

MGI OVERSEAS ASPECTS

The international newsletter for the UK's owner-managed business sector

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MGI Business Solutions Worldwide

With members in over 280 offices and 80 countries across the globe, MGI is one of the largest associations of independent accounting, auditing and consulting firms in the world. Its overseas members pride themselves on their reputation for local expertise, personal service and professionalism as well as their ability to conduct business in English. Accordingly MGI's UK firms can offer their clients access to reliable and up to date advice on the latest worldwide business practices, regulation, and tax planning opportunities. This newsletter highlights a selection of such topical issues which we hope will be of relevance and interest.

CORPORATE TAX PLANNING –

Picking your preferred jurisdiction

The proposed merger of British Airways and Iberia highlights the importance of a company's chosen tax residence – and the same considerations apply to many far smaller businesses.

The BA/Iberia merger is one of the most publicised corporate transactions in recent years and the UK media is keenly interested in just how 'British' British Airways will remain.

A particularly emotive question is where the new company will pay tax - assuming, that is, that the newly-merged company manages to generate a taxable profit.

At the moment British Airways is taxed in the UK because it was incorporated here and because its most important corporate decisions take place within the UK. Iberia, by the same principle, is taxed in Spain.

Typically a company tax residence will be wherever its key decisions are made but the position becomes far less clear when a company is managed in multiple jurisdictions. A cursory glance at the BA/Iberia merger's memorandum of understanding shows that the directors of both companies are already considering the question of where best to locate the newly-merged 'Topco' for tax purposes.

The company will be incorporated in Spain and the majority of board meetings and shareholders' meetings will take place in Madrid. This gives a strong indication of Spanish residency. However, at the same time, the parties have agreed that the day-to-day running of the company will be carried out in the UK. So which is the most important?



The answer lies in the UK's double taxation agreement with Spain, which provides that any company operating in the UK and Spain will be deemed to reside for tax purposes wherever its effective management is located. This is generally where the key day-to-day decisions are made, and typically (but not necessarily) where the directors hold their board meetings.

So, by ensuring that Willie Walsh and his fellow board members fly out to Madrid every few months, the BA/Iberia board hope to make the merged company a Spanish tax resident, thereby

minimising the group tax bill but, more importantly, depriving the UK government of the benefit of any future taxable profits.

The British Airways case shows that to establish and maintain an offshore tax status requires careful planning and should not be undertaken lightly. However, it is important to bear in mind that, even for relatively small companies, the benefits can be considerable and it is surprising how often SMEs fail to take advantage of the international tax planning opportunities that are available to them.

A NEW TYPE OF “PENSION HOLIDAY”



If you have clients who are thinking of emigrating, they may be able to pack their UK pensions and take them with them!

When UK residents retire abroad or otherwise permanently leave the UK they may be able to transfer their benefits within a UK pension fund to what is known as a Qualifying Registered Overseas Pension Scheme or QROP. The same provisions apply to foreign nationals who have a UK pension and are returning home, or to expats who decide to retire abroad.

The transfer of benefits to a QROP is, in effect, a transfer of the **Scheme Rules**. This means that the funds invested in the pension can remain in the UK and need not be re-invested.

Furthermore the scheme need not be transferred

to the country to which the pensioner is retiring, emigrating or returning. This means the location of the QROP can be chosen on the basis of the most flexible and favourable rules available. Hong Kong is a particular favourite QROP destination.

By choosing the right QROP, it is often possible for clients to benefit from:

1. No longer having to buy an annuity;
2. Being able to draw down enhanced lump sums;
3. Being able to bequeath any undrawn pension funds to their heirs on their death; and sometimes
4. To invest funds to buy residential property overseas

The QROP rules are complex and it is important that clients seek specific advice before taking any action in relation to pension transfers.

TAX ON THE SALE OF FOREIGN PROPERTY

The tax arising on the sale of foreign property is becoming an increasingly relevant issue as more and more UK residents buy and sell homes overseas.

Whether or not UK capital gains tax has to be paid on the sale of foreign property will depend on:

1. Where in the world the property is located
2. Where in the world the vendor is located
3. How long the vendor has lived in the property
4. How long the vendor has owned the property
5. Whether or not the property was the vendor's primary residence.

MGI's global coverage means that clients can be provided with advice both in the country in which property assets are held and the country in which the investor is resident for tax purposes.

In essence, UK tax residents with foreign property that is not their primary residence could be liable to capital gains tax (CGT) when they sell it. In addition, many countries around the world levy their own capital gains tax on any property owned locally.

If there is a double taxation agreement in place, the UK resident will probably pay local

CGT in the country in which the property is located but will not usually be liable to further UK CGT as well.

