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issue twenty
may 2005

UTLANDSJURISTEN

report

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the utlandsjuristen report

issue **twenty-one – august** 2005

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Change your domicile

Over the last few years we have built up substantial expertise in convincing the UK Inland Revenue that long-term UK expatriates have rid themselves of their UK domicile and therefore their liability to UK inheritance tax at a rate of 40% on their worldwide estate. We have recently processed a number of such cases in record speed and have retained our 100% success record.

There have been three reported decisions on domicile recently. We will be presenting a special feature on this in the next edition of the Report. All these decisions illustrate the wisdom of resolving this matter as soon as possible so that appropriate plans can be made. In all three cases the matter was not dealt with during lifetime so it was left to others to argue the case after death, which, as the test is essentially subjective, creates substantial difficulties. The very large costs entailed could have been avoided if steps had been taken earlier.

In short, we would repeat our contention that, if you have the best interests of your family at heart, you should let us examine your situation early. Why leave your money to the taxman when it could go to your nearest and dearest?

Shanghai Office

We are progressing well with plans to open a representative office in Shanghai. It is to be headed up by Mr Sunny Liew, a lawyer of many years experience and a Malaysian national.

Further details will appear in the next report but the office will be offering tax planning to those already living in China and entry services to those who wish to do business there.

Sovereign Asian Art Prize

We have just concluded the second year of this successful charitable venture and in the process raised around US$150,000, which will be donated to good causes in the field of the arts. Last year's money has already been spent in establishing a scholarship which is run by the respected Asian Cultural Council. Contributions have also been made to the Cambodia Peace Art Project, which teaches young Cambodian artists to make sculptures out of decommissioned weapons.

We are pleased to announce that Sotheby's, Cathay Pacific and Bulgari will all be helping us again with the Asian Art Prize this year. In Europe our sponsors include auctioneers Bonhams, brewers Heineken, Joseph Perrier champagne and the City Inn Hotel Group.

Trust services in the Isle of Man

The Fiduciary Services Act 2005 in the Isle of Man, which introduces a licensing system for Trust Service Providers (TSPs), completed its legislative passage on 13 July 2005 and was brought into force by Appointed Day Order. This Order includes transitional arrangements to allow existing TSPs to continue in business until their TSP licence application has been decided, provided they apply for a licence by 31 October.

Sovereign is committed to ensuring that its compliance and legal obligations, and those of its clients, are met. We have applied for and obtained appropriate licences and authorisations in every jurisdiction in which we operate, where it is possible to do so. Interestingly no licence is required in many of the onshore jurisdictions that complain so vociferously about the offshore centres!

Sovereign Trust (IoM) already holds a Corporate Service Providers (CSP) licence and will be applying for a TSP licence at the earliest opportunity. At present the majority of The Sovereign Group's trust business is executed under the trust laws of Gibraltar or the Turks & Caicos Islands where we hold existing professional trustee licences. It is anticipated that the new licensing system for TSPs in the Isle of Man will enable us to increase the volume of trust business we carry out under Manx trust law.

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Chairman of The Sovereign Group

EU Savings Tax Directive comes into force – except in Gibraltar

The much-stalled EU Savings Tax Directive was thrown into disarray on the day of its implementation, 1 July 2005, by the disclosure that the new rules do not apply between the UK and Gibraltar. Dawn Primarolo, the UK Paymaster General, and the Government of Gibraltar issued a joint statement saying that the Directive was in place but that, as the UK and Gibraltar are not separate member states, the rules do not apply between them.

"The UK and Gibraltar Governments are in discussion and working together with a view to agreeing arrangements to close this gap between them as soon as possible during the next few months, on terms that would offer a choice between exchange of information and withholding tax," it said.

The 2003 Directive applies to all 25 EU member states, together with their associated and dependent territories, and has also been extended by agreement to key third countries. Other UK associated and dependent territories have called for a suspension of the Directive because, without Gibraltar, it is no longer a "level playing field". Bermuda is also conspicuous by its absence.

