizens taxes evade tax.

Swiss newspaper SonntagsZeitung claimed, on 17 July 2011, that the US had written to the Swiss State Secretariat for Economic Affairs and the Finance Ministry to inform them of its decision. A spokesman for the US Department of Justice had no comment.

US officials had admitted, on 10 June, they were in advanced talks on a deal that would invite the banks to pay a fine, exit their undeclared offshore banking businesses for Americans, and turn over client names to the Internal Revenue Service (IRS) and the Justice Department. The fines would have totalled several billion dollars.

In exchange, the US government agencies would have dropped ongoing investigations into the banks. Banks that "opted out" of the deal would have face heightened scrutiny from US authorities, including a possible legal summons for client names from the IRS and tougher scrutiny by the Justice Department.

A resolution would have marked a shift in how the US treats foreign banks suspected of helping US citizens to evade taxes. In 2009, Switzerland's largest bank, UBS, averted indictment over its undeclared offshore private banking services by admitting to criminal wrongdoing, agreeing to pay $780 million and to turn over more than 4,500 client names.

Since then, the Justice Department has conducted a broad criminal investigation into a number of banks, bankers and third-party intermediaries suspected of helping wealthy American clients to evade taxes. Companies involved include Credit Suisse, the second-largest bank in Switzerland; HSBC, Europe's largest bank; Julius Baer, a private bank based in Zurich; and Basler Kantonalbank, a Swiss cantonal bank in Basel.

The IRS has compiled a "roadmap" of Swiss bankers and their intermediaries based on evidence emerging from a number of criminal investigations and information provided by thousands of US citizens who have disclosed offshore accounts under two voluntary programmes in exchange for reduced fines and penalties.

As a result, both US and Swiss authorities were interested in pursuing a resolution rather than proceeding on a bank-by-bank basis. But, according to press reports, the talks became bogged down due to Swiss insistence that any deal should leave Swiss bankers free from prosecution in the US.

americas+ caribbean

Brazil removes Luxembourg from tax regime "grey list"

Brazil's Federal Revenue Department (FRD) issued, on 28 March 2011, an executive act specifically removing Luxembourg Holding Companies from its grey list of special, or privileged, tax regimes. It is the first time that a foreign tax regime has been delisted for Brazilian tax purposes.

Executive Declaratory Act 03/2011 said there was no reason to continue to regard Luxembourg holding companies as a special tax regime because the Luxembourg government had provided evidence that the holding company regime under the 1929 Luxembourg statute had been terminated and its transition period had expired.

Luxembourg had requested a review under Article 2 of Normative Instruction 1045/2010, which establishes a procedure for listed jurisdictions to request that their status be reviewed. Reviews of requests from Switzerland, Spain, Denmark and the Netherlands are currently pending, and Brazil has temporarily suspended the application of transfer pricing rules requiring additional documentation, aggravated tax rates and stricter thin capitalization rules to these jurisdictions.

Sovereign Comment

As Brazil continues to buck the worldwide trend and its economy powers ahead, it will be interesting to see if other jurisdictions have success in getting off Brazil's grey list because the use of international corporate structures will surely rise with the increase in inward investment. Brazil has already enacted legislation to encourage inward investment, while many Brazilian firms are now gaining market share globally. Sovereign is expanding its coverage in Latin America and we will report more on this exciting region in future editions.

Bermuda extends assurance of tax neutrality

The Exempted Undertakings Tax Protection Amendment Act 2011, which extends a guarantee that the Bermuda government will not charge exempt international businesses any taxes on profits, income or capital gains until 31 March 2035, came into effect on 25 March 2011.

Under the previous legislation, dating from 1966, the Minister of Finance could only grant such an assurance up to 28 March 2016. In order for an exempted undertaking to benefit from the extension of the tax assurance, it must submit an application to the Minister of Finance, together with the application fee of $165.

Application for a tax assurance is not obligatory, but it is expected that most exempted undertakings will apply to secure the benefits of this Act, which is seen as a positive move from the Bermuda government. As defined in the principal Act, the term "exempted undertakings" includes exempted companies and partnerships, and overseas companies and partnerships.

Premier Paula Cox said the government had no intention of starting taxation based on profit, income or capital gain. The amendment was meant to reassure businesses and make them more comfortable investing in Bermuda. She said that extending the agreement had always been on the government agenda, but had been put off in the past because of international concerns that the exception could lead to harmful business practices, favouring international businesses over local.

