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report

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G20 Summit – time to act!

As many of you will have read (and the reason we delayed publication of this issue) the G20 leaders met in St Petersburg last month and agreed to establish automatic exchange of information between tax authorities as the new global standard (see page 12). They also agreed to support the OECD's work in tackling tax avoidance by multinational companies (see page 13) and to require companies to obtain and hold information on their beneficial ownership which will be available to tax and law enforcement authorities through central registries (see page 6).

As we have been advising for some time, any meaningful confidentiality has either gone or will have gone very soon – and taxpayers whose arrangements would not bear scrutiny by their home tax authorities could find themselves in a very difficult position. Sovereign has always maintained that any tax planning that relies on non-disclosure is not tax planning at all. Fortunately, there are still many structures and arrangements that can be highly effective in protecting assets and saving tax – but they must be compliant because they will be examined!

It is also worth noting that the new wave of Intergovernmental Agreements (IGAs) currently being signed by offshore finance centres to enable automatic exchange of information are likely to be accompanied by special "disclosure facilities". These provide taxpayers, for a limited period, the opportunity to notify previously undisclosed offshore assets voluntarily in return for reduced penalties. Anyone with offshore arrangements would be well advised to have an expert review to make sure they are still compliant in this fast changing legislative environment.

chairman

Introducing the JLJ Group

Setting up a business in China is particularly fraught with difficulties and can involve enormous bureaucracy. In April, Sovereign acquired The JLJ Group, an integrated services provider that accelerates international companies' ability to understand and operate in the China market.

The JLJ Group was formed in 2003 and has worked with over 600 clients, including government organisations and companies of all sizes – from Fortune 500 multinational corporations and global brands, to a variety of small and medium-sized enterprises. Its services include market research and consulting, company formation and accounting outsourcing, all of which make it a perfect addition to our global business.

We have been working with JLJ for some time and recognised their considerable expertise. This acquisition will allow us to offer a really high quality service for those clients wishing to do business in China and JLJ's offices in Shanghai and Beijing are being combined with our existing operations in China.

New head of Asian operations

We can also announce that Joe Cheung, previously managing director of Sovereign Trust (Singapore), has been promoted to the position of managing director for Asia. He is now based in our Hong Kong office.

New pensions first for Sovereign

I am also delighted to announce that, as of May this year, Sovereign became the first international pensions provider to offer Money Purchase Illustrations (MPIs) to all pension members and for all pension plans, including QROPS and QNUPS,

MPIs provide a realistic look at the level of pension people can expect in the future given the level of money they have currently put aside. They should assist individuals to assess the adequacy of their pension arrangements and the extent to which they may need to make further provision.

This service will be provided in conjunction with PenTech Group, an Isle of Man-based firm of international pension technicians that has worked closely with Sovereign for a number of years, and is a further example of the enhanced benefits that we can bring to our pension members.

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

EU plans to remove banking secrecy in crackdown on tax evasion

The heads of state and government of the 27-nation European Union agreed, at a one-day summit in Brussels on 22 May 2013, to crack down on tax evasion more effectively by abolishing banking secrecy and by improving the exchange of information on account holders among themselves and with non-EU countries.

Political consensus was reached on the adoption of the revised EU Savings Tax Directive by the end of 2013. EU leaders also agreed that a coordinated approach to fighting base erosion and profit shifting (BEPS) and aggressive tax planning was necessary, with a proposal for a revised Parent-Subsidiary Directive to be presented by the end of the year.

It was also agreed that the EU's position should be that automatic exchange of information covering a wide range of taxable income should be the global standard. The EU will promote this standard through the G8, G20 and the OECD.

The agreement, which followed several years of negotiations, came after Austria and Luxembourg finally dropped their opposition to automatic exchange of bank data. However, both countries reiterated that their cooperation would depend on the outcome of negotiations on the participation of third-party non-EU countries such as Switzerland and Lichtenstein.

"We have not given our final approval to abolish banking secrecy and to join the automatic exchange of data because we are waiting for the outcome of the negotiations with third countries such as Switzerland," Luxembourg's Prime Minister Jean-Claude Juncker said after the meeting. "When these results are available, we will take a speedy decision."

Austria's Chancellor Werner Faymann expressed optimism that a final agreement on an automatic exchange of bank data among all members of the EU could be possible by the end of this year. "Today is a bad day for tax evaders because we will take action against them jointly," he said.

President of the European Council Herman Van Rompuy said the summit managed to "break a number of frozen files" and had achieved significant progress towards combating tax evasion and tax fraud. The leaders expressed their resolve to reach a final deal on automatic exchange of bank data by the end of this year. They also agreed to complete as soon as possible negotiations with five non-EU nations – Switzerland, Liechtenstein, Monaco, Andorra and San Marino – on their participation, he said in a statement.

In April, five Member States – France, Germany, Italy, Spain and the UK – announced their intention to develop and pilot a multilateral agreement for automatic tax information exchange. This will be based on the model intergovernmental agreement drawn up for implementation of the US Foreign Account Tax Compliance Act (FATCA). The aim is to limit tax evasion through the automatic exchange of a wide range of financial information between the five states.

41 europe

PM says UK territories should not be called "tax havens"

UK Prime Minister David Cameron, speaking in the House of Commons on 9 September 2013 – just after the G20 summit in St Petersburg, where tax evasion and tax-related issues were high on the agenda – said he believed it was no longer fair to characterise the UK's dependent territories as tax havens.

Responding to a question about the timetable for the Overseas Territories and Crown Dependencies to sign the OECD's Multilateral Convention on Mutual and Administrative Assistance in Tax Matters, Cameron confirmed all had agreed to take required action on tax information exchange with the UK, international tax co-operation and beneficial ownership.

"I cannot recall the exact timetable off the top of my head, but I will make this point: I do not think it is fair any longer to refer to any of the Overseas Territories or Crown Dependencies as tax havens," he said.

"They have taken action to make sure that they have fair and open tax systems. It is very important that our focus should now shift to those territories and countries that really are tax havens. The Crown Dependencies and Overseas Territories, which matter so much — quite rightly — to the British people have taken the necessary action and should get the backing for it."

Welcoming his comments, leaders of the Overseas Territories said: "We further wish to reiterate our support for Mr. Cameron's presidency of the G8 and the G8 agenda as we work together on the global fight against the scourge of tax evasion and money laundering as set out in our Action Plans on beneficial ownership."

Cyprus agrees deal on €10bn bailout

The Cyprus parliament narrowly approved, on 30 April 2013, the terms of a €10 billion bailout package with the European Commission, European Central Bank and International Monetary Fund. The deal hit foreign investors hard, particularly Russians who were estimated to hold more than €20 billion of the €68 billion deposited in Cypriot banks.

The agreement, backed by 29 MPs and opposed by 27, avoided a controversial levy on all bank accounts but instead forced large losses on big deposits in the island's two largest lenders, which together accounted for about half of total deposits.

Attempts to agree a deal triggered financial chaos in April when parliament rejected a plan to impose a levy on all depositors to fund the recapitalisation of banks heavily exposed to debt-crippled Greece. It was followed by a two-week bank closure. The fallback option, now agreed, involved winding down the second largest bank, Laiki, and imposing losses of up to 60% on uninsured deposits (above €100,000) in the largest, Bank of Cyprus.

The ECB had threatened to cut off funds supporting Cypriot banks, which would have precipitated the island's exit from the euro if an agreement had not been reached. The aim is to shrink the Cypriot banking sector to the European average of three-times national output from its previous seven.

In accordance with its agreement with international lenders, Cyprus has also made a number of changes to tax rates, most notably the corporate tax rate was increased from 10% to 12.5%, with effect from 1 January 2013.

On 17 April, the European Commission cited "poor practices of risk management" in the Cypriot banking sector as the cause of the crisis. It announced that a new Support Group for Cyprus would be set up to facilitate the implementation of the adjustment process.