Of EU members, 22 are required to share information about interest payments regarding the identity of the benefactor, residence, the payer of the interest, account number and the type of debt on which the interest is being paid. Anguilla, Aruba the Cayman Islands and Montserrat will also exchange tax information on interest payments made to EU residents.

Although they will not participate in the exchange of information, Austria, Belgium and Luxembourg are to impose a withholding tax on interest income during a transitional period. The withholding tax, 75% of which will be paid to the country of the taxpayer's residence, will be 15% until 2008, 20% until 2011 and 35% afterwards.

Agreements have also gone into effect under which Andorra, Liechtenstein, Monaco, San Marino and Switzerland will apply similar arrangements. The British and Dutch territories of the British Virgin Islands, Guernsey, the Isle of Man, Jersey, the Netherlands Antilles, and the Turks & Caicos Islands will also apply the withholding tax over the same period.

Sovereign comment

The EU has been debating savings tax since 1989, so it beggars belief that Gibraltar has slipped through the net. It remains to be seen how effective the Directive will prove to be and the European Commission's head of tax policy Michel Aujean said the EU would continue to monitor its progress, in particular against the development of more sophisticated financial products or signs that investors are moving their savings elsewhere, particularly Asia. He said the EU aimed to start talks with Singapore and Hong Kong. For further detail on the EU Savings Tax Directive see page 9 of this Report.

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UK targets chargeable gains

A Finance (No. 3) Bill is to include new measures to counter avoidance of capital gains tax (CGT). The measures were announced in the 2005 Budget and apply to disposals carried out on or after 16 March 2005.

The Bill provides that nothing in the terms of a relevant tax treaty will prevent the UK from taxing gains arising to trustees in any case where a disposal is made in a year in which the trustees are at some time resident or ordinarily resident in the UK and not at the same time treated as resident in another territory by the provisions of a treaty. The range of assets that are treated as located in the UK for CGT purposes is also to be expanded.

Bilateral treaties with Belgium, Portugal and Austria have also enabled UK nationals to claim non-resident status just one year after leaving the UK. It is now proposed that any capital gains will remain liable to CGT with credit being given for any taxes paid in the other country. As a result, individuals will have to remain outside the UK for at least five complete tax years to avoid CGT.

Sovereign comment

It is still possible to mitigate CGT by converting a gain into income and then taking a distribution while resident abroad. In this case, the individual would only need to stay non-resident for one complete tax year to avoid the tax on income.

The Netherlands proposes corporate tax reform

The Dutch government published a white paper on 29 April 2005 outlining proposed changes to its corporate tax system that are intended to make the Netherlands more competitive for corporate investment.

The main proposal is to reduce the corporate income tax rate from 31.5% to 26.9%. An earlier proposal had called for a reduction to 30% by 2007. The Netherlands has supported moves for tax harmonisation within the EU, if combined with the establishment of a minimum tax rate, but wishes to establish a more attractive tax regime in the short term.

The participation exemption would also be simplified so as to apply to all shareholdings of 5% or more, regardless of whether the shares are held as a passive portfolio investment or whether the subsidiary is taxed on its profits. The 0.55% capital tax would be abolished as of 1 January 2006.

The white paper is to be discussed in parliament. The proposals are expected to result in a draft bill that will be considered by parliament in 2006 and brought into force on 1 January 2007.

Sovereign comment

The Netherlands is probably the top jurisdiction for royalty planning – there is no withholding tax on royalty payments made by a Dutch company to a non-resident. Tax is paid only on the margin (7% minimum) between the royalties received from the sub-licence agreement and those paid out under the master licence, so any reduction to the corporate income tax rate will bring a slight benefit. The Netherlands is also popular for holding companies because, subject to certain conditions, it does not tax dividends on arrival. Any simplification of the participation exemption rules is therefore to be welcomed.

Wealth Report anticipates slower growth in 2005

By comparison to 2002 and 2003, which saw the wealth of high-net worth individuals (HNWIs) grow at rates of 2.7% and 7.7%, respectively, 2004 was a better year, according to the Merrill Lynch–Capgemini World Wealth Report 2005. The two primary drivers of personal wealth generation – GDP growth and increase in market capitalisation – worked in concert to drive HNWI wealth growth at a faster than expected rate of 8.2%.