Sovereign Comment

The importance of certainty in any aspect of tax planning is crucial. In these days of economic upheaval, long term assurance such as that described in this story is all too rare and Sovereign applauds the decision taken by the Bermuda government in this regard. The jurisdiction enjoys a well-deserved first class reputation and the extension of these rules for exempted undertakings will strengthen this further. Bermuda's advantages come at a cost – companies are amongst the most expensive in the international corporate services business – but in the right case this can be money well spent given the overall quality of the offering. For example, Bermuda companies are often used in the business aviation industry where a first class aircraft registration service combines to create a winning, albeit expensive, product.

Sensex plunges on Mauritius tax treaty review talk

The importance of the India-Mauritius double tax treaty was underlined when the Bombay Stock Exchange Sensex plunged by 3.1% in early trading after the Indian government announced, on 20 June 2011, that it would resume treaty revision talks with Mauritius.

middle east, africa + asia

38

A clarification by Finance Ministry sources to the effect that a timeline on the talks had yet to be decided led to a recovery from the day's lows, but not enough to salvage the damage completely. As much as 35% of India's FDI (foreign direct investment) and FII (foreign institutional investors) inflows are routed through Mauritius.

In April, the Indian Finance Ministry said it had written to the Ministry of External Affairs to take up the issue of expanding the areas of information exchange in the tax treaty with Mauritius. It hoped that engaging the External Affairs Ministry would expedite the process.

Under the existing 1982 treaty, Mauritius-based investors do not pay capital gains tax either in India or in Mauritius and the Finance Ministry has said it believes the treaty is being misused by many third country investors.

Following a series of corruption scandals, the Indian government has come under intense pressure to plug loopholes from tax havens. In the revised tax treaty with Mauritius, which has been under discussion between the two countries for several years, the Finance Ministry wants to include an article on exchange of banking information and assistance in collection of taxes.

"The Article 26 on exchange agreement provides for exchange of tax matters between the countries. It does not contain sharing of banking information and assistance in collection of taxes," said Sudhir Chandra, chairman of India's Central Board of Direct Taxes (CBDT).

India has 79 tax treaties in force and is negotiating 65 others. It is also in negotiation with 22 jurisdictions for signing Tax Information Exchange Agreements (TIEAs).

The Jersey government admitted that it had declined to sign a TIEA with India in March after officials discovered that the agreed tax information exchange measures were substantially more stringent than some others recently signed between India and other jurisdictions. Jersey chief minister, Terry Le Sueur, said the dispute could not be settled on the spot due to travel schedules.

UAE approves three-year visa for property investors

The United Arab Emirates' federal government approved, during a cabinet meeting on 28 June 2011, the extension of visas for real estate investors from six months to three years.

The move is designed will help boost the beleaguered real estate sector in the emirates. The UAE, particularly Dubai, was one of the worst hit during the downturn, with nearly half of projects stalled and prices dropping by as much as 60% from their peak.

Presently, foreign owners of property worth more than AED1m ($272,250) are eligible for a six-month visa, which needs to be reviewed every six months. The new visa rules will not apply to those buying land and only investors with properties worth more than AED1m with qualify for the extended visas.

Law No (7) of 2011, which incorporates the first ever amendments to Law No (9) of 2004 – the "Original Law that established the Dubai International Financial Centre (DIFC) as the first Financial Free Zone in the UAE – was also enacted on the 4 April 2011. It was gazetted and brought into force on 21 April.

The new law comes as part of the Dubai's ongoing strategic commitment to diversify the Emirate's economy by supporting the growth of the banking and financial services sector through DIFC.

DIFC governor, Ahmed Humaid Al Tayer, said: "The amendments to Law (9) provide greater legal clarity and improve the corporate governance of DIFC. These changes further strengthen DIFC's legal and financial infrastructure as a whole, and reinforce the government's commitment to the independence of each of the Centre's bodies. This is an important step forward in the growth of DIFC as a global financial hub and complements the Centre's continuous efforts to develop its services."

Sovereign Comment

We welcome this news. The UAE Federal Cabinet decision to extend visas for real estate investors to three years will significantly enhance investor confidence and drive the growth of the country's property sector, while the passing of Law No (7) shows that Dubai is committed to the diversification of its economy not least by the active support of its finance centre. It is encouraging to see the authorities react in this proactive and positive way. Sovereign's own office in Dubai continues to grow rapidly and we hear similar stories from our friends in the UAE.

