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This third edition of our Private Banking European Tax Newsletter is dedicated to upcoming changes in various national tax jurisdictions, which will influence the tax situation and investment decisions of private clients.

We are also very pleased to provide you with some insight from Lebanon, which we believe could play the role of a gateway to the Middle East region. Lebanon is recognised as a centre of expertise for Private Banking and maintains strong links with European markets.

Tax transparency and the fight against tax evasion are still high on the agenda. Latest news on client reporting requirements and some national tax fraud investigations are provided in this regard.

We hope you will enjoy reading this Newsletter.

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Germany:

Reforming the Reform – Inheritance tax changes announced

With effect from 1 January 2009, the German government introduced an Inheritance and Gift Tax (IHT) reform. The tax reform was due to a decision of the German Constitutional Court stating that the existing law was not in the line with the constitution.

The reform mainly focused on a valuation of all assets including business property and real estate, which have historically been assessed with rather low values, at their fair market value. The law also foresees substantial tax discounts (85% or even 100%) on the transfer of businesses or shares in companies exceeding 25% by gift or inheritance.

However, such discounts are only granted under strict conditions. For example, the successor cannot enjoy the tax benefits if more than 50% of the business assets are so-called "administrative assets" (more than 10% in the case of a 100% discount). Such assets include real property rented out to third parties, participations in companies of less than 25%, commercial papers, bonds, portfolios, as well as similar claims to art, collections, and noble metals. If the "administrative assets" do not exceed 50% of the value of the transferred business, the transfer of the whole business including those assets can benefit from the discount. Whilst the 50% ratio is applicable at all levels of an affiliated group, the 10% ratio is only applicable to the top company/partnership of the group. In consequence, many planning ideas have been developed as to how benefit from a 100% discounted transfer by avoiding administrative assets at the level of the top company and how to spread such assets within the group. With innovative planning and strict timing, even pure asset management vehicles ("cash companies") may enjoy the tax benefits.

Already in 2009 the first amendments of the new law were enacted, partly with retroactive effect. By the end of 2010, parliament will most likely decide on further amendments to the IHT law within the course of the 2010 Annual Tax Act.

Whilst the amendments in 2009 were made for the benefit of taxpayers, most of the amendments in 2010 will increase the hurdles for a (partly) tax exempt transfer of businesses or shares. German taxpayers and their advisors are increasingly becoming irritated by this attitude.

Those proposed amendments mainly reflect the intention to close loopholes around "administrative assets". In the future, the 10% threshold will not only be applicable at the level of the top company but at all levels of an affiliated group. Moreover, a drop down of those assets to subsidiaries will not have any tax effect. The volume of "administrative assets" will be calculated on a consolidated basis, even when the ratio at the level of the respective subsidiary is below the threshold.

Thus, timing is crucial. If business transfers to the next generation are intended in near future, they should be completed prior to the end of November 2010.

Finally, one positive amendment in the IHT law can be reported: Registered civil partners will be treated like spouses in all respects.

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Lebanon:

A Gateway to Middle East based on a resilient and sound banking system

Lebanon was one of the very few countries around the world that was able to weather the global financial crisis. It has shown a high resilience to the international downturn. Lebanese banks have even reported strong profits with a significant growth in deposits. Moreover, as the Lebanese Banking Sector is increasingly perceived as a banking safe haven (maintaining its Banking Secrecy) in the region, capital has been flowing in from abroad and notably from the rest of the Middle East region and Africa.

The resilience of the Banking Sector in Lebanon was not by mere coincidence; it was rather accomplished by following the Central Bank's regulatory requirements around minimum capital, reserves and liquidity. The Central Bank has also put limitations on the foreign investments of banks, especially in structured products. Moreover, reserve requirements prevented banks from expanding lending practices beyond deposit levels which discouraged banks from venturing into risky investments using the clients' money and deposits. Another key factor behind the country's financial well-being was the insight of the Governor of Lebanon's Central Bank, Riad Salameh, who in 2007 ordered the country's private banks to exit all mortgage-backed securities and brace for the financial crash he saw looming.

To elaborate more on private banking in Lebanon, specialised financial institutions offer a dynamic range of private banking and wealth management services, which are present in Lebanon and wealthy countries in the Middle East region, as well as a privileged presence in Europe (such as Switzerland and France). The Best Local Private Bank in Lebanon, as per Euromoney survey, is the Audi Saradar Private Bank, which caters to Super Affluent and High Net Worth Individuals and has USD 730 mio of total assets under management and over USD 1.1 bn of total customer deposits (as at 31 December 2007).