The USA and Asia-Pacific drove the pace and, significantly, North America surpassed Europe both in total HNWI population and wealth for the first time since 2001. The US, the country with the largest HNWI population, saw 226,000 more people join the ranks of wealthiest Americans, an annual growth rate of 9.9%. Canada also performed well, adding almost 17,000 HNWIs.

Europe's HNWIs grew at the far slower rate of 4.1%, a result of the continued low growth of its largest economies: France, Germany and Italy. Despite low interest rates across most of Western Europe, high tax burdens in the region hindered personal wealth accumulation. Against this backdrop, HNWI population growth in the UK and Spain, at 8.9% and 8.7%, respectively, appeared to be significant.

The Asia-Pacific region enjoyed much higher growth rates, with the HNWI population increasing by 8.2% and HNWI wealth advancing by 8.5%. Within the Asia-Pacific region, Singapore, Hong Kong and Australia showed impressive growth in HNWI populations, gaining 22.4%, 18.8% and 14.8% more members, respectively.

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The outlook for 2005 was for a period of slower growth, and HNWIs would have to navigate carefully to maintain and enhance their wealth. The Report predicted HNWI wealth to grow at a 6.5% compound annual growth rate and to reach US$42.2 trillion by 2009.

Sovereign comment
The Report also found that a significant number of HNWIs were increasingly concerned with the management of their wealth and wanted a more coordinated service to protect and grow their assets. This group, identified as "Mid–Tier Millionaires" (MTMs), with between USD 5–30 million in investable assets, represent about 9% of the world's HNWIs and tend to be corporate executives or owners of small to mid–sized businesses, for whom earned income represents the largest portion of their financial assets.

While MTMs needed products and services that are often as complex as those of much wealthier individuals, they lacked the financial resources needed to access a family office, and instead relied on a fragmented group of specialist advisors instead of a single source. The Sovereign Group has developed a comprehensive advisory service, embracing asset management, investment and financing, banking, intellectual property, yacht registration, property holding, in addition to the provision of corporate and trust services and estate and tax planning. We believe this gives us a distinct competitive advantage.

US bill targets "tax haven" CFCs

US Senators Byron Dorgan and Carl Levin introduced a bill on 12 April 2005 that would treat controlled foreign corporations (CFCs) set up in "tax havens" as domestic corporations for US tax purposes.

Under the Bill, the Internal Revenue Code would be amended to include a new provision (s7875), which would treat a foreign corporation as a "tax haven CFC" if it was organised under the laws of a "tax-haven" country and was a CFC for an uninterrupted period of 30 days or more during the taxable year.

As proposed, the bill would apply to taxable years beginning after 31 December 2007 and would include a "blacklist" of tax haven countries that would be subject to the new rule. An exception would be provided if substantially all of the CFC's income for the taxable year was derived from the active conduct of a trade or business within the "tax haven" country.

Sovereign comment
The move pre-empted the release of a General Accounting Office (GAO) study which found that 59 of the top 100 publicly traded federal contractors had set up subsidiaries in offshore jurisdictions. They included some of the biggest names in US business, such as: Fluor Corporation, which received US $932 million in federal contracts and had 27 offshore subsidiaries in Bermuda, Barbados and Mauritius; Exxon-Mobil which received $707 million and had 11 offshore subsidiaries in the Bahamas; and Halliburton, which received $534 million and had 17 offshore subsidiaries, including 13 in the Cayman Islands. In conducting its analysis, the GAO used the list of 39 "tax havens" compiled by the OECD in 2002.

Uruguay commits to major tax reform

The Uruguayan government pledged broad tax reform and a major overhaul of the tax administration in a Letter of Intent to the International Monetary Fund, sent on 24 May. It is to submit a detailed tax reform plan to the Parliament in December, with suggested effect from mid-2006. The goal is to extend the tax base and increase taxes overall.