Hong Kong, Spain sign treaty

The Hong Kong SAR government signed, on 1 April 2011, a treaty with Spain for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. It will come into force after the completion of ratification procedures on both sides.

Currently, income earned by Spanish residents in Hong Kong is subject to both Hong Kong and Spanish income tax, and profits of Spanish companies doing business through a branch in Hong Kong are fully taxed in both places. Under the treaty, tax paid in Hong Kong will be allowed as a credit against Spanish tax payable.

The Spanish withholding tax rate on dividends from Spain, currently subject to the Spanish withholding tax at 20%, will be capped at 10%. Withholding tax on interest and royalties, currently at 19% and 24% respectively, will both be capped at 5%. The treaty also incorporates the latest OECD standard on exchange of information.

It is the twentieth tax treaty concluded by Hong Kong following those with Belgium, Thailand, the Mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland and Portugal.

Sovereign Comment

It is interesting to see the continued emphasis that Hong Kong is placing on negotiating tax treaties – now up to 20 and notably half with EU members. Sovereign's two largest offices are in Hong Kong and Gibraltar and we are therefore extremely well placed to provide clients with advice on the terms of this particular treaty from either location.

UK Treasury issues tax residency and non-dom tax consultations

The UK Treasury released, on 17 June 2011, two major consultation documents, one proposing the establishment, for the first time, of a statutory residence test (SRT) for tax purposes; the other, proposing an increase in the annual tax charge for long term non-domicile individuals resident in the UK.

The aim of the consultations is to provide “clear or specific principles that are applicable to all taxpayers”, and create a new test that is “transparent, objective and simple to use”, the Treasury said.

The residency consultation has been eagerly awaited to replace current rules that even the Treasury admitted were “vague, complicated and subjective”, particularly in view of recent high-profile tax cases involving Robert Gaines-Cooper, a Seychelles-based businessman, and Lyle Grace, an airline pilot.

The SRT will comprise three sections: Part A will test whether an individual is conclusively resident outside of the UK; Part B sets out a test that will provide that an individual is conclusively resident in the UK; Part C is applied if A and B are inconclusive and takes into account connecting factors in the UK, such as family and available accommodation.

The proposals include clear definitions of the relevant conditions for non-dom status and a broad simplification. Distinctions will be drawn between “arrivers”, who were non-UK resident throughout the previous three years; and “leavers”, who were UK-resident in any of the preceding three years.

The key proposals include a minimum stay qualification. Anyone present for less than a minimum of 45 days cannot be resident, or 10 days if the individual was resident in the preceding three years. A full-time working abroad exemption will be maintained with a clearer statutory definition, which includes being present in UK for less than 90 days, with up to 20 days working in the UK per year.

The second consultation involves a proposed reform of the UK’s non-dom tax structure, which was flagged up in the most recent UK Budget. This will increase the remittance basis charge for those non-doms who have been in the UK for at least 12 of the last 14 tax years to £50,000 annually, from £30,000, beginning from 6 April 2012.

It also proposes a remittance exemption for investment into "trading companies", which category would include investments in companies developing or letting commercial property, in order to encourage foreign individuals to invest in UK enterprises.

“By bringing the tax treatment of domiciled and non-domiciled individuals closer, the rules will be made fairer," said the Treasury. The closing date for responses for both consultations is 9 September.

Sovereign Comment

As mentioned in the item on Bermuda on page 6, certainty is crucially important in tax planning and UK advisors have been pleading for just such clarity in this area. It is not simply desirable but essential if the UK is not to fall behind other countries, such as Switzerland, that wealthy individuals consider when deciding on tax and physical residency issues. The broad principles behind the proposed SRT appear to be objective and should provide simplification and greater certainty over the current position.

38 fiscal

Uruguay approves treaties with Switzerland and Liechtenstein

The Uruguayan government approved and sent to the parliament, on 3 March 2011, draft laws to ratify Uruguay's pending tax treaties and protocols with Switzerland and Liechtenstein. Both were signed in Bern on 18 October last year and will enter into force after the exchange of ratification instruments, with their provisions applying as of January of the following year.

Under both treaties dividends are taxable at a maximum withholding tax rate of 5% if the beneficial owner is a person that holds directly at least 25% of the dividend payer's capital. In other cases, dividends are subject to a maximum rate of 15%. Interest and royalties are taxable at a maximum withholding tax rate of 10%.

Representatives from Uruguay and Malta also signed a tax treaty in Rome on 11 March. The treaty, which is the first tax agreement signed between the two nations, will enter into force after the exchange of the ratification instruments.