Most recently, FFA Private Bank chose to list their MENA fund on the Luxembourg Stock Exchange. The chairman claims that this listing gives them both more visibility and the international status that they are looking for. Moreover, the existing regulatory constraints related to listing on the Luxembourg Stock Exchange give credibility to the seriousness of the Private Bank's management. The bank's management had a choice between two or three other jurisdictions, but thought Luxembourg was the best.

To conclude, the Banking Sector in Lebanon is proving to be an increasingly attractive arena for international players. At the same time local players are looking at Europe for privilege, accessibility and credibility with an obvious access to the wealth of the Middle East and Africa.

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Luxembourg:

Client reporting as a differentiating factor for Private Banks

In light of the recent international tax developments a trend towards higher transparency is appearing as well as increasing requirements regarding reporting and accountability. As a consequence, more and more banks are developing new services to help clients properly declare revenue in their country of residence.

Today, clients show a great interest in tax reporting assistance. Therefore, some banks are rapidly considering the provision of tax reporting services to create a competitive advantage. For some banks, tax reporting services are still generated manually and are only provided to a limited number of clients, most often on demand. The growing demand for such services has obliged banks to rethink their processes in order to industrialise the production of tax certificates for clients. In the future banks would propose tax reporting services to all clients. Some banks are also considering becoming a tax reporting centre of expertise for their banking group. These banks could also in the medium-term provide an outsourced tax reporting solution to external entities (i.e. smaller banks, which cannot afford the infrastructure).

Challenges faced by banks

Banks need to analyse their current ability to deliver high quality tax reporting services to their clients. They will face two types of challenges:

1. Ongoing monitoring:

- Changes in tax law

  Banks could propose to their private clients an ongoing monitoring to follow up the changes in tax law in their countries of residence.

- Tax reporting of related data

  In order to prepare reporting for Private Banking Clients, banks need to retrieve the underlying data. They will need to find tax related data for each country of domicile of their client and perform a gap analysis between existing data captured in the system and the data required for tax reporting purposes.

- Product classification

  Banks will need to classify all existing and future products into tax clusters and validate the tax treatment for the income tax returns of private clients.

2. System implementation and monitoring:

Depending on the bank's internal organisation, three possible strategies with an increasing degree of externalisation (ext.) can be considered:

- In-house development

  The bank develops its own tax calculation and reporting module for each country of residence of its clients within the bank system.

  The internal tool will be updated at least annually to fit within the business needs and tax requirements.

- Tax reporting software

  The bank acquires a tax reporting software to perform the calculation and the reporting.

  The maintenance of the tax rules and reporting is done by the software provider and/or tax experts.

- Outsourcing

  The bank outsources the production of the tax certificates to an external provider that will host the software, perform quality assurance on the data received from the bank and produce the tax certificates.

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NORWAY:
What does residence for tax purposes mean in Norway?

An individual resident in Norway for tax purposes is subject to Norwegian taxation on his global income. In several Norwegian newspapers there has been a debate during the past weeks about the Norwegian rules regarding emigration or migration work. As there have been various statements within the media, we would like to clarify the main rules in the area.

The domestic rules are described below. Please note that different solutions may apply based on the relevant double tax treaty between Norway and the state of residence, and the treaty must be assessed thoroughly.

Emigration from Norway:

An individual who has been tax resident in Norway for more than ten years and moves abroad will be considered to be a non-resident for tax purposes in Norway at the date of expiration of the third income year after the income year the taxpayer actually became resident abroad, assuming that the following conditions are met:

- The taxpayer has a permanent residence abroad;
- The taxpayer has not stayed in Norway for more than 61 days during each of the three last income years; and
- The taxpayer does not own or rent residential real estate in Norway.

Migration:

An individual who is resident abroad is considered to be a resident of Norway for tax purposes if the following conditions are met:

- The taxpayer has stayed in Norway for more than 183 days during a twelve months period; or
- The taxpayer has stayed in Norway more than 270 days during any three year period (e.g. not more than 90 days in average per calendar year).

In Norway the income tax year follows the calendar year. When counting days one day is equal to a calendar date, i.e. a person who arrives in Norway at 23 p.m. and leaves the country the day after at 7.00 a.m. has stayed 2 days in Norway according to Norwegian legislation.

Update on Specialised Funds

Regarding the information given in the last edition where we described the new rules for Specialised funds (hedge funds) in Norway with effect from 1 July 2010, the Ministry of Finance published a statement the same day that the new regulation shall not apply for other investors than those who are regarded as professionals according to the MiFID rules. Accordingly, it is still not permitted to market such funds in the retail market in Norway.

