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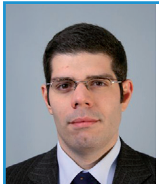

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We are pleased to present the second edition of the Private Banking European Tax Newsletter. As outlined in our February edition, estate tax consequences are of increasing interest for HNWIs. This current newsletter keeps on focusing on issues, which are impacting wealth management, such as:

- **Theft/sale of privacy data**
- **Tax evasion inquiries**
- **Double tax treaties and exchange of information**
- **Anti tax avoidance measures**
- **Tax residency issues**
- **Tax aspects relating to immovable property**

As a general trend, we continue to see an increased request for transparent through efficient tax planning. Down the road focusing more on tax transparency, we also observe a growing interest in tax reporting tools. At the same time clients tend to search for more sophisticated products, representing a challenge in terms of consulting and set up of reporting tools. In addition, HNWIs not only seek for complexity and sophistication, but also ask to be actively involved in the process.

On September 15, 2008, the EU commission issued its report ont the functioning of the Directive as required by Article 18 of the Directive. Further to this report, the EU Commission has issued several draft proposals for an amended EU Savings Directive (EUSD). The last available version of the draft was issued on November 25, 2009.

The aim of this proposal is to extent the scope of application of the EUSD.

Definition of beneficial owner

The Council proposes to clarify the term beneficial owner by clarifying which information is to be used to establish the identity and residence of beneficial owners. The aim is to ensure that the real beneficial owner, i.a. the person identified under the Know Your Customer rules, is also considered beneficial owner from an EUSD perspective. Based on the anti-money laundering measures dated 2005 (Directive 2005/60/EC), the Council proposes to adopt a "look through approach" to payments made to certain effectively low taxed entities established or having their place of effective management in certain countries or territories where the Directive or measures to the same or equivalent effect do not apply.

Extension of the scope of the EUSD

The scope of the EUSD would be extended to financial instruments which, according to the level of risk, are considered as debt claims. It is therefore necessary to ensure that it covers not only interest but also equivalent income. The scope of the EUSD would then be extended to:

- **Life insurance contracts** containing a guarantee of income return or the performance of which is at more than 40% linked to income from debt claims or equivalent income covered by EUSD.
- **Structured Products and other Instruments** with a capital guarantee of at least 95% or producing a return linked to at least 95% interest as defined in the EUSD.
- **Investment funds established in the European Economic Area (EEA):** all investment funds or schemes independently of their legal form which are located in the EEA, rather than UCITS only.

Entry into force

The draft proposal provides that the member states implement the measures of the directive at the latest on December 31, 2010. The domestic measures implemented by each member state in accordance with the EUSD shall apply on in-scope transactions and situations as of January 1, 2013. However, the measures would apply to interest accrued as from July 1, 2010.

For example, in case an in-scope structured product or Sicav Part II shares (non UCITS) would be sold in 2012 the EUSD will not apply. If the sale arises in 2013, the EUSD will retrospectively apply on their accrued interest component as from July 1, 2010.

Denmark: Offshore account tax amnesy

The Danish Government together with the absolute majority of the opposition parties have agreed on a temporary mitigation of sentence programme for non-reported foreign wealth and income.

Basically, the programme covers:

- all individuals, buisnesses, corporations, etc.
- foreign accounts or deposits with banks and/or similar institutions,
- in countries from which Denmark could not get bank information as per January 1, 2008,
- and that report themselves to the Danish tax authorities or the police during the period of January 1, 2011 to December 31, 2011.

The programme is voluntary and aims at:

- an individual or company, who wants to use the programme, provides the Danish tax authorities with all information necessary to do a tax assessment and which the individual or company can get hold of,
- no prison sentence is given for tax avoidance no matter the amounts involved, etc.,
- the matter can be settled without the attention of the public and no involvement of courts,
- the fine is 60% of the amount evaded and of course, the taxes/duties that should have been paid.

Should it at a later point of time become clear that the tax payer did not provide all the required information, the above no longer applies i.e, prison sentence may be given, involvement of the public and/or courts, etc.

Further, the agreement implies that the Danish tax authorities will consider what to do should they receive offers for getting account information about Danish residents hiding wealth outside Denmark. The tax authorities will decide on a case-by-case basis whether or not to accept the information and payment of possible remuneration.

A draft Bill will be put forward after the summer holidays (in October 2010) to implement the agreement.