Sovereign Comment

This story can be read together with the item on Brazil removing Luxembourg from its “grey” list on page 6. It is fascinating to see the increasing importance placed by these two South American countries on their links with financial centres in Europe, particularly within the EU, which is an increasingly important market for Brazil in particular. Our long-established office in neighbouring Uruguay reports a recent, and sustained, upsurge in interest in their corporate services; we encourage readers to contact them should you be considering expanding into this dynamic region.

Malta tax scheme for highly qualified expatriates

The Minister of Finance, the Economy and Investment issued a legal notice, on 25 March 2011, providing details on a new beneficial tax scheme available to qualifying expatriates in Malta.

Effective from 1 January 2010, highly qualified persons may opt for a flat 15% rate of tax on emoluments instead of the standard tax rates. The scheme, designed to attract further foreign investment to Malta, is industry-specific and focuses on a narrow range of industries comprising the banking, financial, investment and insurance sectors.

The scheme is available to employment income earned by an expatriate under a qualifying contract of employment on or after 1 January 2010. The scheme also applies if the expatriate was in receipt of income earned under a qualifying contract of employment requiring the performance of duties in Malta for a period not exceeding two years before 1 January 2010.

The minimum tax payable under the rules is €11,250 (equivalent to a minimum annual income of €75,000) and the maximum tax payable is €750,000 (equivalent to income of €5 million). Income exceeding €5 million in respect of a qualifying contract of employment is not subject to tax in Malta. Tax on any remaining income is to be calculated at the standard applicable rates.

In the case of EEA (including EU nationals) and Swiss nationals, the rules will apply for a consecutive period of five years, and for third-country nationals, the rules will apply for a consecutive period of up to four years, after which the employment income will be chargeable to tax at the standard rates of tax applicable to the individual.

Dutch Finance Ministry lays out corporate tax plans

Dutch State Secretary of Finance Frans Weekers published a "Fiscal Agenda" on 14 April 2011, which contained the outlines of tax policy, including a proposed reduction in the corporate income tax rate from 25% to 24% from 1 January 2012.

It noted that under the proposals, the corporate tax basis would expand, but tax revenue would not be expected to increase because of the concurrent reduction in the corporate income tax rate. The paper says the corporate tax rate could be reduced even further, depending on the use of revenue generated through other existing measures.

The paper also proposed limiting the deduction of excessive interest expenses by an acquisition company that is subsequently joined in a fiscal unity with the acquired Dutch target company; and moving to a full territorial tax system for the income of foreign branches.

The introduction of Deduction Limitation Rule for cases in which acquisition structures are excessively financed with debt, would allow the interest expenses of the Dutch acquisition company to offset the profits of the fiscal unity only insofar as the profits are attributable to the Dutch acquisition company. Interest expenses could no longer offset profits of the acquired Dutch entity.

The territorial tax system for foreign branches would mean that foreign results would no longer be included in the worldwide profit of a Dutch taxpayer, regardless of whether a foreign permanent establishment (PE) was subject to any tax. Therefore, losses incurred by a foreign PE would no longer be deductible from the taxable income of the Dutch taxpayer. Under EU law, however, losses incurred by a foreign PE would remain deductible in the event of its final discontinuation.

The policy paper also states that the rules governing foreign substantial interest holders would be amended. The European Commission has requested that the Netherlands amend legislation that exempts domestic companies from tax on their income from substantial interests, but taxes companies established elsewhere in the EU and European Economic Area on income from substantial interests in a Dutch company if the substantial interest does not belong to an enterprise carried on by the EU or EEA company.

38 fiscal

The policy paper said legislative proposals are expected for the third quarter of 2011.

Sovereign Comment

The "Fiscal Agenda" sets out a wide-ranging series of proposals and initiatives. We will follow further developments in this area and report on them in future editions. Netherlands' corporate structures can convey enormously useful benefits under certain circumstances, of which royalty routing is just one example, although they can appear expensive compared to other jurisdictions. For up to date information on these proposals or advice on Dutch corporate structures, contact our Amsterdam office.

OECD seeks to clarify "beneficial ownership" in tax treaties

The OECD's Committee on Fiscal Affairs (CFA) launched, on 29 April 2011, a public consultation on the interpretation of the term "beneficial ownership" in double tax treaties.