Sovereign Comment

Many commentators have suggested that this "deal" is nothing less than theft. It may also set a precedent for any further bailouts required within the EU. However, the tax changes do not detract from Cyprus's attractiveness as a holding company jurisdiction. Cyprus's corporate tax rate is still one of the lowest in the EU and the tax-free flow of dividends through Cyprus and its wide network of double tax agreements remains intact.

Guernsey introduces Image Rights Register and Foundations

The States of Guernsey passed, on 28 November 2012, the world's first legislation aimed at protecting people's image rights. The law enables the registration and protection in Guernsey of voice, mannerisms, expressions and names, as well as pictures, videos and recordings.

Personalities that can be registered include natural persons, legal persons, joint personalities, groups and fictional characters. The legislation also allows for the personality of a deceased person to be registered for up to 100 years after their death (or dissolution in the case of a legal person).

The ability to register image rights in a jurisdiction that recognises them by statute provides greater clarity in the definition of these rights and a higher degree of protection from unauthorised use. It will enable athletes, teams, performers, artists and authors to centralise the ownership of their image rights in Guernsey. Registration will also provide collateral evidence in other countries of the intent to protect the proprietary image.

The Foundations (Guernsey) Law 2012 came into force on 8 January 2013 and reflects accepted civil law characteristics of foundations while differing from other common law jurisdictions that have also recently introduced foundations.

A foundation must have a registered office in Guernsey, at which all records of the foundation must be kept. Neither the charter nor the rules are available for public inspection, although the charter must be delivered to the registrar upon establishment. A Guernsey foundation only requires a guardian where there is a purpose in respect of which there are no beneficiaries, or there are disenfranchised beneficiaries.

The Guernsey legislation contains a distinction in the status of beneficiaries – "enfranchised beneficiaries" with rights to information and "disenfranchised beneficiaries" without rights to information. This may be used to distinguish between family members who have taken a genuine and active role in the family business and those who have not.

The Law further provides for migration of foundations to Guernsey and for the Guernsey courts to have the same power to assist foundations as they do trusts. Reserved powers enable the founder to amend, revoke, vary and terminate the foundation but are only available during the founder's lifetime or, where the founder is an entity, for 50 years.

europe

Sovereign Comment

The new image rights law will complement the IP legislation already in place in Guernsey and will further secure Guernsey's position as a jurisdiction for IP management and the administration and management of image rights for sportsmen, entertainers and celebrities.

The Foundations Law enables fiduciaries to consider the use of a foundation, as well as a trust, when creating wealth structures for clients in Guersey. Foundations will be particularly attractive to those based in civil law jurisdictions in Europe and further afield in the emerging markets of China, Russia and Latin America, where the foundation concept is more familiar than that of a trust.

Spain to drop matriculación tax on yacht charters

The Spanish Consejo de Ministros (Council of Ministers) announced, on 28 June 2013, that it will end the imposition of matriculación tax currently payable on the hull value of yachts over 15 metres in length that charter in Spanish waters.

Since 1992 Spain has levied an additional tax on certain means of transport known as Impuesto Especial sobre Determinados Medios de Transport – more commonly known as "matriculación tax". The tax consists of a one-off payment of 12% on a yacht's total value in addition to the Spanish VAT which is also payable at the current rate of 21%.

The European Union Court of Justice ruled in late 2011 that Spain was not in compliance with EU rules, stating that member countries could only collect this type of tax if a yacht is permanently based within its territory, and that the amount should be proportionate to the duration of use within the territory. The European Commission therefore formally requested the government change its application of the tax law.

It is understand that a final approval to the change has to be given by the Spanish parliament but it is hoped that a revised law will take effect in 2014. It seems likely that matriculación tax will remain payable on private yachts greater than eight metres in length registered in Spain and/or used in Spanish waters by individuals or companies who are Spanish resident and/or deemed to be established in Spain.

Malta introduces new Global Residence Programme

Malta introduced a new Global Residence Programme (GRP), with effect from 1 July 2013, which offers special tax status for individuals who are not nationals of the European Union, European Economic Area (EEA) or Switzerland. It replaces the previous Residence Scheme for High Net Worth Individuals (HNWIs) with more favourable conditions.

Under the GRP rules, the minimum annual Malta income tax payment payable by the individual in respect of income from foreign sources and remitted to Malta, inclusive of the number of dependents of the individual, has been lowered to €15,000 from the previous €25,000 under the HNWI scheme. A requirment for a €500,000 government bond contract has also been removed completely. There is no minimum residence period but an individual may not reside in any other tax jurisdiction for more than 183 days in any calendar year.

Maltese residents are not subject to tax in Malta on foreign-sourced income thst is not remitted to Malta. Nor are they subject to tax on any foreign-sourced capital gains whether remitted to Malta or not. Permanent Residents of Malta are entitled to taxation at the flat rate of 15% on remitted income. Malta further has over 60 double tax treaties, ensuring that tax should not be paid twice upon the same income. There is no inheritance tax.

Applications under the GRP are open to non-EU, non-EEA and non-Swiss nationals. Within 12 months of taking up residence under the GRP, residence permit holders are required to demonstrate that an address is available to them in Malta by buying or renting property in Malta. The minimum property value requirements are €275,000 for property in Malta (or €9,600 in annual rent) and €220,000 for property in Gozo and the southern region of Malta (or €8,750 in annual rent).

Sovereign Comment

This new scheme is the most advantageous residence scheme available to non-EU nationals and will appeal not only to those who actually want to live in Malta but also to those from countries such as China, Taiwan or South Africa where political and economic stability may be a concern.

Residents and nationals of such countries often like to have a "bolthole" if life becomes too difficult at home. This scheme will also appeal to people who have a passport that is difficult to travel on. If they obtain Maltese residency they can then apply for a Schengen visa that will allow them to travel freely within Europe without further authorisation for up to six months of every calendar year.

UK's dependencies and territories agree to exchange information

The UK Treasury announced, on 2 May 2013, that its Overseas Territories – Anguilla, Bermuda, the British Virgin Islands, Montserrat and the Turks and Caicos Islands – had followed the Cayman Islands and its Crown Dependencies – the Isle of Man, Guernsey and Jersey – by agreeing to share information automatically with Britain.

The UK government previously announced in April that it was to develop and pilot a new "multilateral tax information exchange agreement" with four of its largest EU fellow members – France, Germany, Italy and Spain – which is based on the model Intergovernmental Agreement (IGA) negotiated by the five countries with the US last year for implementing the US Foreign Account Tax Compliance Act (FATCA).

HMRC, the UK revenue, noted that the new agreement would "help catch and deter tax evaders as well as providing a template for wider multilateral automatic tax information exchange". The intention is to persuade all the other EU member states to sign up as part of what will develop into a "global system of automatic information exchange".

The US Treasury is in the process of negotiating bilateral IGAs with more than 50 countries and jurisdictions, including most offshore financial centres. On the basis that its Dependencies and Overseas Territories would therefore be providing more information to the US than to itself, the UK decided to secure similar deals. Under the new agreements they will automatically provide names, addresses, dates of birth, account numbers, account balances and details of payments, not just in respect of UK taxpayers but in respect of its EU partners as well.

At the G8 summit in June 2013, led by UK Prime Minister David Cameron, participants made further commitments to develop new measures to ensure that information about the beneficial ownership of companies and trusts would be made accessible to the relevant authorities.

The UK has already published its own action plan aimed at counteracting misuse of companies, trusts and other legal arrangements and designed to enhance transparency. This incorporates the following principles:

- to ensure that companies hold accurate information on their beneficial ownership and, by amendment to the Companies Act 2006, to make sure the information is available to the authorities through a central registry at Companies House; there is to be a consultation on whether this information should be publicly available;
- to review corporate transparency including issues relating to bearer shares and nominee directors;
- to ensure that trustees of express trusts are obliged to hold accurate information on beneficial ownership of the trust, that the relevant authorities have access to this and that mechanisms are in place to share it with other jurisdictions;
- to support the Crown Dependencies and the Overseas Territories in publishing their own Action Plans on Transparency.