Germany: Data theft and tax fraud investigations

The headline event in the German private banking sector during the first and second quarter of 2010 was the acquisition of a CD-ROM by the German tax authorities that, allegedly, contained information on more that 1,400 German bank customers with untaxed bank accounts in Switzerland. The CD-ROM was acquired at the end of February from an anonymous source for a reported purchase price of EUR 2.5 million. The first house searches by the German tax fraud investigation seem to confirm rumours that the acquired data mainly concerns customers of major Swiss bank Credit Suisse.

To escape criminal prosecution, tax offices throughout Germany received more than 16,000 so-called self-declarations from tax evaders until the end of April 2010, resulting in additional tax payments of more than EUR 1 billion. Under German tax law, tax evaders may escape criminal prosecution by means of a self-declaration provided the evaded taxes of the last five/ten years are paid to the tax office before the tax evasion is revealed.

Although relatively straight forward on paper, a self-declaration may bear several pitfalls in practice. Because an incorrect self-declaration will almost inevitably lead to criminal prosecution with sentences ranging from money fines to prison sentences of up to ten years, it should not be prepared without the help of an experienced tax lawyer. To achieve an exemption from criminal prosecution, a valid self-declaration must, inter alia, state the correct amount of the evaded taxes. This does not only require an in-depth knowledge on the taxation of a great variety of financial products but also expertise on the tax treatment of offshore structures such as foreign trusts. Moreover, bank customers and their tax advisors should refrain from transferring the bank accounts physically to Germany to eliminate the risk that they get confiscated at the German border. For the same reason, bank records should not be sent by mail to Germany. Instead, bank customers should seek the assistance of a German tax law firm with offices in the country where the bank records are located.

Looking at the bigger picture, it must be observed that German investors with untaxed foreign bank accounts face an increasingly high risk of criminal prosecution in Germany. From the G20 summit in April 2009, Germany has concluded several tax information exchange agreements (TIEA) with offshore financial centres such as Bermuda, the Channel Islands or Liechtenstein.

The new TIEA and double tax treaties (DTT) follow article 26 OECD model treaty and give the German tax authorities a right to request all necessary information, including bank records etc., that are necessary to substantiate a reasonable suspicion for tax fraud in Germany.

Especially the new TIEA with Liechtenstein that was signed on September 2, 2009 and the new DTT with Switzerland that is expected to be signed shortly will affect that German investors with untaxed investments in both major financial centres in that they will no longer be protected by the banking secrecy of both countries.

German investors concerned should use the time left to legalise their foreign investments and avoid criminal prosecution in Germany.

Norway: New regulation regarding Specialised funds

From July 1, 2010 new regulation that allows for establishing as well as marketing Specialised Funds (Hedge Funds) in Norway enters into force. Previously, sale of such foreign funds has only occurred as part of investment advice.

Most Norwegian (HNWIs) have structured their share investments through a private holding company due to tax reasons and inheritance tax planning. Share income (dividends and capital gains) received by a corporation is comprised by the Norwegian Tax Exemption Method (NTEM) resulting in deferral of a 28% tax until distribution to the individual shareholder. It is expected that there will be an increase in the market of Specialised Funds investments by private holding companies under the new regime.

Deferral of tax can be achieved without the use of a private holding company by investing in life insurance products. Accordingly an individual can buy a life annuity where the tax on profits of the underlying assets is deferred until the future pension payment.

Russia: Recent evolutions in the national tax law

The President's Budget message

- Russia is actively following international developments in the area of taxation and is looking for possible ways to prevent tax evasion and increase budget revenues.
- In particular, the Budget message of the President Medvedev announced on May 25, 2009 referred to the following measures:
  - Prepare changes to tax legislation on the basis of practical experience accumulated by Russian arbitrazh courts aimed at preventing of abuse of Russian tax laws.
  - Promptly develop changes to the existing transfer pricing rules to ensure control over the prices used in inter-company transactions and avoid the risks of varying interpretations.

 - Introduce legal provisions aimed at preventing of abuse of double tax treaties concluded by Russia in situations where beneficial owners of income resides outside their respective treaty countries.

- Overall, the above measures were viewed by taxpayers and tax professionals as a move of the Russian tax system towards a "substance over form" approach which is in line with international developments.
- The Government of the Russian Federation is currently working on legislative changes which are expected to be introduced in 2011.