The term "beneficial owner" appears in the first paragraph of Article 10 of the OECD's Model Tax Convention, which provides a template for countries to negotiate bilateral tax treaties. Its main function there is to make ensure that the jurisdiction from which a dividend, interest or royalty payment is made (the source state) can refuse treaty tax relief on the payment, even if paid directly to a resident of the other jurisdiction.

The aim is to discourage "treaty shopping", where payments are made through conduit companies that are resident in a jurisdiction different from that of the source or final destination, in order to exploit tax treaties in a way not intended by the signatory states.

In some common-law jurisdictions, however – particularly those with their own domestic trust law – the term "beneficial owner" has been used in a legal sense that differ from the OECD's usage, giving rise to different interpretations of tax treaties by different jurisdictions' courts and tax administrations.

A discussion draft has been prepared for the purpose of inviting comments from interested parties and will be reviewed in the light of the comments received. It does not necessarily reflect the final views of the OECD and its member countries. The CFA invites interested parties to send comments before 15 July 2011.

Sovereign Comment

Most regulators around the world insist that corporate service providers, such as Sovereign, identify and check on the beneficial owner(s) of structures under management. Most of our banking partners also insist on this information and it is not uncommon to see the phrase Ultimate Bene ficial Owners (or UBO for short) on bank documentation. Many of our clients use one of our nominee companies to act as shareholder for a wide range of wholly legitimate reasons but this does not change the identity of the UBO. It is interesting to see the OECD tackle this issue but from our point of view, this is an area that is already effectively self-policed by the practitioners themselves.

OECD Global Forum issues further peer review reports

The OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes published seven country peer review reports on 14 April 2011 and a further nine on 1 June 2011.

In the first tranche, Aruba, The Bahamas, Belgium, Estonia and Ghana underwent "Phase 1 tests", to evaluate their legal and regulatory preparedness for tax information exchange. Canada and Germany combined a Phase 1 check with an assessment of their implementation in practice – the "Phase 2 test". In the second tranche, Hungary, the Philippines, Singapore and Switzerland underwent "Phase 1 tests", to evaluate their legal and regulatory preparedness for tax information exchange, while those for the Isle of Man, Italy, France, New Zealand and the US also covered implementation.

The OECD said the majority of jurisdictions previously reviewed had changed their domestic legislation following Global Forum recommendations.

"Countries take the peer-review reports very seriously and they all have pledged to address the deficiencies we identified. In some cases they started to act even before our reports were completed. This shows that peer reviews are working and that we are moving towards a truly level playing field," said Mike Rawstron, the Australian chair of the Global Forum. An additional 25 peer review reports are due to be completed by November 2011, bringing the number of reviews to about 60 before the next G20 Summit in Cannes.

Australian court clears tax office to use "stolen" bank records

Australia's Full Federal Court dismissed, on 11 May 2011, an appeal by two taxpayers who had challenged the Australian Taxation Office's (ATO) use of stolen information from the LGT Bank in Liechtenstein.

The case related to the use of Liechtenstein bank data copied by IT worker Heinrich Kieber, who secretly passed details relating to Australian taxpayers to the ATO, which subsequently issued them with tax assessments. Although the German authorities paid $6.4 million to Kieber for information relating to German-resident clients of LGT in 2007, the ATO said it did not pay for its information.

The taxpayers, Kevin and Mirja Denlay, argued that "the receipt and bringing into Australia of documents containing the LGT Group information" contravened the Australian Criminal Code. They said it was reasonable for tax officials to suspect the disks handed over by Kieber were "proceeds of crime" and that the ATO acted on the information with "conscious maladministration".

The ATO argued that it was entitled to use the information and that its officers had acted "in good faith" in administering the tax laws.

The Full Federal Court said it appeared that Kieber had taken a back-up hard disk "off the shelf" from LGT's workplace. Kieber than copied that information to other disks, which were given to the Australian tax officials. But the judges said these copied disks were not stolen, and the tax officials who received them "had no reason to suspect" they were.

The judges also said that the information contained on the disks could not be said to be "proceeds of crime" because the information – the bank details – could not be described as property.

"The proscriptions in (the Criminal Code) are upon receiving and moving property, not upon obtaining or using information," the judges said. Lawyers acting for the Denlays said they were considering appealing the decision. The Denlays are disputing the tax assessments in a separate court case.