Sovereign Comment
These new agreements are part of an ongoing global initiative that will, sooner rather than later, see confidentiality disappear completely. There are still many taxpayers whose offshore arrangements would not bear scrutiny by their home tax authorities but hiding money offshore or in the major banking centres is no longer a feasible option. Fortunately there are still many compliant structures and arrangements that can be highly effective in protecting assets and saving tax. Anyone with concerns over their existing arrangements would be well advised to contact their nearest Sovereign office for an expert review.

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TCI offers new Permanent Residence Certificates

The TCI Cabinet agreed, on 18 September 2013, to the limited offer of 200 Permanent Residence Certificates (PRCs) for certain categories of investors as of 15 October. The move, under an amendment to the Immigration Regulations, is intended to encourage economic development and stimulate the construction sector.

The PRCs will be made available based on investments above a certain level in a new home or a business. They will not be available on the purchase of an existing house.

Investments of $1.5 million in a home or business on Providenciales and the developed cays and $500,000 in North and Middle Caicos and other less developed islands are major qualifiers for the limited offer PRCs.

When applicants have been vetted and meet all the other requirements for the granting of a PRC, they will receive an undertaking that they will recieve a PRC upon completion of their development.

Border Control and Labour Minister Don-Hue Gardiner said the option of more being offered was there but that the initial cap had been set to see what the uptake was like. "We will hope that as time goes on and we see how the uptake is, maybe over the next short while we can then see whether to open it wider or perhaps reduce it," he said.

Persons who have already started projects, and are prepared to make the requisite investment after the amendment to the regulations takes effect will be eligible.

Switzerland and US agree deal on tax dispute with Swiss banks

Switzerland and the US signed, on 29 August 2013, a joint statement in Washington setting out the framework for Swiss banks' to cooperate with the US authorities. This will enable some Swiss banks to pay penalties to avoid or defer prosecution stemming from the long-running investigation into tax evasion by US taxpayers using Swiss bank accounts.

The agreed solution is made up of three components: the joint statement between the Swiss and US governments; a unilateral US programme in which Swiss banks not under investigation can participate voluntarily; and, on the Swiss side, the model authorisation of 3 July 2013 which governs Swiss banks' cooperation with the US. Banks that decide to participate in the US programme must apply to the Swiss Federal Council for individual authorisation.

The US programme is open to all Swiss banks except "Category 1" banks, which are the 14 banks currently under criminal investigation in the US. "Category 2" banks, which believe they have violated US tax law, may request a non-prosecution agreement before 31 December 2013. They must supply the US authorities with information on their cross-border relations – particularly leaver lists but not client names – and must also pay a fine in relation to the volume of untaxed US assets they hold and the date on which the accounts were opened. The fines amount to 20% for accounts that existed on 1 August 2008, and 30% for accounts opened between then and 28 February 2009. If a bank opened an account with untaxed US assets after 28 February 2009, the fine will be 50%.

Banks that consider that they have not violated US tax law (Category 3) and those whose business is local in nature (Category 4) can report to the US authorities between 1 July 2014 and 31 October 2014 to request a non-target letter.

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OECD members more willing to provide "shell" companies

An independent study, published by Australia's Griffith University, condluded that it was three times harder to obtain an untraceable shell company – the vehicle of choice for money launderers, bribe givers and takers, sanctions busters, tax evaders and financiers of terrorism – from so-called "offshore" financial centres than from many of the leading OECD member states.

Researchers posing as customers asked 3,700 incorporation agents in 182 countries to form companies for them. They sent three types of emails to their prospective incorporators, posing as applicants from low, medium and high-risk countries. Overall, 48% of the agents who replied failed to ask for proper identification; and almost half of these did not want any documents at all.

"Running directly counter to conventional policy wisdom on the subject, providers based in tax haven countries were significantly more likely to follow the rules," reported the authors, "to apply the 'Know Your Customer' principle, than those in non-tax haven countries. Another surprise was that providers in poorer, developing countries were at least as compliant as those in rich, developed countries."

Jurisdictions found to be most inclined to compliance included "offshore" financial centres such as Jersey, the Cayman Islands and the Bahamas, while leading "onshore" centres like the UK, Australia, Canada and the US ranked near the bottom of the list.

"It is easier to obtain an untraceable shell company from incorporation services in the USA than in any other country save Kenya," the report said.

Only ten of the 1,722 US providers who responded to the mystery shoppers asked to see notarised identity documents. There was considerable variation between different states, with those in Wyoming, Delaware and Nevada being the most likely to supply untraceable shell companies.

According to *The Economist* magazine: "This study makes sobering reading for anyone who worries about the link between financial crime and corporate secrecy," "OECD countries show little willingness to tackle their own weaknesses and end their hypocrisy. Movers of dirty money know where the best shells are to be had, and it is not on a Caribbean island."

Sovereign Comment

It is ironic that firms who set up and manage companies and trusts in offshore jurisdictions are heavily regulated, while those who undertake the same activity onshore are not. The OECD complains about offshore jurisdictions assisting with tax evasion and money laundering but the reality, as this study demonstrates, is that most of these activities take place onshore.

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US delays FATCA deadline by further six months

The US Treasury announced, on 12 July 2013, that implementation of the Foreign Account Tax Compliance Act (FATCA) would be deferred from 1 January 2014 to 1 July 2014 to give foreign financial institutions (FFIs) around the world a further six months to prepare to comply. This is the second postponement.

The US Treasury is looking to conclude discussions with more than 80 countries now seeking to establish intergovernmental agreements (IGAs) in a bid to mitigate some of the more costly aspects of the new law.

IRS Notice 2013-43 also provided additional guidance for the treatment of FFIs whose country had signed an IGA or where the US Treasury would treat the country as if they had. At the time of the announcement, only 10 IGAs had been signed, although discussions for many more were ongoing.

FATCA compliance may differ significantly depending on whether or not an FFI is in a country with an IGA. There will be further differences according to the type of IGA – Model 1 or Model 2 – and whether the IGA has provisions requiring US reciprocity in reporting US financial institution information.

Some foreign governments have insisted on "equivalent levels of reciprocal automatic exchange" with financial institutions in the US. The US Treasury has requested statutory authority to impose reciprocity on US financial institutions from Congress but it seems far from certain that Congress will be minded to pass the necessary legislation.

BVI enacts new Trade Marks and Aircraft Mortgaging laws

The BVI House of Assembly passed the Trade Marks Act 2013, which repeals the Merchandise Marks Act, Registration of UK Trade Marks Act and Trade Marks Act and makes new provision for the registration and protection of trademarks in the British Virgin Islands, on 30 April 2013. It was gazetted on 23 May.

The new Act streamlines BVI trademark procedure by replacing the former dual system, which provided for either independent or UK-based applications, with a single system for filing applications in the BVI. The changes assimilate BVI trademark law to that applicable in UK and other developed intellectual property (IP) jurisdictions. It will also be possible to file applications electronically instead of as previously by physical filings.

New legislation to support the expansion of the BVI's aircraft registry was also brought into force on 15 October 2012. The Mortgaging of Aircraft and Aircraft Engines Act 2011 and the Mortgaging of Aircraft and Aircraft Engines Regulations 2012 enable aircraft operators to register ownership of aircraft and aircraft engines in the BVI under three separate registries – for aircraft, their engines and their mortgages.

Lending institutions require that entities demonstrate legal ownership of assets before providing financing, to achieve legal certainty that they may retain a debtor's assets in the case of a credit default. The new law will enable local operators to register ownership of aircraft and aircraft engines unlocking credit opportunities for fleet expansion.