More focus on transfer pricing

- The current draft of changes to transfer pricing rules follows the OECD guidelines in many respects. Generally, when fixing a price, splits of functions, risks and assets between parties to a transaction should be taken into account. Such splits should be documented in the transfer pricing documentation package, notably in the functional analysis which Russian taxpayers will be required to prepare. Further, inter-company transactions will be subject to reporting. New rules are expected to be effective as of January 1, 2011.
- Developments in transfer pricing legislation cover individuals as well, in particular:
  - mechanism of establishing a fair market value for non-quoted securities sold by individuals have been introduced in 2010;
  - new concepts such as market value, estimated price and the maximum limit of market fluctuations for non-quoted securities. The procedure for determining these parameters is to be established by the federal executive agency on the stock market, as agreed with the Russian Ministry of Finance.

Beneficial ownership

- The Government is currently working on the draft law which aims to introduce beneficial ownership concept to Russian domestic tax legislation. Expected legislation will limit application of DTTs concluded by Russia in situations where beneficial owners of income, be it legal entities or individuals, reside outside treaty countries.
- Once these changes are introduced, it may be expected that the tax authorities will take a less formalistic approach when reviewing the correctness of application of DTTs by Russian groups and question whether the recipient of income from Russian sources may be viewed as its beneficial owner.

Negotiations of DTTs concluded by Russia

- In line with the global move towards greater transparency in tax matters, Russia has initiated a campaign to sign Protocols to the existing DTTs. The main focus of the Protocol is on introduction of extended exchange of information article in accordance with the OECD Model Convention, introduction of limitation of benefits provision and changes to provisions related to taxation of capital gains from sale of shares in Russian companies holding primarily real estate in Russia.
- A respective Protocol has been signed between Russia and Cyprus and currently is pending ratification in the State Duma of the Russian Federation.
- Similar negotiations have been initiated with Luxembourg and Switzerland however, the draft Protocols to respective treaties have not yet been published.

New DTT model

- The Russian Ministry of Finance has developed a new model for the DTTs to be signed by Russia with other countries. The new model was approved by the Russian Government on February 24, 2010.
- The new DTT model generally follows OECD model convention. However, it contains a new Article 29 – Limitation of Benefits.
- According to Article 29, competent authorities may refuse treaty benefits to any person with respect to any transaction if they suspect abuse of treaty benefits. Treaty benefits are not available to a foreign company if more that 50% of interest in such company is held directly or indirectly by shareholders who are not residents in the same treaty country. The exception to these rules are companies carrying out active business activity in the treaty country. Mere ownership of shares/other assets and auxiliary and preparatory activities are not viewed as active business activity.

Spain: VAT on services relating to immovable property

Good news for all individuals owing a house in Spain. Last April 13, 2010, a Royal Decree was approved by the Spanish Parliament containing a reduction on the VAT rate for all reparation or renovation works made in buildings destined to housing (dwellings). The tax rate will be 8% (7% up to June 30, 2010) instead of the general 18% tax rate (16% up to June 30, 2010). This reduction will imply important savings to all the individuals performing works in their homes. The requirements to apply this reduction on the VAT rate are the following:

- The payee must be an individual not acting as an entrepreneur or professional and the house must be for private use. In the case of a condominium the payee can be also the community of property.
- The construction or the last rehabilitation of the house must be more than 2 years old.
- The professional that carries out the reparation or renovation works does not provide the materials or if so, the cost of those materials must be less than 33% of the final price of the works.

This modification was done to promote renovation works in Spain, but will only be applicable until December 31, 2012. After that date the application of this reduced VAT rate will be reserved to a few specifically and restricted works in the house. It is especially interesting for those that were thinking about repairing or renovating their homes in Spain (also second residency) to do so before June 30, 2010, because then the tax rate will be only 7%.

Switzerland: Data Theft from Banks in Switzerland

Swiss private banking clients who are foreign tax resident have recently extensively made use of the possibility to file so-called self declaration for their investments held in Switzerland. This has mainly been the case for German individuals who are filing tax declarations for undisclosed income from capital investments accrued in the last 10-13 years. There are a number of events that have accelerated this wave of self declarations, such as client data stolen from Swiss banks and sold to the German tax authorities and the introduction of tax information agreements (e.g. between Germany and Liechtenstein). But also mid to long term developments such as the Financial Action Task Force (FATF) - an OECD task force – who has defined new rules that qualify tax evasion as a predicate crime to money laundering, fuelling current international discussions to increase penalties in the area of tax evasion, may trigger more self declarations. It is therefore expectable that self declarations will become in the near future a topic of interest for residents of other countries, especially if beneficial tax regimes for the retroactive declaration of assets held offshore are introduced.