In terms of direct taxes, one of the government's main proposals is the reinstatement of a comprehensive personal income tax. The new administration also has said it intends to reform and rationalise taxation, including corporate tax.

Once the tax reform starts to yield benefits, the indirect tax burden will be reduced, and several minor distorting taxes will be eliminated, the government said. To further strengthen tax collections, the government is planning general changes in the country's tax management system, with a special emphasis on reducing tax evasion and improving the efficiency of the tax collection agencies.

Sovereign comment
It is clear that tax evasion has been and may still be common amongst residents of the South American region. As the tax authorities get more serious about tax collection there will be an increasing need for sophisticated advice and compliant tax saving structures. Sovereign has had a presence in the region for some time and would be pleased to help.

China to restrict offshore investment by PRC individuals

Chinese residents must for the first time get approval from the State Administration of Foreign Exchange (SAFE) before starting or investing in an offshore company, according to notices from the regulator dated 24 January and 8 April 2005. The new rules are designed to stop companies setting up overseas to strip state-owned assets and avoid paying domestic taxes.

The regulations introduce two approaches to monitoring the offshore investments of PRC individuals. First, overseas investments by PRC individuals are now subject to approval procedures similar to those that apply to Chinese companies so that all “PRC residents” investing overseas for the purpose of establishing or controlling an offshore company must obtain the approval of the SAFE and the Ministry of Commerce (MOFCOM).

The second approach restricts foreign exchange registration of certain foreign invested enterprises (FIEs). All PRC residents who intend to acquire any overseas equity or other property interests in exchange for domestic equity or assets must also obtain certain additional SAFE approvals in forming the FIE.

Although the new rules do not have a retroactive effect, the local SAFE is required to identify any existing FIEs that fall in the above category and to monitor closely the foreign exchange-related activities of such FIEs.

Meanwhile Donald Tsang, Hong Kong’s former chief secretary and acting chief executive, was automatically selected as Hong Kong’s new chief executive on 16 June after Beijing’s electoral committee declared him to be the only valid candidate. He was formally inaugurated on 23 June in Beijing, replacing the former chief executive Tung-Chee Hwa, who resigned in March.

Tsang has pledged to maintain Hong Kong's "simple low-tax regime". He also plans to review the existing structure of the executive branch with a view to improving efficiency. Beijing has insisted that the new chief executive will initially only serve out the remaining two years of Tung’s five-year term of office.

Sovereign comment

It had become common practice for Chinese nationals to set up offshore companies to reinvest back into China and, at the same time, to secure tax breaks intended for foreign investors. This practice is common elsewhere, notably India, and is often referred to as "round tripping". There are many unresolved issues relating to the SAFE regulations and it remains to be seen how they will be implemented. The Beijing-based China Venture Capital Association has called for consultation and a revision of the rules. Chairman Chang Sun said: “SAFE has valid concerns about people transferring assets offshore, but the rules as currently published are impractical, hard to implement, and detrimental to foreign investment in China.''

Singapore Advance Ruling System

A guide to the advance ruling system, due to be introduced in Singapore as of 1 January 2006, was issued by the Inland Revenue Authority of Singapore (IRAS) on 8 June. Previously the IRAS has provided advance rulings to taxpayers for proposed business arrangements upon written request, but these have not been legally binding.

The circular sets out that a ruling request should involve an interpretation of Singapore tax law and how the law applies to a specific taxpayer and a proposed arrangement that is seriously contemplated by the taxpayer. The advance ruling system will only be applicable to income tax matters.

An advance ruling is final. If a taxpayer disagrees there is no requirement to follow it, but when completing an income tax return, the taxpayer should indicate its existence and whether it was relied on. The comptroller may withdraw an advance ruling at any time by notifying the applicant in writing with reasons. It will also cease to apply if a relevant provision of the Income Tax Act is amended.

Sovereign comment

Opinion is mixed on whether advance rulings are a good idea. In theory they give certainty, but in fact they tend to be so specific that it can be difficult to ensure that an arrangement follows the ruling exactly. They can also highlight the affairs of a particular taxpayer and may serve to attract additional unwelcome scrutiny from the tax authority.