Sovereign Comment

The BVI is a popular jurisdiction for the holding of corporate assets such as real estate investments, securities, jets and ships. The BVI's IP legislation is well-established and the BVI has now modernised its trade mark legislation to improve its offering in the field of intellectual property holding structures. When brought into force it will further improve the position of the BVI as a tax neutral jurisdiction for the holding of IP.

While the BVI has been operating in the aviation sphere for several decades, until recently it has been known only as a tax-efficient aircraft holding company domicile and few aircraft have actually been registered on the islands' Aircraft Register. The new law complements the BVI's status as a US Federal Aviation Authority Category One aircraft register by creating a framework for registration in the BVI of security over aircraft, and separately, aircraft engines.

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Singapore strengthens international cooperation framework

Singapore strengthened its exchange of information (EoI) framework by signing the Convention on Mutual Administrative Assistance in Tax Matters on 29 May 2013. This will enable it to extend EoI to its existing tax agreement partners without having to update the bilateral agreements and will therefore expand its network of EoI partners by 13 jurisdictions, including Brazil and the United States.

This follows its endorsement of an internationally agreed OECD standard for the exchange of information for tax purposes in 2009. Since then, Singapore amended its laws to implement the OECD standard and has revised over half its tax treaties to facilitate tax information exchange information.

The Inland Revenue Authority of Singapore (IRAS) will also be allowed to obtain bank and trust information from financial institutions without having to seek a court order. This will streamline the administration of EoI without undermining the basic safeguards of taxpayers. The IRAS will continue to assess whether the requests are in line with the OECD standard and taxpayers will continue to have the right of appeal.

Singapore further announced its plan to conclude an Intergovernmental Agreement (IGA) with the US, which will enable financial institutions in Singapore to comply with the Foreign Account Tax Compliance Act (FATCA), a rule that requires foreign banks and other financial institutions outside the US to inform the US government about the financial accounts held by US persons. Singapore has indicated that it plans to adopt a "Model 1" type IGA. Singapore will make the necessary legislative changes to effect the above before the end of 2013.

The government is concerned that Singapore's financial system is not used to harbour illegitimate funds or as a conduit for the flow of undeclared assets. Singapore has already imposed stricter rules that require financial institutions to identify and close, if necessary, accounts that are strongly suspected to hold proceeds of fraudulent or willful tax evasion before 1 July 2013. From that date, the Corruption, Drug Trafficking and Other Serious Crimes (Confiscation of Benefits) Act has been amended to include tax crimes as money laundering (ML) predicate offences in Singapore.

The Monetary Authority of Singapore (MAS) said the new rules were part of "efforts to protect the integrity and reputation of Singapore as a trusted international financial centre." With onshore governments worldwide seeking to improve tax collection and Swiss banking secrecy under attack, Singapore has faced accusations that some of the funds flowing in may be undeclared.

Sovereign Comment

Many banks have recently opened operations in Singapore and many bank clients have moved their accounts to Singapore in the hope that it offers greater confidentiality and would allow them to avoid being reported to their home tax authorities. If anyone was in any doubt, it is now clear that this is not the case. Nobody should and nobody can rely on confidentiality to avoid their tax obligations.

HK and Singapore move to dampen property markets

Hong Kong Financial Secretary John Tsang Chun-wah announced, on 22 February 2013, that an across-the-board doubling of stamp duty on residential and non-residential properties would apply to all buyers who are not permanent residents. Warning that "the risk of an asset bubble is increasing", Tsang said that a further 2% price rise in January this year had pushed prices up by 120% since the trough of 2008, "and the momentum is continuing".

Last October the government imposed a 15% emergency tax buyers of residential property last October in a bid to dampen the island's property market. The tax applies to both non-resident and corporate purchasers. Stamp duty has also been increased for speculators who sell on properties soon shortly after purchase. For sales within six months of purchase, the rate has gone up from 15 to 20%, while a 15% duty will apply to sales within 12 months and 10% for sales within three years.

Singapore countered on 26 February when Finance Minister Tharman Shanmugaratnam announced additional taxes on luxury homes and investment properties, effectively adding anywhere from 12 to 20% to the purchase price.

This move followed January's increase to 15% of the Additional Buyer's Stamp Duty (ABSD) payable by non-Singaporean property buyers, a year after it was first introduced at 10%. The government was reacting after prices climbed to a 2012 fourth-quarter record high, yet private home sales continued to soar – by a reported 43% - in January.

HK passes trust law and exchange of information reforms

Hong Kong's Legislative Council passed, on 17 July 2013, a long-awaited amendment to the Special Administrative Region's outdated trust law, which is intended to boost the competitiveness of Hong Kong's international trust planning regime. The consultation process began in 2008.

By means of amendments to the Trustee Ordinance (Cap 29) and the Perpetuities and Accumulations Ordinance (Cap 257) – which date back to 1934 and 1970 respectively – the reforms introduce a statutory duty of care on trustees; provide trustees with powers to appoint agents, nominees and custodians, as well as to insure trust property against risks of loss; allow professional trustees to receive remuneration; provide for a court-free process for the retirement of trustees on beneficiaries' directions; and impose statutory control on exemption clauses that seek to relieve professional trustees from liabilities.

The new law also allows settlors to reserve to themselves some limited power and abolishes outdated rules against perpetuities and excessive accumulations of income. As a result, new non-charitable trusts – such as private trusts for wealth and estate planning – are no longer limited in duration. Singapore, which has significantly modernised its trust law in recent years, imposed a cap of 125 years.

At the end of 2011, Hong Kong's trust industry held assets estimated at US$335 billion, with more than 60% from non-Hong Kong investors.

LegCo also enacted, on 10 July 2013, the Inland Revenue (Amendment) Bill 2013, which provides for existing exchange of information (EoI) arrangements under double tax treaties (CDTAs) to be strengthened and for the government to enter into stand-alone tax information exchange agreements (TIEAs) with other jurisdictions where necessary. Previously, under the Inland Revenue Ordinance, Hong Kong could only exchange tax information with another jurisdiction under the framework of a comprehensive tax treaty.

The amendment follows the recommendations of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes that Hong Kong should put in place a legal framework for entering into TIEAs prior to the Phase 2 peer review of its compliance with the international EoI standard in September 2013.

South Africa signs new tax treaty with Mauritius

South Africa and Mauritius signed, on 17 May 2013, a new tax treaty and protocol that will replace the existing treaty dating from 1996. The most significant changes in the new treaty concern dual residence; the withholding tax rates on dividends, interest, royalties and capital gains; and the exchange of information provisions.

Under the existing treaty, dual resident companies are treated as being tax resident solely where the place of effective management is located. The new treaty contains a different tiebreaker clause, which provides that the dual residence of entities will be decided by mutual agreement of the two contracting states. If no agreement is reached the company falls outside the scope of the treaty, except for the exchange of information provisions.

The treaty has also been updated for the introduction of South African withholding tax on interest. While the existing treaty provides for a zero rate of withholding tax on interest, under the new treaty interest payments between South Africa and Mauritius will be subject to a 10% withholding tax, subject to certain exemptions.

The new treaty reduces the withholding tax rate on dividends from 15% to 10% if the recipient holds less than 10% of the capital of the company declaring the dividends. If it holds more than 10% of the capital of the payer company, the withholding tax remains at 5%. Royalties, which were historically not taxable in South Africa, will now be subject to tax at a rate of 5% on the gross amount.

The capital gains tax exemption for gains derived from the sale of shares of an immovable property company will no longer be available if more than 50% of the shares derive their value directly or indirectly from immovable property.

The exchange of information article in the new treaty gives the South African tax authority (SARS) powers to gather information from Mauritius regardless of whether Mauritius has any domestic interest in such information. It also contains provisions for assistance in the collection of taxes along the lines of the OECD Model Agreement.