United Kingdom: Latest case law on tax residency

The impact of Gaines-Cooper case on UK tax residency

In the past, there has been an over reliance on ''day counting'' in determining whether an individual resides in the UK for taxation purposes. The recent judgement of the UK Court of Appeal in the Gaines-Cooper case has dispelled this myth.

Mr Gaines-Cooper's problems began in October 2006, when the UK tribunal found that despite him seeking to claim residency in the Seychelles, he had remained resident in the UK. Mr Gaines-Cooper claimed that he had relied on guidance issued by HMRC that set out the circumstances in which an individual would, or would not, be treated as resident in the UK and therefore liable to UK income and capital gains tax. A key part of the guidance that Mr Gaines-Cooper relied on was that spending less than 91 days a year in the UK meant that he would not be treated as UK resident. In particular, he had relied on days of arrival in and departure from the UK not being counted for the purposes of the 91-day test to spend the weekend in the UK, flying in on Saturday and out on Sunday to avoid the visits being counted.

The UK Court of Appeal decided that the guidance published by HMRC can be regarded as binding, subject to its terms, in relation to any case falling clearly within the terms of that statement. Unfortunately, Mr Gaines-Cooper did not fall clearly within the terms of the guidance, and his claim failed because he did not show a clear break in the pattern of residence in the UK.

Following the Gaines-Cooper case, HMRC is showing increasing appetite in litigations involving tax residency cases, especially where there are significant amounts of tax at stake. In such circumstances, anyone wishing to ensure that their departure from the UK is effective from the UK tax perspective is strongly advised to undertake forward planning and detailed record-keeping, so that there is sufficient evidence in place to defend the tax residence position if HMRC open an enquiry. As always, seek professional advice, which is now more important than ever!

The Finance Act 2010 was enacted

After receiving Royal Assent on April 8, 2010, the Finance Act 2010 became effective in the UK. This legislation enacts a number of important changes to UK tax legislation, including those affecting private banking industry (these are addressed in more detail below).

However, not all of the measures announced in the March 2010 Budget were included in the Finance Act 2010. The dissolution of the Parliament in advance of the general election on May 6, 2010 has reduced the time available for scrutiny and discussion of the legislation. Thus the Government decided to postpone some of the measures until the new Parliament reassembles after the general election. The precise measures that will be introduced by the new Parliament will naturally depend on the results of the general election.

Introduction of bank payroll tax

The Finance Act 2010 has introduced a 50% bank payroll tax. This tax applies to any cash and non-cash bonuses over £25,000 paid by banks and certain other financial institutions to a relevant banking employee. It is payable by the employer rather than the employee.

Bank payroll tax will have effect from December 9, 2009 until April 5, 2010. Self assessment and payment of bank payroll tax must be made by August 31, 2010. Record keeping is necessary, even if a company subject to bank payroll tax has no liability.

In most cases, the quantification of ultimate bank payroll liability is not straightforward and requires knowledge of legislation, HMRC clarifications and other sources of information. Professional advice on the most appropriate approach to the estimation of liability to bank payroll tax is highly recommended.

New measures to tackle offshore tax evasion

The Finance Act 2010 has also introduced new legislation providing for higher penalties for UK individuals and businesses that fail to declare the full extent of their tax liability relating to offshore income or capital gains. This legislation will have effect for periods commencing on or after April 1, 2011. Where the failure occurs in a jurisdiction with which the UK has an agreement to exchange information automatically, the penalty provisions will not change (i.e. will be a maximum of 100% of the under-declared tax). However, where the relevant jurisdiction will only exchange information with the UK upon request, the penalty can be increased to a maximum of 150% of the under-declared tax. Where there is no exchange of information between the UK and the relevant jurisdiction, the penalty will be a maximum of 200% of the under-declared tax.

This measure can be seen as increasing the pressure on those who deliberately withhold information in respect of income or assets held offshore. However, there is also a danger that the new rules will penalise those with existing offshore assets who fall foul of the complex tax rules around offshore income and gains. As a result, to avoid these significantly increased penalties, those with complex offshore tax affairs will need to ensure that they have taken appropriate care in arranging their offshore affairs in a way allowing them to fully disclose their UK tax liabilities.

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