New Zealand to introduce reporting for foreign trusts

New Zealand is to introduce reporting requirements for New Zealand resident foreign trusts, Revenue Minister Michael Cullen announced on 29 April. Under the proposal, foreign trusts with New Zealand resident trustees will be required in the future to report tax information to New Zealand's Inland Revenue Department (IRD).

Under current New Zealand law, foreign trusts that have New Zealand resident trustees but no New Zealand source income are not required to provide any information to the IRD. This, said Cullen, created difficulties when countries with which New Zealand has a tax treaty seek information on trusts with a New Zealand presence – requests those countries are entitled to make under the treaties.

In July 2004, Cullen agreed, in principle, to introduce legislation changes to impose some record-keeping and filing requirements on foreign trusts with New Zealand resident trustees, and two rounds of consultations have been held.

As a result New Zealand will require resident trustees of foreign trusts to provide limited information to the IRD and maintain financial records in New Zealand for each trust. Also, at least one New Zealand resident trustee of each trust will be required to be a member of an IRD-approved organisation, such as an accounting or legal firm. Changes to the reporting requirements for foreign trusts will apply from April 2006.

Sovereign comment

As regular readers of this report will know, all OECD members and all OECD-identified "tax havens" have pledged to introduce full exchange of information upon request, so this is just an extension of that process. New Zealand is starting to become a premier trusts jurisdiction and its success in this area has prompted this attention. We would remind clients that good planning does not, and never will, rely on confidentiality for success. Any arrangement should be able to withstand scrutiny from any relevant tax authority.

Hong Kong Court rejects Ramsay in estate duty case

On 5 January 2005, the Court of First Instance held that the *Ramsay* principle could not be applied to disregard the round-robin finance and assess as gift inter vivos, the sale of two landed properties by the deceased (X) to a Hong Kong company controlled by his son.

In *Graceful Mark Ltd v The Commissioner of Estate Duty*, the company acquired two properties with a total market value of HKD 15.3 million from the deceased four days before his death. The company used a HKD 10.58m bank loan to fund the purchase. X remitted the disposal proceeds to Macao where he gave the money to his son as a gift.

The son, a director of Graceful Mark Ltd, lent the money he received from X to the company as a loan from a director. The company subsequently repaid the loan from the bank with the money injected. X's son and daughter-in-law held 90% and 10%, respectively, of the shares in the company.

The Commissioner contended that X's round-robin transactions had no commercial purpose and should be ignored according to the *Ramsay* principle. The sale of properties was in substance a "gift" to the company by X made within the three years preceding his death and the full value of the properties should therefore be subject to estate duty.

But the Court concluded there was a commercial purpose for X to dispose of the properties because X had shown an intent to dispose of the properties a year before his death but the disposal did not take place at that time because of an objection by the co-owner of the properties. It therefore held that the *Ramsay* principle was not applicable and the properties were not a gift within three years of death.

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Sovereign comment
The *Ramsay* principle allows the tax authorities to look at the intent of a transaction and ignore the transaction for tax purposes if it had no commercial reason other than the avoidance of tax. The first successful application of the *Ramsay* principle against a taxpayer in Hong Kong took place in December 2003, in the Court of Final Appeal's decision in *The Collector of Stamp Revenue v Arrowtown Assets Ltd*. The proper approach, according to Lord Millett in this case, was to ask whether the purpose of a statute would be defeated if a transaction was respected. If it was, then the transaction should be disregarded. Generally, that is the result when a transaction has been entered into for no reason other than tax avoidance.

Taxpayer wins central control and management case on appeal

In the last issue of the Sovereign Report (issue 20) we reported on the UK case of *R v Holden*. This judgment has now been overturned in the Court of Appeal but many of the principles outlined in the original case were reiterated and confirmed in the appeal.

In the original case it was found that because directors in the Netherlands did not have sufficient information to make informed decisions about documents they were signing, the company was managed and controlled in the UK.

On appeal, the Court agreed that if the directors of an overseas company had signed documents without due consideration or fully understanding the transactions to which they related, then those directors did not manage and control the company.