Sovereign Comment
Mauritius has been the preferred route for investment by South Africans into Africa for many years and SARS has regularly sought to challenge the tax residence of Mauritius companies on the grounds that their effective management is in South Africa. Under the new treaty, failure to produce sufficient evidence of effective management will allow SARS to exclude a company from the scope of the treaty.

For investments into South Africa and the funding of South Africa companies, the increase in the withholding tax rate on interest may remove the benefit of investing via Mauritius. As a result of the new capital gains tax provisions, it will be necessary to examine whether any alternative holding company structure would be more appropriate.

middle east, africa + asia

Free zone firms need DED licence to operate in Dubai

The Department of Economic Development (DED) restated, on 20 November 2012, that no free zone company across the UAE can conduct business within Dubai unless it has a licence or opens a branch in Dubai in accordance with Law No. 13 of 2011 on business registration and licensing in the Emirate.

The DED has been receiving complaints from various Free Zone companies, most of them operating outside Dubai, that their licensors had promised they could do business in Dubai under the free zone licence.

"We have clarified to them that there is an established route to doing business in Dubai," said Mohammed Shael Al Saadi, head of Business Registration & Licensing at DED. "Through Law No.13 of 2011, Dubai has acknowledged the role of Free Zone companies in economic activity in the UAE and the leadership wants to allow such companies to contribute further to overall development. DED's role is to enable businesses that choose Dubai as their base to benefit from a competitive environment and best practices."

Law No. 13 also allows free zone companies that have no local partners to open branches in Dubai, provided that the branch has a local service agent. A local service agent is a UAE national or company that will sponsor employees for the Dubai branch of a free zone company at the Ministry of Labour. The local service agent will have no voting or decision-making rights. A free zone company can operate a branch in Dubai provided it is active within the free zone but any termination of the free zone activity will reflect in the Dubai licence as well.

Finance Ministers agree plans for Asia Region Funds Passport

The Finance Ministers of Singapore, Australia, South Korea and New Zealand signed a statement, on 20 September 2013 in Bali, Indonesia, for the joint development of an Asia Region Funds Passport (ARFP) to facilitate the cross-border offering of funds in Asia.

The ARFP is essentially a collective investment vehicle passport that will facilitate the cross-border distribution of funds management products that are created, administered and distributed within a set region. Funds that meet the agreed set of regulatory requirements can be sold both domestically and across borders within the passport region.

The Ministers endorsed a framework document that sets out the high-level principles, basic arrangements and indicative timeline for developing the ARFP. Each of the four countries will conduct a joint public consultation in 2014 on the detailed rules and arrangements for the launch of the ARFP in 2016. Other countries that have expressed an interest include Hong Kong, Taiwan, Japan, Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

Tharman Shanmugaratnam, Deputy Prime Minister, Minister for Finance, and chairman of the Monetary Authority of Singapore, said: "The ARFP will benefit investors and fund managers, and ultimately help in the much-needed deepening of regional capital markets."

Sovereign Comment
European funds have dominated the Asian market accounting for the vast majority of foreign funds sold in the region. With 60% of the world's population and 12% of the world's total funds under management, the funds market in Asia has the potential to grow exponentially and to become the global centre of GDP growth.

The ARFP, when implemented, will offer fund managers operating in a passport economy a direct and efficient route to distribute their funds. It is intended to strengthen the region's fund management capability, deepen capital markets, and provide finance for sustainable economic growth. In the longer term, it could also facilitate funds from the Asian region being marketed in Europe by way of a mutual recognition agreement.

G20 sets automatic exchange of information as new global standard

Leaders of the world's 20 largest economies endorsed, at the G-20 summit in St Petersburg on 6 September 2013, plans to exchange tax information automatically between themselves by the end of 2015 and called "on all other jurisdictions to join us by the earliest possible date".

In the official declaration issued at the conclusion of the summit the G-20 leaders formally abandoned the "on request" standard for exchanging confidential taxpayer information in favour of a new model of international tax co-operation based on automatic exchange of information in accordance with the OECD Multilateral Convention on Mutual assistance in Tax Matters.

In August, China became the 56th signatory to the Convention and the final G20 member country to fulfil the commitment made at the 2011 G20 Summit in Cannes to move to automatic exchange of information as the new global standard.

In July, G20 Finance Ministers and Central Bank governors mandated the OECD to create a single global standard for the automatic exchange of information. The aim is for the OECD to unveil the new standard, together with a Model Competent Authority Agreement, in February 2014 and to finalise technical procedures for effective automatic exchange of information by mid-2014.

The official declaration said: "We fully endorse the OECD proposal for a truly global model for multilateral and bilateral automatic exchange of information. Calling on all other jurisdictions to join us by the earliest possible date, we are committed to automatic exchange of information as the new global standard, which must ensure confidentiality and the proper use of information exchanged.

"In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015. We call on all countries to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters without further delay. We look forward to the practical and full implementation of the new standard on a global scale.

"We encourage the Global Forum to complete the allocation of comprehensive country ratings regarding the effective implementation of information exchange upon request and ensure that the implementation of the standards are monitored on a continuous basis. We urge all jurisdictions to address the Global Forum recommendations in particular those 14 that have not yet moved to Phase 2.

"We invite the Global Forum to draw on the work of the Financial Action Task Force (FATF) with respect to beneficial ownership. We also ask the Global Forum to establish a mechanism to monitor and review the implementation of the new global standard on automatic exchange of information."

The G20 agreement followed a deal struck by the G8 countries in June to establish automatic exchange of tax information between tax authorities.

Sovereign Comment

It cannot be over emphasised that all confidentiality has now disappeared. Any "high tax" nation can request the information it requires from any offshore jurisdiction via Tax Information Exchange Agreements and tax treaties. Those procedures will now be radically enhanced by automatic exchange of information. This does not mean that offshore structures can no longer provide tax advantages. They can. But it does mean that the days of simply failing to declare income or capital gains are over. Legitimate planning that utilises compliant structures can however be equally effective. Expert advice is essential not just to get the planning right but also to demonstrate that you have taken care to achieve tax compliance.

41 fiscal

France adds three "havens" to its offshore blacklist

France added Bermuda, the British Virgin Islands and Jersey to its blacklist of "uncooperative tax havens" published in the Journal Officiel on 21 August 2013, despite all three jurisdictions having signed tax information exchange agreements (TIEAs) with France.

French tax laws apply extreme withholding tax rates of 75% on all capital flows from France to countries deemed to be uncooperative, including payments of dividends, interest, royalties, capital gains and salaries.

The finance ministry in Paris said the three territories had been added to the blacklist for not complying with a new criterion enforced by the government, of unsatisfactory compliance with an existing convention with France.

It said, in the case of Jersey, this concerned an individual who owed tax to France who had refused to supply information. It was up to Jersey to elicit the information, an official said. He added that the terms of the blacklist would not enter into force for the three territories until 1 January 2014, allowing them time to be removed from the list if they fulfilled their obligations by the end of the year.

Former French President Nicolas Sarkozy introduced the blacklist in 2010 to increase pressure on offshore financial centres. The updated list now contains 10 jurisdictions. As well as Bermuda, the BVI and Jersey, it cites Botswana, Brunei, Guatemala, the Marshall Islands, Montserrat, Nauru and Niue. The Philippines has been removed after amending its double tax treaty with France to include provisions for exchange of information.

Netherlands signs new tax treaty with China

The Netherlands and China signed a new tax treaty on 31 May 2013, which will replace the current tax treaty dating from 1987. Ratification procedures are due to be completed in 2014.

The main benefits of the new treaty are a reduction from 10% to 5% in the withholding tax rate on intercompany dividends, if the recipient company holds at least 25% of the capital of the company paying the dividends. A zero rate will apply to dividends paid to the government or related entities). A 10% rate will apply in all other cases.