Sovereign Comment

This is an interesting case that is likely to provoke widely differing reactions depending on one's point of view. Whatever the final outcome of the case itself – and there may be an appeal – one fact is certain, the tax authorities are now in possession of the relevant information and cannot in any way "undo" that knowledge. Most concerned will be any individuals who continue to maintain secret foreign bank accounts on the assumption that they will not be discovered. This is not tax planning but fraud and we would recommend that they seek advice as how best to regularise their affairs.

38 legal

Italian court dismisses Dolce & Gabbana tax case

An Italian court dismissed, during a preliminary hearing in Milan on 1 April 2011, tax evasion charges against Domenico Dolce and Stefano Gabbana of the fashion house Dolce & Gabbana, meaning that they will not stand trial. Judge Simone Luerti said he found no evidence of criminal activity and refused to allow the case to proceed.

Italian finance officials had been investigating a company set up in Luxembourg through which sales royalties passed and which was taxed at 3% enabling them to avoid higher rate Italian taxes. The investigation focused on an alleged failure to declare revenues of around 840 million euro.

It was claimed that Dolce & Gabbana had created a company in Luxembourg, called Gado Srl, in 2004, which was given control of the group's brands thereby avoiding Italian taxes. Finance officials alleged that the Luxembourg company was in fact run from Italy, a claim that the designers denied.

According to media reports, the two collectively faced up to $1 billion in unpaid taxes, interest, and fines and could each have received a prison sentence of up to three years. Five other unnamed people who were implicated have also had their cases dropped.

Italy has been cracking down on widespread tax evasion in recent months in an effort to raise government revenues following the global economic crisis. Giuseppe Bana, lawyer of Dolce and Gabbana's accountant, said: "The judge prevented this from going too far, it's an investigation that should never have been initiated in the first place."

Portugal Fiscal Representation rule violates EU treaty

The European Court of Justice held, on 5 May 2011, that Portuguese provisions that oblige non-resident taxpayers who receive Portuguese-source income to appoint a Portuguese fiscal representative are in violation of the EC Treaty's free movement of capital rules, but not those required by the European Economic Area Agreement.

In *European Commission v. Portugal* (C-267/09), the Commission asserted that the provisions under Article 130 of Portugal's personal income tax code constituted a restriction on the free movement of capital obligations under article 56 of the EC Treaty and article 40 of the EEA Agreement. It argued that the requirement was effectively a new charge on non-residents, who must pay representatives. Portugal argued that the provisions were necessary to ensure the effectiveness of fiscal supervision and the prevention of tax avoidance.

The ECJ held that the obligation to appoint a tax representative was an unjustified restriction on the free movement of capital in some circumstances but not in others. For taxpayers residing in other EU countries who receive Portuguese-source income requiring the submission of a tax return, the obligation to appoint a fiscal representative went beyond what was necessary and did constitute an unjustified restriction of the EC Treaty. But for taxpayers residing in countries that are within the EEA but not the EU, the obligation to appoint a Portuguese fiscal representative was a justified restriction because the framework of cooperation between EU member states did not exist between member states and a non-member that had not entered into any undertaking of mutual assistance.

Sovereign Comment

In accepting the ECJ's ruling, Portugal is following her neighbour Spain which some years ago also amended its law so that a non-resident was no longer obliged to employ a local fiscal representative. Over the years, Sovereign's Portugal office based on the Algarve has built an enviable reputation for this type of work at a very reasonable cost. Despite the change in law, our Portuguese colleagues report that most non-residents are more than happy to continue using Sovereign to manage their local tax affairs. This is a good example of where sheer practicality and common sense outweigh the actual letter of the law.

in the press:

Where there is a Will... there may not be a way

A version of this article by Sovereign Group chairman Howard Bilton was first published in the June issue of Hong Kong Golfer Magazine

It seems it is loony season in the UK courts... again. A recent decision seems to suggest that the UK is moving towards a civil law type system, which removes the right of individuals to decide who benefits from their estate on their death. Until now an individual could leave their property to whomever they wished without interference from the courts. It seems this is no longer the case.

In countries that apply civil or Sharia law the state largely dictates what must happen to a person's wealth after their death. Such laws can be generically described as "forced heirship legislation".

Provisions vary from country to country but in most civil law jurisdictions, one third of the total estate must go to the surviving spouse, one third must be equally divided between children, and the testator can do what they wish with the remaining third. Under Sharia law (applicable in most Muslim countries) there are even greater restrictions. These laws would apply not only to residents and nationals of those countries but also to assets located in same – so beware if you have investments in such countries.