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Spain:
The fight against tax evasion and an update on upcoming changes in the tax law

Spanish taxpayers holding Swiss accounts

A few days before the prescrition of the 2005 Personal Income Tax and Wealth Tax Act, the Spanish Tax Authorities launched an investigation of Spaniards with bank accounts in Switzerland.

The Spanish Tax Authorities sent a formal request of information to the identified individuals.

As a result of this formal request, certain individuals have chosen to make a self-declaration showing the income derived from these accounts in order to avoid further investigations of the Spanish Tax Authorities. On the contrary, other individuals have chosen not to declare based on the position that the Swiss information was illegally obtained and as such cannot be used in an administrative or criminal proceeding.

The period to make voluntary self-declarations expired in July 2009. Therefore, the next months will be crucial to see what new measures are used by the Spanish Tax Authorities to fight against this alleged tax evasion.

Spanish Wealth Tax

In 2008, the Spanish Government decided to repeal the Spanish Wealth Tax. Recently, and due to the economic crisis, the Spanish Government has decided to establish a new Wealth Tax. During his State of the Nation address held in July 2010, the Spanish Prime Minister announced, that there would be a new Spanish Wealth Tax by the end of 2010 and that the tax would be in force from 2011.

The configuration of this new Wealth Tax is not known at this time. Some tax advisors believe that the new tax will be similar to the French Wealth Tax while others believe that the old Spanish Wealth Tax will be in force again. The main features of the new tax will be known by the end of 2010.

Higher Tax Rates

On the lines of the measures taken by the Central Government and to address the economic crisis, some of Spain's autonomous regions have increased Personal Income Tax rates for tax bases higher than EUR 60,000 by up to 3 percentage points. These measures are expected to be in force by 2011.

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Switzerland:

Equity Finance – Swiss withholding tax refund practice

The Swiss Federal Tax Authority (FTA) has started reviewing in detail Swiss withholding tax refund claims filed by foreign market participants on Swiss dividends derived during equity finance transactions (WHT, statutory rate 35%). Claims are reviewed in an international context by applying the Swiss beneficial ownership and tax avoidance practice.

The FTA is systematically requesting additional information regarding the trades incurred with Swiss equities such as:

- Holding period of the equity position;
- Effective counterparties of the equity and derivative leg;
- Details of the derivative used for hedging purposes (swaps, call/put combos, etc);
- Details of the financial flows.

The FTA categorically denies claims where beneficial ownership is deemed to be missing (e.g. where a contractual obligation to pass on a dividend or an equivalent payment to a counterpart exists such as in the case of over the counter swaps used for hedging). Long term transactions are under scrutiny as well, such as transactions where the derivative hedge is regularly rolled into a new derivative (e.g. over-the-counter futures).

Based on the stringent interpretation of Swiss tax law by the FTA and the deriving legal uncertainty, it is essential to review the current WHT refund position in order to prevent long-standing discussions with the FTA. Furthermore, current and future derivative transactions with Swiss equities should carefully be analysed. Based on the current developments, they qualify as being at high risk from a WHT refund perspective.

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United Kingdom:

Emergency budget 2010 – an overview on upcoming changes

The new UK Chancellor of the Exchequer, George Osborne, delivered the emergency Budget on 22 June 2010, setting out his five-year plan to eliminate the structural budget deficit, rebalance the British economy and design a new model or economic growth.

Among other fiscal measures, the emergency Budget introduced a number of significant tax changes affecting private entrepreneurs and their businesses. The most notable of those changes are outlined below.

Capital gains tax increase

The most significant change for holders of business and non-business assets is that the rate of capital gains tax has been increased from 18% to 28% for higher rate taxpayers (i.e. those with taxable income and gains in excess of GBP 37,400) with effect from 23 June 2010. The rate of capital gains tax remains at 18% for individuals whose total taxable income and gains do not exceed GBP 37,400.

For trustees and personal representatives of disable persons, the normal rate of capital gains tax is increased to 28% (previously it was 18%).

These changes do not affect individuals who are not residents and not generally residents of the UK for tax purposes. In most case, capital gains realised by such individuals will continue to be exempt from UK capital gains tax, irrespective of the situs of the assets being disposed.

We suggest that a regular review of the private clients residence status and investments be conducted so that a proactive approach could be adopted.

Extension of entrepreneurs' relief

To alleviate the negative impact of the increase in capital gains tax on investments in business, the UK Government has extended the life-time limit for entrepreneurs' relief from GBP 2 mio to GBP 5 mio. This relief provides a special 10% rate of tax for qualifying gains on the disposal of business assets and is available to UK residents domiciled both in the UK and outside the UK. The increase in the lifetime limit for entrepreneurs' relief has effect from 23 June 2010.