The rate on interest will remain capped at 10%, although a 0% rate will apply to loans guaranteed by the government or state-owned financial institutions. The rate on royalties will also remain at 10% although a newly introduced effective rate of 6% will apply to payments for the use of industrial, commercial and scientific equipment. No tax will be withheld on payments of interest or royalties from the Netherlands to China because the Netherlands does not impose withholding tax on interest or royalties under domestic law.

Under the current treaty, capital gains from the disposal of shares of a company are taxable in the country in which the company whose shares are sold is resident. The new treaty instead allocates taxing rights on gains from the disposal of shares to the country in which the owner of the shares is resident, unless the recipient has held directly or indirectly at least 25% of the shares at any time during the 12-month period before the disposal.

The new tax treaty includes a modern information exchange provision that is based on article 26 of the OECD model treaty. It does not contain a limitation on benefits provision but instead introduces specific anti-treaty shopping rules, under which no withholding tax relief will be granted if the main purpose, or one of the main purposes, for creating or assigning shares or other rights is to take advantage of the reduced treaty rates.

G20 adopts action plan against "base erosion and profit shifting"

The G20 leaders agreed, at the St Petersburg summit on 6 September 2013, to adopt an OECD Action Plan for the prevention of base erosion and profit shifting (BEPS). The move is intended to close the gaps between national tax systems by re-examining existing international tax rules on tax treaties, permanent establishment and transfer pricing.

G20 leaders called on members to examine how their own tax systems contribute to BEPS—asserting that "profits should be taxed where economic activities deriving the profits are performed and value is created" and "international and our own tax rules [should] not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions."

The need to address BEPS was raised at the G20's Los Cabos Summit in 2012 and the OECD was asked to report on what action could be taken. All non-OECD G20 countries have now signed up to a BEPS project, through which they will develop proposals and recommendations for tackling the issues identified by the OECD.

In a "Tax Annex" to the leaders' declaration, the G20 reiterated the general and specific action steps set forth in the OECD plan required to address BEPS:

- identify the "main difficulties that the digital economy poses for the application of existing international rules and develop detailed options to address these difficulties";
- develop treaty provisions and recommendations for neutralising the effect of hybrid instruments and entities;
- strengthen existing controlled foreign corporation (CFC) rules;
- limit base erosion via interest deductions and other financial payments;
- counter harmful tax practices more effectively, taking into account transparency and substance;
- prevent treaty abuse;
- prevent the artificial avoidance of permanent establishment (PE) status;
- ensure that transfer pricing outcomes are in line with value creation in respect of intangibles, risks and capital, and other high-risk transactions;
- establish methodologies to collect and analyse data on BEPS and the actions to address it;
- require taxpayers to disclose their aggressive tax planning arrangements;
- re-examine transfer pricing documentation;
- improve dispute resolution mechanisms;
- develop a multilateral instrument to assist in implementing measures developed in the course of the work on BEPS.

fiscal

Sovereign Comment

The timeline for BEPS is ambitious, aiming for completion by December 2015, and will integrate a number of related on-going OECD projects on fundamental tax issues, among them the definition of permanent establishment and the transfer pricing of intangibles. Multinational groups should assess their existing and planned structures, considering the increased focus on "substance" and the potential for more public transparency in respect of their tax return information and allocation of profits.

Portugal hikes taxes on investment income and assets

Law 55-A/2012, published in Portugal's official gazette on 29 October 2012, included various austerity measures and tax rises that may affect non-residents. In particular, the tax rate on certain investment income is increased significantly. The law applies generally as from 30 October 2012, although some changes apply retroactively as from 1 January 2012.

The tax rate on investment income derived by non-resident entities that are subject to a beneficial tax regime in their country of residence and appear on Portugal's blacklist is increased from 30% to 35%. The same rate increase applies to investment income of non-resident entities that is paid or made available in bank accounts of one or more holders if the beneficial owner's identity is undisclosed.

New stamp duty rates apply to buildings whose value for municipal property tax purposes exceeds €1 million. The rate is 1% for urban residential property and 7.5% for urban property owned by a company that is resident in a jurisdiction on Portugal's blacklist. For the calendar year 2012, the rate was 0.5% or 0.8%, depending on whether the property had been valued under the annual municipal property tax code.

New rules were also introduced for the assessment of taxable income for personal income tax based on "displays of wealth", which assess if a taxpayer's reported means justify the value of an acquisition. The threshold for declared income has been reduced from 50% to 30% below the "deemed" income for ownership of certain assets such as real estate, cars, pleasure boats, private aircraft and shareholder loans.

In addition, amounts transferred from or to deposits of securities accounts opened by a taxable person in financial institutions resident in jurisdictions with a beneficial tax regime where the identity of the beneficial owner is not disclosed are now deemed to be a sign of wealth. In this case, the standard income is deemed to be the sum of all transfers. These rules apply as from 1 January 2012.

Sovereign Comment

It was hoped that it might be possible to appeal against the new stamp tax demands if the tax value of a property had fallen below €1 million during 2012 but investigation found that the tax value taken into consideration in the calculation of the stamp duty is as at 31 December 2011. In 2013, those properties whose tax value remains above €1 million as at 31 December 2012 will continue to be charged under this new tax. Sovereign is taking legal advice for an opinion as to whether this tax may be unconstitutional.

German court imposes gift tax on trust distributions

The German Federal Tax Court (Bundesfinanzhof) held, in a decision on 27 September 2012, that all distributions from foreign trusts to beneficiaries with their residence or habitual abode in Germany are subject to the German gift tax. This rule applies to both discretionary and fixed-interest trusts and regardless of whether a trust distributes income or part of its assets.

The tax treatment of foreign trusts under German law has been uncertain. German civil law does not recognise the concept of a common law trust and Germany has not acceded to the Hague convention on the law applicable to trusts, so German legislators and the tax authorities have never set out specific rules on the taxation of trusts. Only in 1999 was the German Inheritance and Gift Tax Act (GGTA) amended to explicitly include some events relating to foreign trusts.

The Federal Tax Court has now followed the revenue service and a 2010 decision of the Tax Court (Finanzgericht) Baden-Wuerttemberg in holding that any distribution of trust income or trust assets to beneficiaries with residence in Germany will be subject to German gift tax, regardless of whether such distributions are also subject to German income tax. Establishing a trust for estate planning purposes should be very carefully considered if either the settlor or any beneficiary is resident or has his or her habitual abode in Germany. Multinational families may also have children, grandchildren or other relatives residing in Germany who are or may become beneficiaries of a trust.

UK Supreme court rules against oil trader in divorce case

The UK Supreme Court held, on 12 June 2013, that the English family courts could in effect "pierce the corporate veil" in a divorce case because the companies involved actually held their assets on trust for the ex-husband as beneficial owner. The decision sets a precedent for anyone seeking to protect possessions from a former partner by setting up a company.

In a unanimous decision, the Supreme Court upheld an appeal by Yasmin Prest, the ex-wife, who was seeking a share in seven properties in London and the Caribbean owned by Petrodel Resources Ltd and several related companies that were registered in the Isle of Man. At an earlier hearing, oil trader Michael Prest had been ordered to pay a lump sum of £17.5 million to the wife. He had failed to do so, claiming he was £48m in debt.

Prest and his companies appealed and in October 2012 the England and Wales Court of Appeal (EWCA) found that the High Court had been too ready to override the strict rule of company law that a company's assets did not belong to its shareholders, and that the "corporate veil" could not be pierced just because the claimant was an ex-spouse.

Yasmin Prest appealed to the Supreme Court. Delivering its ruling, Lord Justice Sumption said that because her ex-husband had failed to comply with court orders with particular regard to disclosing evidence, adverse inferences could be drawn against him. "The court inferred that the reason for the companies' failure to co-operate was to protect the properties, which suggested that proper disclosure would reveal them to [be] beneficially owned by the husband," he said.