In the recent UK case, Mrs Melita Jackson left the vast majority of her estate to a group of charities and specifically excluded her daughter Heather from benefit. Alongside her Will, Mrs Jackson wrote a letter to her executors that explicitly set out her attitude to her estranged daughter:

"I have made no provision in my Will for my only child and daughter, Heather Ilott, for the reasons stated below.

"My daughter left me on Sunday 19 February 1978 when she was only 17 years of age. Whilst I was still sleeping she crept out of my house during the early hours of the morning... "I have only seen my daughter twice since she left home, on my 60th birthday and in May 2001. My daughter now has five children and I have not seen any of them since my 60th birthday.

"My daughter has been extremely deceitful to me and has told me a number of lies.

"Because my daughter left me without any explanation and has made no effort to reconcile with me I feel as though I have no moral or financial obligation to provide for her. My daughter has not been financially reliant upon me since she left home, although I did make gifts of money to her on her birthday and at Christmas up to and including her 21st birthday, although she refused to acknowledge any of the payments that I made to her.

"If my daughter should bring a claim against my estate I instruct my Executors to defend such a claim as I can see no reason why my daughter should benefit in any way from my estate bearing in mind the distress and worry she has caused me over the years. I have made it clear to my daughter during her lifetime that she can expect no inheritance from me when I die.

"My Executors should use this letter as evidence in any Court proceedings as they think fit."

Despite this letter, Heather successfully claimed £50,000 from the Will using a provision of English law that is normally applied when a dependent of the testator is left without financial support. The total value of the estate was £486,000, so her award was over 10%. It seems the court awarded this sum on the sole ground that Heather had five children and was living on benefits. Obviously, a very responsible individual, then! Heather decided to appeal the case asking for more. This, it seems, was an error on her part as the charities that were losing out cross-appealed and the High Court reduced her entitlement to zero, but the Court of Appeal later reaffirmed the original judgment and reinstated the £50,000 provision.

This is a very worrying development. Heather seemed less than a model child and, as she had survived for 17 years without resort to her mother's finances, was definitively not a dependent. There seems little reason why the court should award her anything from the Will unless the UK courts now hold that testators are no longer free to do what they wish but must, under all circumstances, bequeath at least a portion of their estate to their children. Remember, other English common law systems are not bound to follow UK decisions but they do tend to be highly persuasive. Could this case be used by disinherited children to claim part of an estate? Probably.

The solution is relatively simple. Do not die owning anything of substance. There are many different ways of avoiding the often lengthy and expensive administration (the probate procedure) of a Will. You can give all your money away before you die (in the UK you will have to do this at least seven years in advance to avoid lifetime transfer charges) but many people find this unpalatable, as they do not wish to be reliant upon others for their future upkeep.

You could spend it all. That would be the most fun but people generally want to leave something to family and children and timing your rate of spending precisely could be difficult.

The best option is to transfer all substantive assets and wealth into a trust structure or equivalent, which removes the need for a Will altogether. If these arrangements are structured correctly they should not only prevent claims against the estate arising (because there isn't one to claim against) but may also have substantial tax and asset protection advantages. It will certainly allow for quick and easy administration of the estate, because your affairs will be sorted out while you are still around to do it. After all, you will know better than anybody else where your assets are and how they can best be transferred. Trusts have long been used for this purpose and, provided they are both set up and administered correctly, can prove extremely effective in by-passing the provisions of civil and Sharia law (and now avoiding claims similar to this under UK common law principles).

Global wealth continued solid recovery in 2010, says survey

Global wealth increased by 8%, or $9 trillion, to a record of $121.8 trillion in 2010, according to Boston Consulting Group's (BCG) eleventh annual Global Wealth report published on 31 May 2011. That level was about $20 trillion above where it stood just two years prior during the depths of the financial crisis.

Among the other key findings, North America had the largest absolute gain of any regional wealth market in assets under management (AuM), at $3.6 trillion, and the second-highest growth rate, at 10.2%. Its $38.2 trillion in AuM made it the world's richest region, with nearly one-third of global wealth. In Europe, wealth grew at a below-average rate of 4.8%, but the region still had a gain of $1.7 trillion in AuM.

Wealth grew fastest in Asia-Pacific (excluding Japan), at a 17.1% rate. In the Middle East and Africa, growth was somewhat above the global average, at 8.6%. In Latin America, wealth grew by 8.2%. Together, these three regions accounted for 24.4% of global wealth in 2010, up from 20.9% in 2008.