It disagreed, however, on the facts finding that the directors had received reports on the transactions from UK accountants whom they had retained as advisors. The directors had also sent the documents for review by the company's Dutch lawyers and the transactions in the UK did not proceed until two directors based in the Netherlands confirmed that it was desirable to do so.

Sovereign comment
We would repeat the comments we made in relation to the original case in Issue 20. It is still the case that offshore directors sometimes receive complex documents with an instruction that they be signed and sent back by return. We would contend that only a fool would sign a document without reading it thoroughly and understanding it. Directors have a need to protect themselves from liability and should always fully understand the document itself and the background to it before signing. This process necessarily involves some time and expense, but is vital to protect the interests of both the directors and the tax status of the company. Good practice onshore is rarely different to good practice offshore and the position of any director should be respected – that process should also ensure that the profits of an offshore company do not become taxable onshore.

ECJ opinion clears way for cross-border loss relief

Marks & Spencer plc, the UK clothing retailer, can claim group relief on losses incurred by subsidiaries in other EU member states, according to Advocate General Luíz Miguel Poiares Pessoa Maduro of the European Court of Justice.

In *Marks & Spencer plc v David Halsey (HM Inspector of Taxes)*, Poiares Maduro found that the UK government's rejection of M&S's claim to offset the losses of its foreign subsidiaries under the UK group relief regime was incompatible with the EC Treaty principle of freedom of establishment. In an opinion delivered on 7 April, he recommended that the ECJ find in favour of the taxpayer.

Poiares Maduro said the UK group relief regime, by limiting the surrender of losses to UK resident companies, was tantamount to an "exit restriction" because it dissuaded companies established in the UK from setting up subsidiaries in other EU member states. It was therefore a restriction of the freedom of establishment.

Sovereign comment
An ECJ decision upholding Poiares Maduro's opinion would have significant ramifications, not just for the UK, but across the whole EU. Over 100 international groups have already made similar claims for loss relief in their UK tax returns, and many other EU member states have group relief regimes that contain elements that may not withstand a challenge before the ECJ. The ECJ decision is expected later this year.

China to unify corporate rates for foreign and domestic firms

Foreign companies in China are to lose their preferential tax treatment from 2007. A proposed transition period would allow investors entering before the date of reform to continue to receive tax exemptions for five years, with companies entering after the reform paying the full, unified rate.

Although foreign-invested firms and domestic Chinese companies are officially subject to the same headline corporate tax rate of 33% at present, foreign businesses actually pay an effective average rate of 11 to 12% through a system of tax breaks and holidays, according to government estimates.

China's present corporate tax laws were introduced on 1 July 1991 and were intended to encourage foreign direct investment. The government has been under pressure from domestic companies to provide a level playing field but has previously postponed reforms so as maintain inward investment. The current move comes in order to satisfy China's obligations as part of joining the World Trade Organisation.

Previous estimates put the anticipated unified tax rate for firms in China at 24% or 25%, but the latest proposed figure is 27%. When the reform is implemented, tax incentives will be retained for companies, both foreign and domestic, in hi-tech, energy-efficient and environmentally friendly industries, while low-end investors will be subject to full rates.

A big concern for foreign companies is how the transition to a new tax system will be handled for those just beginning to build business in China. A proposed transition period would allow investors entering before the date of reform to continue to receive tax exemptions for five years, with companies entering after the reform paying the full unified rate. Any decision on tax reform taken by the State Council will have to be ratified by the National People's Congress, which meets in March next year.

Sovereign comment

We previously advised investors to make investments into the People's Republic of China via a tax treaty partner, we now believe such a route is essential. In our experience the best jurisdictions are Mauritius and Singapore. Not only do these treaties offer substantial reductions in terms of withholding taxes, but both countries have also concluded Investment Promotion and Protection Agreements with China, which are designed to encourage investor confidence by setting high standards of investor protection applicable in international law. Key elements include provisions for equal and non-discriminatory treatment of investors and their investments, compensation for expropriation, transfer of capital and returns and access to independent settlement of disputes.