Sumption explained that Prest had bought the family home in the name of a company that had no resources at the time. He must therefore have bought it with his own money such that the property was held on trust for the person who paid for it. The same principle applied to seven investment properties. Although the evidence that Prest had paid for them himself was far from conclusive, he had made no attempt to rebut it. "The court is entitled to draw all proper inferences against a party whose conduct shows that he has something to hide," Sumption concluded.

The Court therefore ruled unanimously that the assets of Prest's wholly owned companies should be counted as his own for the purposes of his divorce. It restored the High Court's original order and instructed the Petrodel companies to transfer the disputed assets to Mrs Prest. In his written ruling, Sumption said that whether this rule would apply to other cases would depend on their facts, but that "in the case of the matrimonial home, the facts are quite likely to justify the inference that the property was held on trust for a spouse who owned and controlled the company."

Sovereign Comment
By ruling in favour of Mrs Prest, the Supreme Court recognised that all assets in a marriage must be assessed to achieve fairness in a divorce – even if that means "piercing the corporate veil" when it is fair and just to do so. This judgment should not have an impact on companies that are properly run and which properly own the assets held in their names.

It is difficult to see how this structure gave Mr Prest any advantage. Even if the court had decided that the corporate veil should not be pierced, Mr Prest would still have owned the shares in the companies and, as these would have a value equivalent to the assets, his net worth would be the same. A much stronger position would have resulted if the shares in the companies or the assets themselves had been transferred into trust. Trusts set up in advance of – or even during – a marriage tend to be excluded in a matrimonial settlement. If a husband or wife wishes to keep assets outside the "matrimonial pot" they would be much better advised to negotiate a prenuptial agreement and transfer assets into trust prior to marriage.

41 legal

Billionaire toymaker pleads guilty to Swiss tax evasion

US billionaire Ty Warner, founder of "Beanie Babies" stuffed toy maker TY Inc., pleaded guilty in a federal court in Chicago on 2 October 2013 to evading US taxes by failing to pay $885,300 in taxes on $3.1 million in income held in a secret Swiss offshore account.

Prosecutors alleged that Warner, whose net worth is estimated at $2.6bn by Forbes magazine, set up an account with UBS in 1996 and transferred the account with a balance of $93m to Zurcher Kantonalbank in late 2002. He failed to report $24.4 million in income from 1999 to 2007 and failed to pay taxes of about $5.6 million.

In court, Warner acknowledged that he told no one of his foreign bank accounts, not even his accountants. He had concealed his identity by placing the account in the name of a foundation.

According to his plea agreement, Warner faces up to five years in prison for one count of tax evasion. He also agreed to pay a civil penalty of $53m for failure to file a Foreign Bank Account Report (FBAR).

In 2009 UBS agreed a settlement with the US government under which the bank agreed to pay $780m in penalties and turn over the account information of thousands of US clients. Since that time, the US has prosecuted 68 US taxpayers, three Swiss banks, and 30 bankers, lawyers and advisers. The IRS has also offered several amnesty programmes since 2009, allowing US taxpayers who had failed to report offshore accounts to pay penalties but avoid prosecution. Warner applied to the voluntary disclosure programme in 2009 but was rejected.

UK Tribunal deems painting a "wasting asset"

The UK's Upper Tribunal ruled, on 18 March 2013, that a £9.4 million painting fell into the category of "plant and machinery" as defined by the Taxation of Chargeable Gains Act 1992 and no tax was therefore payable on its sale more than 10 years ago.

Omai, a portrait by Sir Joshua's Reynolds dating from 1776, was part of the estate of Sir George Howard, who died in 1984. It was sold at Sotheby's in 2001. His executors argued that, as the painting had been on loan to the estate company of Castle Howard since 1952, it should be viewed as "plant" used in the running the house as a business and thus exempted from capital gains tax.

Mr Justice Morgan accepted their plea that the painting was part of the "functional apparatus" of the company and should therefore, under section 44 of the 1992 Act, be classified as a "wasting asset" after it was placed on public display – even though its value has in fact continued to increase. No tax was therefore payable on the sale.

Sovereign Comment
This decision seems to be very good news for art collectors but the UK revenue (HMRC) is expected to appeal. Art is generally not a wasting asset but an appreciating one. The decision therefore seems illogical and is likely to be overturned. However, there are better and more certain ways to achieve a similar result. Art collections can often be owned advantageously by an offshore trust structure and leased back to the settlor. With careful structuring, such an arrangement would avoid capital gains tax and, more importantly, inheritance tax.

Canadian Supreme Court rules on tax residency of a trust

The Supreme Court of Canada issued a landmark ruling in 2012, in a case involving determination of a trust's residency for tax purposes. It held that two Barbados trusts with Canadian beneficiaries were resident in Canada because the trusts' central management and control was in Canada, even though the trustee resided in Barbados.

In *Fundy Settlement v Canada* [2012 SCC 14], the case involved two family trusts settled by an individual resident in St. Vincent in the Caribbean for the benefit of Canadian resident beneficiaries. The trustee, a corporation resident in Barbados, disposed of shares that the trusts held in two Ontario corporations and the purchaser remitted some C$152 million to the Canadian Revenue as withholding tax on account of Canadian tax from capital gains of about $450 million realised by the Barbados trusts on the sale of the shares.

The trustee subsequently applied for a refund based on an exemption from Canadian capital gains tax under the Canada-Barbados tax treaty. Under this treaty, tax is only payable in the country in which the seller was resident. The trustee claimed that because it was resident in Barbados, the trusts were also resident in Barbados. As a result, there was no basis for withholding tax in Canada.

The Canada Revenue Agency (CRA) refused the request for a refund on the grounds that the trusts were resident in Canada for tax purposes. This decision was upheld in the Tax Court and the Federal Court of Appeal. The trustee then appealed to the Supreme Court.

The Supreme Court followed the Tax Court in finding many similarities between a trust and a corporation. "The function of each is, at a basic level, the management of property," it said. As with corporations, therefore, the residence of a trust should be determined by the principle that the trust resides where "its real business is carried on", which is where the central management and control of the trust actually takes place.

In this case it found that the trustee did not have responsibility for decision-making beyond the execution of documents as required and did not exercise its powers and discretions under the trust deeds. Rather it followed the recommendations of two of the principal beneficiaries, both of whom were resident in Canada. Further, the terms of the trusts effectively provided that the protector could replace the trustee and that a majority of the beneficiaries could replace the protector. The trusts and beneficiaries also shared the same tax and investment advisors

Sovereign Comment

Although this case dates from last year it is included because it shows how important it is that trusts are properly administered from the location of the trustees and that trustees can demonstrate that they exercise their powers to manage and control the trust fund. The role of a trustee is not just to provide administrative services and trustees should not allow beneficiaries, or other persons, to make decisions on behalf of a trust.

UK Appeal Court rejects stamp duty avoidance scheme

The Appeal Court rejected, on 13 August 2013, a scheme used to avoid £2.6 million stamp duty (SDLT) on the purchase of a building in London's Regent Street. The scheme was designed to take advantage of the sub-sale rules for SDLT, as well as the rules that deal with transfers of interests to partnerships.

DV3 Regent Street Ltd (DV3), a property fund, set up a BVI limited partnership with three connected companies and a unit trust. DV3 had a 98% interest in the partnership. On the same day that it acquired the head leasehold interest in the former Dickins & Jones shop building, DV3 transferred it to the partnership.

It argued that because DV3 and people connected to it were the partners in the partnership, the SDLT partnership rules meant that the property was treated as transferred for nil consideration and no SDLT was payable.

HM Revenue and Customs (HMRC) accepted that the scheme was designed for genuine commercial reasons but disagreed with the principle that no tax was paid. It first challenged the scheme in the Upper Tribunal – which found that the scheme worked – and then took the case up to the Court of Appeal.