With the recent increase in the headline rate of capital gains tax to 28%, the differential between the capital gains tax rates with and without the entrepreneur's relief can be as high as 18%, increasing the tax costs of not qualifying for entrepreneurs' relief to GBP 900,000.

There are various complex conditions that should be met in order for a given disposal to qualify for entrepreneurs' relief. In some cases (e.g. when shares are held by a family trust), the relief is not readily available and restructuring of the existing structure may be required to take advantage of the relief. This is a complex area and different interpretations exist in relation to the application of entrepreneurs' relief in a particular case. In view of this, professional advice should

be sought to ensure that the availability of entrepreneurs' relief is maximised.

Review of the tax regime for non-domiciled individuals

The emergency Budget, together with the HMRC notes accompanying the Budget, contained no special reference to the UK taxation of non-domiciled individuals. Nevertheless, HMRC's Budget letter to the Financial Services included a statement that the UK Government intends to review the taxation of non-domiciled individual 'to ensure that such individuals make a fair contribution to reducing the deficit, in return for greater certainty and stability for those bringing skills and investment to the UK'.

It could therefore be expected that the favourable UK tax regime for non-domiciled individuals will be reformed at some point in the future, but the scope and timeframe of such reforms are uncertain now. PwC will be making appropriate representations and keep monitoring this issue.

Corporation tax reduction

With effect from 1 April 2014, the main rate of corporation tax, payable by companies with profits above GBP 1,5mio, is reduced from 28% to 27%. There will be further gradual reductions by 1% per year until the level of corporation tax is reduced to the level of 24% in April 2014.

Companies with profits chargeable to corporation tax below GBP 300,000 will pay corporation tax at the small tax rate of 20% from 1 April 2011, down from 21%.

The reduction in the corporation tax rates means that the mismatch between corporate taxation and personal taxation (the maximum rates of income tax is 50% and capital gains tax is 28%) is increasing even further. Thus, the use of a corporate element in an investment structure can potentially provide substantial tax benefits. However, the opportunities for tax planning critically depend upon an investor's personal, financial and tax profile. This makes it important to review your profile on a regular basis.

The UK as a holding company jurisdiction

With the introduction of the dividend exemption with effect from July 2009 has dramatically improved the attractiveness of using the UK as a holding company location. Since then, we have seen many enquires from our clients asking us to advise on the benefits and drawbacks of using the UK for establishing a holding company.

The UK certainly offers some attractive features for those searching for a favourable holding company location, including in particular:

- Tax exemption for dividend income;
- Favourable capital gains treatment for disposal of substantial shareholdings;
- Nil withholding tax on dividends;
- Comprehensive treaty network; and
- UK corporate law is well understood.

However, there are downsides that should be weighed against the positive aspects:

- Complex criteria to qualify for the substantial shareholding exemption;
- High withholding taxes levied in overseas territories on dividends, interest and gains; and
- Onerous anti-avoidance rules.

The emergency Budget and the Coalition Agreement have raised a number of issues affecting the ability of the UK to compete as a holding company location. Although the reduction in the headline rate of corporation tax is a positive change, prospective investors should be aware that there are a large number of consultations currently underway. In particular, the consultations are being conducted in relation to the reform of CFC rules, imposing of limitations on interest deductions and introduction of general anti-avoidance rule.

Whilst the key aspects of the UK tax system relevant to holding activities are under review, the advantages of using the UK as a holding company location would need to be weighed against an additional factor - a lack of certainty over the long term tax efficiency of locating a holding company in the UK. PwC will keep you informed on further developments.

Introduction of immigration cap

The UK Government has imposed a temporary cap on immigration of workers from outside the EU/EEA with effect from 19 July 2010. The temporary cap represents a slight reduction in the current number of migrants and is intended to prevent a surge in the UK visa applications before April 2011, when a permanent immigration cap is due to be introduced. The UK Government is going in the consultation process to decide the form and precise level of the permanent cap.

The temporary immigration cap affects individuals entering the UK under the sub-category of Tier 1 visa for highly skilled workers and Tier 2 visa for sponsored skilled workers. The permanent cap is also to be targeted at those two categories of migrants.

We have found out that more wealthy individuals would apply through investor visa route (rather than the above-mentioned two routes) to immigrate to the UK. One of the main conditions for this category of visa is that an applicant must make a large investment (circa GBP 1mio) in the UK economy. However, from a UK tax perspective, it is critical that proper planning is undertaken before making this investment; otherwise, significant tax exposures in the UK may be triggered.

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