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Switzerland revokes "50/50" and "80/20" tax practices

Switzerland's long-standing "50/50" and "80/20" tax practices, designed to determine the tax bases of certain corporate taxpayers in cases where it could be difficult to substantiate expenses, was revoked by the Federal Tax Administration as of 1 July.

The move follows criticism by the OECD that the tax practices did not adhere to the arm's-length standard for transfer pricing. Under grandfathering provisions, taxpayers that had obtained 50/50 and 80/20 rulings before 30 June may continue to operate under those tax rules until the end of 2008.

The 50/50 practice, generally applied to reinvoicing companies, estimated deductible expenses to be 50% of gross profit and the 80/20 practice, generally applied to intellectual property (IP) branches, permitted companies to deduct up to 80% of gross foreign-source income. The taxpayer was not required to substantiate the expenses unless claiming expenses higher than 50% or 80%, respectively.

Sovereign comment

Under the new tax practice, all expenses must be commercially justified and documented, and must meet the arm's-length standard. The tax administration will continue to grant advance rulings in specific cases, but will not accept unsubstantiated lump-sum deductions. Our new office in Zurich can advise.

South Africa withholds on non-resident sale of fixed property

New rules published by the South African Revenue Service (SARS) introduce a withholding tax on the proceeds from the sale of immovable property by non-residents, which must be withheld by the buyer. The legislation will come into effect on a date to be determined by the President in the Government Gazette.

The tax, which includes the sale of non-residents' holiday homes and shares in a company, excludes primary residences up to R1 million (US$150,850). If the amount exceeds R2 million, the full amount is subject to the withholding tax at a rate of: 5% if the seller is an individual; 7.5% if the seller is a company and; 10% if the seller is a trust.

An interest in immovable property includes shares in a company where more than 80% of the net value of the company is attributable to immovable property, and the non-resident must hold a minimum of 20% of the equity share of the company either directly or indirectly.

The act places the onus on the buyer to withhold the tax and pay it over to SARS, but only if the buyer "knows or should reasonably have known" that the seller is a non-resident. The withheld amount must be paid within 14 days from the transaction date. Non-resident buyers will have 28 days to pay over the withheld amounts.

Failure to withhold the tax will mean that individual buyers may be held liable for the whole amount, plus interest and a 10% penalty. The obligation to withhold the tax also applies to estate agents and conveyancers, who must give written notification to buyers if the seller is a non-resident.

Sovereign comment

SARS is aware of the profit taking of non-residents in local fixed property speculations. Such profits have been subject to CGT, but this has proved difficult to collect. Hence, the withholding tax. When purchasing fixed property, the buyer should ensure that the estate agent has investigated the vendor's residence status and that there is written confirmation to that effect.

Q&A on EU Savings Tax Directive

The European Union Savings Taxation Directive came into force on 1 July. So did the savings taxation agreements concluded by the EU with Andorra, Liechtenstein, San Marino, Monaco and Switzerland, and by the individual EU Member States with the ten dependent and associated territories of the UK and the Netherlands (Anguilla, Aruba, the British Virgin Islands, the Cayman Islands, Guernsey, the Isle of Man, Jersey, Montserrat, the Netherlands Antilles and the Turks & Caicos Islands).

Effect of the EU Savings Taxation Directive?
Under the Directive, each EU Member State will ultimately be expected to provide information to other Member States on interest paid from that Member State to individual savers resident in those other Member States. But for a transitional period, instead of providing information, Belgium, Luxembourg and Austria will apply a withholding tax on interest income that is paid to individual savers resident in other EU Member States. The rate will be 15% for the first three years (1 July 2005-30 June 2008), 20% for the subsequent three years (1 July 2008-30 June 2011) and 35% from 1 July 2011 onwards). These three Member States will transfer 75% of the tax withheld to the tax authorities of the resident's Member State, retaining 25% to cover their administrative costs. Withholding tax will not be applied if the taxpayer presents a certificate from the tax authorities of his Member State of residence that confirms that they are aware of the investment made abroad (Luxembourg will also allow the individual to authorise the paying agent to disclose the information to the tax authorities).