Lord Justice Lewison held that the scheme had merely shifted the obligation to pay SDLT from the company to its partnership. The Court of Appeal agreed with HMRC that the SDLT partnership rules did not apply in that situation and tax was due on the full purchase price. DV3 now intends to take the case to the Supreme Court for a final ruling. The ruling affects 87 follower cases, totalling £68 million in tax.

Sovereign Comment

It is undoubtedly becoming more and more difficult to avoid tax generally and stamp duty in particular. Despite this there are still legal and compliant ways in which the normal levels of stamp duty can be reduced from the higher levels to 1% or 2%. Recent changes mean that most, but not all, stamp duty reduction techniques will no longer work. Certainly counsel's opinion should be sought prior to implementing any such scheme. Sovereign can arrange this upon request.

legal

41

Italian designers receive jail sentences for tax evasion

A court in Milan handed, on 19 June 2013, Italian fashion designers Domenico Dolce and Stefano Gabbana suspended prison sentences of 20 months for evading around €400 million in taxes on the sale of their D&G and Dolce & Gabbana brands to a company in Luxembourg in March 2004.

A judge ruled that the pair, who are the joint owners of the multinational fashion group, had avoided declaring taxes on royalties of about €1 billion by selling their brands to Gado, a Luxembourg-based holding company, which later took control of the business.

Prosecutors said the sale of the brands to Gado enabled them to avoid a higher rate of tax in Italy, thereby defrauding the Italian state. They alleged that the designers had "participated actively" by "signing the contracts for the sale of the brands" and sought prison sentences of up to 30 months.

The judge also ordered the designers to pay €500,000 each as a first instalment of a fine that could reach €10 million. They were acquitted of filing inaccurate tax returns but still risk a possible tax bill of more than €400 million as a result of the case. The jail sentences are suspended pending appeals and they are unlikely to serve any time because of the length of the appeals process in Italy.

Investigations began in 2007. A court cleared the designers of the allegations of tax evasion and fraud in 2011 but last November the Supreme Court in Rome overturned that acquittal and ruled that they could be prosecuted for tax evasion, though not for fraud.

Inheritance tax U-turn: expats must plan ahead

A version of this article by Howard Bilton, chairman of The Sovereign Group, first appeared in *The Daily Telegraph*.

The UK's coalition government has reneged on the Conservative Party's pre-election pledge to reform the inheritance tax system. George Osborne, the Chancellor, announced in February that the level at which inheritance tax becomes payable will remain frozen at £325,000 until at least 2019 to fund reform of the social care system.

Before the election, the Conservatives had pledged to increase the inheritance tax limit to £1 million – with both Osborne and David Cameron saying that the right to pass on untaxed assets was a "most basic human instinct". This little non-change could cost some families £270,000. Expats may think that they need not be concerned. They would be wrong.

Most UK expatriates fail to realise that they remain domiciled in the UK and therefore subject to UK inheritance tax (IHT) even if they have lived abroad for many years. IHT is charged at a rate of 40% of the amount by which the total value of their worldwide estate exceeds the nil rate band of £325,000 (or £650,000 per married couple).

There is an exemption from the tax for transfers between spouses but only if they are both domiciled or not domiciled. This catches many expats who have married foreign spouses. The exemption only delays the tax, which then hits on the death of the survivor and often comes as a nasty and very costly surprise to the family of a deceased UK expatriate.

Collection of IHT is generally quite simple for HMRC, the UK revenue service. Most expats will have assets in the UK. Many will have made a UK will. Probate is the process whereby the executors are granted permission to take over the assets of the deceased and distribute them to the heirs named in the will. A grant of probate cannot be given without a tax clearance and payment of any IHT due.

Even the estates of expats that contain no UK assets may still face an IHT claim. Tax treaties and other international agreements contain clauses under which foreign governments are duty bound to help collect tax and may well mean that a death abroad gets reported back to the UK. Expats would be foolish to hope they won't get noticed. They would be wise to plan.

So what should a UK expat do? First and foremost they should check their domicile to see whether they need to be concerned. Under UK law a person must have a domicile but cannot have more than one. A person will usually take his father's domicile at birth. This is the Domicile of Origin. From the age of 16 a person can obtain their own Domicile of Choice by establishing a new permanent home.

Many UK expats go abroad to work or live for a temporary or indefinite time and intend to return to live in the UK at some stage in the future. If they do intend to return to the UK to live they will remain UK-domiciled even if they have lived abroad for many years.

Others have no intention to return to the UK but move from place to place so do not establish a new permanent home outside the UK. Others do not cut their ties with the UK sufficiently to lose their domicile of origin even though they have been abroad in one place for many years. All of these will remain UK-domiciled.

"Expats would be foolish to hope they won't get noticed. They would be wise to plan."

The legal test of domicile is one of intent alone. If the expat has established a new permanent home in another country and intends to remain in his new country indefinitely, he or she will have established a new domicile. HMRC would look for this intent to be evidenced by a show of real commitment to the new country. It looks for factors such as: the purchase of a house; taking steps to become a national/permanent resident and a long period of residency; establishment of a business and other financial ties; establishment of social, religious and political ties; disposal of the family home in the UK; ownership of a burial plot in and making one's main will under the law of the new country; education of children in the new country; relinquishing the right to vote in the UK and taking up such rights in the new country; severance of business and social ties within the UK.

Unhelpfully HMRC will not give rulings on domicile or give any indication of what they think about a person's domicile. If an expat were to write to HMRC outlining their facts and circumstances and asking them whether they think they were domiciled or not, it either won't reply or will just tell them to consult a tax expert. What a service!

It used to be possible to force a ruling by filing a return reporting a "chargeable transfer" obliging HMRC to decide on the matter. This was done by transferring an amount in excess of the lifetime and annual exemptions – say £400,000 – into a discretionary trust. The excess is taxable at 20% if the transferor is domiciled. If HMRC agreed no tax was due, it had effectively agreed that you were no longer domiciled in the UK.

HMRC was reluctant to give these rulings and many who had gone to the trouble of making and reporting the chargeable transfer waited many months or even years for a reaction. Now HMRC refuses to react at all unless "there is considerable tax at stake". Again unhelpfully, HMRC won't confirm how much that is. Suffice it to say that it is a lot and the risk is not acceptable so this procedure is no longer recommended. The alternative is to obtain legal counsel's opinion. This can be done quickly and relatively cheaply.

Once a new domicile has been obtained, UK IHT liability disappears on all but UK assets. It is relatively easy to convert UK assets into non-UK assets and eradicate UK IHT on those as well. Be aware, though, that just because UK IHT may not apply there may still be liability to IHT or estate duty in the new country and individual assets may be subject to IHT in their country of situs.

And there is an additional danger. UK IHT no longer applies only for as long as that new domicile is retained. If for any reason the non-dom moves country it is often the case that the new foreign domicile is lost and the UK domicile of origin is revived. The good news is that anything transferred into trust remains outside the scope of IHT so standard planning is to transfer as much as possible into trust immediately after obtaining opinion. This should get rid of IHT forever. However transfers into trust would attract a lifetime IHT charge of 20% if the transferor is domiciled. Hence the need for certainty on this issue.

For those expats who are still domiciled, there are other strategies available. If all assets are given away at least seven years before death there would be no IHT. Most, quite understandably, don't want to do this as they would then have to rely on family to maintain them for the rest of their lives.

Transferring all assets to a family limited company can eradicate IHT. With such companies the donor of the assets would normally keep the voting and income shares so they can control the company and maintain themselves but would give away the capital shares seven years before death, removing value from their estate. A transfer of assets to a qualified non-UK pension scheme (QNUPS) also removes assets from the estate as long as this is done to provide a bona fide pension income rather than as part of an IHT plan.

One way or another it's best to know where you stand and plan appropriately. To a certain extent it is true to say that IHT is one of the easier taxes to plan against but it is necessary to start planning early. The Chancellor has just clarified the need for even those of relatively modest wealth to pay attention if they want their family to benefit from their lifetime of work rather than HMRC.

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