Wealth declined by 0.2% in the Japanese market to $16.8 trillion. As recently as 2008, Japan accounted for more than half of all the wealth in Asia-Pacific. In 2010, it accounted for about 44%.

In terms of individual countries, the nations showing the largest absolute gains in wealth were the US, China, the UK and India.

The strong performance of the financial markets accounted for the lion's share (59%) of the growth in AuM. Its impact was amplified by the ongoing reallocation of wealth. From year-end 2008 through 2010, the share of wealth held in equities increased from 29% to 35%.

"During the crisis, cash was king," said Monish Kumar, a BCG senior partner and a co-author of the report. "Since then, clients have been steering their assets back into riskier investments." North America continued to have the highest proportion of wealth held in equities – 44%, up from 41% in 2009.

"The wealth management industry has overcome tremendous adversity over the past several years, and the sustained recovery of global wealth bodes well for its future," added Kumar. "But the positive signs should not be misread as a return to normal. A number of disruptive forces, including increased regulatory oversight and changes in client behaviour, are rewriting the rules of the game – both literally and figuratively."

Millionaire households represented just 0.9% of all households, but owned 39% of global wealth, up from 37% in 2009. The number of millionaire households increased by 12.2% in 2010 to about 12.5 million.

The US had by far the most millionaire households (5.2 million), followed by Japan, China, the UK and Germany. Singapore continued to have the highest concentration of millionaire households, with 15.5% of all households having at least $1 million in AuM, and also the fastest-growing number of millionaire households, with 170,000 – up nearly a third from 2009.

Switzerland had the highest concentration of millionaire households in Europe and the second-highest overall, at 9.9%. Three of the six densest millionaire populations were in the Middle East – in Qatar, Kuwait and the United Arab Emirates.

"The relative importance of offshore centres is changing rapidly. Some are benefiting from continued asset growth, while others are suffering large asset outflows."

The proportion of wealth owned by millionaire households increased the most in Asia-Pacific, at 2.9 percentage points, followed by North America, at 1.3 percentage points.

For the first time this year, BCG also published figures on the countries with the highest number of "ultra-high-net-worth" (UHNW) households – defined as those with more than $100 million in AuM. The US had the largest number with 2,692, while Saudi Arabia had the highest concentration of UHNW households, measured at 18 per 100,000 households, followed by Switzerland with 10, Hong Kong with 9 and Kuwait and Austria, both with 8. China experienced the fastest growth in the number of UHNW households, which jumped by more than 30% to 393.

The amount of offshore wealth – defined as assets booked in a country where the investor has no legal residence or tax domicile – increased to $7.8 trillion in 2010, up from $7.5 trillion in 2009. At the same time, however, the percentage of wealth held offshore slipped to 6.4%, down from 6.6% in 2009. The decline was the result of strong asset growth in countries where offshore wealth is less prominent, such as China, as well as stricter regulations in Europe and North America, which prompted clients to move their wealth back onshore.

"Offshore private banking remains a tumultuous part of the business," said Anna Zakrzewski, a BCG principal and a co-author of the report. "The relative importance of offshore centres is changing rapidly. Some are benefiting from continued asset growth, while others are suffering large asset outflows, with wealth being repatriated to onshore banks, transferred to other offshore centres, redirected into non-financial investments, or simply spent at a faster rate."

For most clients, however, the core value proposition of offshore banking remains, Zakrzewski said. "Offshore wealth managers offer a sense of stability and security that these clients cannot find in their home countries. Other clients value the expertise or access to certain investments provided by offshore private banks. To continue to grow, offshore wealth managers will need to adapt to the changes imposed by the push for greater transparency while accentuating their strengths in areas that remain extremely relevant to clients around the world."

BGC expects global wealth to grow at a compound annual rate of 5.9% from year-end 2010 through 2015 – to about $162 trillion – driven by the performance of the capital markets and the growth of GDP in countries around the world. Wealth will grow fastest in emerging markets. In India and China, for example, it is expected to increase at a compound annual rate of 18% and 14% respectively. As a result, the Asia-Pacific region's share of global wealth (ex-Japan) is projected to rise from 18% in 2010 to 23% in 2015.

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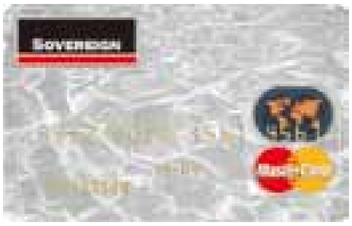

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38

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