Income covered by the Directive?
The definition of "interest" in the Directive and Agreements is a broad one, covering interest from debt-claims of every kind, including cash deposits and corporate and government bonds and other similar negotiable debt securities. The definition of interest extends to cases of accrued and capitalised interest. This includes, for example, interest that is calculated to have accrued by the date of the sale or redemption of a bond of a type where normally interest is only paid on maturity together with the principal. The definition also includes interest income obtained as a result of indirect investment via collective investment funds.

Will the Directive give rise to double taxation?
No. The application of the withholding/retention taxes can be avoided if the taxpayer discloses the savings income or allows it to be disclosed to the EU Member State where he is resident. If withholding/retention tax has been levied, the taxpayer's Member State of residence will credit it against the tax due by the taxpayer in that State. If the withholding tax exceeds the tax due in the Member State where he is resident, the Member State of residence will refund the remainder of the withholding tax.

Effect of EU savings taxation agreements with European third countries?
The five "third countries" will apply a retention tax, under the same arrangements as are applicable in Belgium, Luxembourg and Austria, to the savings income of EU residents that is paid in those five countries. The retention tax can be avoided if the taxpayer authorises disclosure of the interest payments to the EU Member State where he is resident. Moreover, these third countries will exchange information on the request of tax authorities of EU Member States in all criminal or civil cases of tax fraud on the part of taxpayers, on the basis of reciprocity.

Effect of the bilateral agreements with EU dependent and associated territories?
The BVI, Guernsey, Isle of Man, Jersey, Netherlands Antilles and TCI will apply a withholding tax during the same transitional period and in the same way as applies to Austria, Belgium and Luxembourg. These arrangements have a reciprocal effect. EU Member States will receive information or tax relating to EU residents with interest income from savings in those territories, but they will also be required to exchange information or apply a withholding tax on interest income from savings that arises in an EU Member State and is payable to a resident of one of those territories. Anguilla, Aruba, the Cayman Islands and Montserrat will provide for automatic exchange of information. These arrangements are not reciprocal as residents of those territories are not taxable on their savings income.

What certificate is required to avoid withholding tax?
The Directive lays down general requirements such as that the certificate must contain details of beneficial owner and paying agent and be valid for a period not exceeding three years. It is a matter for each Member State to decide on the appropriate certificate.

How will tax information be transmitted to other Member States?
The Directive and Agreements lay down the details of the information that paying agents must report to tax authorities, such as the identity and residence of the beneficial owner, the amount of the interest payment and the identification of the debt claim giving rise to the interest. The Council agreed on a standard format that Member States would use to exchange information with each other on interest payments made to individual savers. Communication of the information in this standard format would be automatic and would take place at least once a year.

Will the Directive cause EU investors to invest outside the EU?
The EU has also concluded agreements on savings taxation with five key third countries and with the dependent and associated territories of the UK and Netherlands. It also concluded that the bilateral arrangements that EU Member States have concluded with the USA are sufficient to enable EU Member States to apply their tax rules to their residents with savings in the US. The European Commission is also due to commence discussions shortly with other important financial centres with a view to providing for the adoption by those jurisdictions of measures equivalent to those to be applied within the EU.

Why are interest payments made to companies excluded?
Because there are many more problems of tax evasion in the individual taxation area than in the company tax area. Companies are required to lodge annual tax returns and they are audited or are subject to the possibility of being audited on a regular basis. As far as companies are concerned, non-taxation of interest payments is not the main problem for tax administrations. The issue is more that of tax avoidance through aggressive tax planning. Some concerns have been expressed that individuals will claim to be representatives of companies in order to avoid the application of the Directive. The Commission hopes that Member States will, on the basis of the standards and rules laid down in this Directive, be able to establish the true identity of beneficiaries of interest and that the scope for tax evasion will be limited.

Editor: Christopher Owen
Publisher: Kamilian Limited
enquiries@kamilian.com
www.kamilian.com
Printer: Pioneer Printers Limited
www.pionprint.com.hk

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