Some countries in the world have a tapered rate of capital gains tax that is paid depending on the length of time the property has been owned, while others charge a flat fee. Because capital gains taxation rules and rates differ from country to country and depend on so many different factors, anyone advising a client on the purchase or sale of property overseas should seek specific international taxation advice to avoid what can easily be a very costly mistake.

CYPRUS – CURRENTLY A ‘HOT DESTINATION’ FOR OFFSHORE TAX PLANNING

The status of Cyprus as a member of the EU, coupled with its very low tax regime means it is no surprise that even relatively small UK clients are starting to use Cypriot companies to save significant amounts of tax.

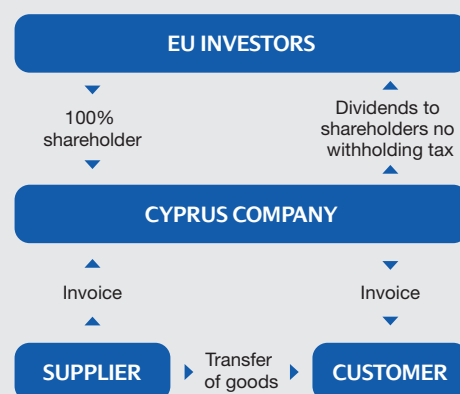
Specifically:

1. A Cypriot company that owns property in the UK can sell the property free from CGT in Cyprus.
2. UK investors who own companies via a Cypriot holding company benefit from very low levels of withholding tax on dividends paid to

the holding company, and zero withholding tax on dividends paid to the UK shareholders by the holding company.

3. UK importers that buy goods from Asia for delivery to the EU can often use a Cypriot company to benefit from a 10% rate of corporation tax. The goods do not have to go via Cyprus and the UK shareholders can take dividends free of withholding tax (see diagram).

With member firms throughout the world, MGI can provide access to local knowledge on tax and company law matters in Cyprus and other low-tax regimes.



OBAMA'S WAR ON TAX HAVENS

Uncertain times for companies with US parents

Earlier this year, the US Government proposed a number of international tax reforms that are intended to close several perceived tax loopholes.

If enacted, the proposals - which are currently expected to affect accounting periods commencing after 31 December 2010 - could have a significant impact on non-US companies with US parents.

Some of the key proposals are set out in the inset boxes below:

1. Changes to tax deferral

At the moment, businesses that invest overseas can take immediate deductions on their US tax returns for expenses supporting their overseas investments, and can defer paying US taxes on the profits they make from those investments. The administration's proposals on deferral would prohibit companies from taking such deductions, with the exception of research and development expenses, until they repatriate their earnings.

If implemented, the changes are bound to add even more complexity to the reporting requirements for UK subsidiaries of US companies.

2. Changes to foreign tax relief

At the moment double tax relief is calculated on a corporation by corporation basis, allowing selective repatriation of certain pools of non-US earnings and cross-crediting.

Obama's second proposal would require US taxpayers to calculate double tax relief with respect to foreign taxes paid by a subsidiary on a blended basis. This would involve aggregating foreign taxes paid with earnings and profits of all non-US subsidiaries.

This could result in companies converting non-US subsidiaries in high tax jurisdictions

into branches so that foreign taxes associated with those non-US earnings would be treated as taxes paid directly by the US taxpayer and therefore eligible for a direct foreign tax credit rather than being subject to the blending.

It is also thought that US multinationals may consider repatriating high taxed income prior to the enactment of this proposal. Where there are UK subsidiaries in the group it is worth noting that the new UK dividend exemption could facilitate such repatriations.

3. Reform of "check the box" rules

US Groups have, for many years, been able to use so-called 'check-the-box' rules so that foreign subsidiary corporations are treated as 'disregarded entities'. Taxpayers can move money between these disregarded entities, thereby shifting income from high-tax to low-tax jurisdictions without incurring US tax on that income.

There is speculation that the check the box rules may be repealed altogether, which would create huge uncertainty for many entities subject to US taxation.

4. Cracking down on the abuse of tax havens by individuals

A comprehensive package of disclosure and enforcement measures has been proposed to make it more difficult for financial institutions and wealthy individuals to evade taxes.

The proposals would increase penalties, as well as extend the statute of limitations for enforcement. US individuals would be required to report on their income tax return any transfers or receipts of money or property with a value of more than \$10,000 from any foreign financial account owned by them. Furthermore, US financial intermediaries that make such transfers would have to meet certain reporting requirements as well.

5. General anti-avoidance provisions

The US courts have developed a common law doctrine that denies a taxpayer the benefits of certain tax-motivated transactions regardless of whether the transaction satisfies the literal requirements of a provision. This is known as the economic substance doctrine. In order to ensure a consistent approach, the Obama administration is considering including the doctrine on the statute book.

From a UK perspective, this is a worrying development as we know that HMRC regularly meets with the IRS to share best practice and, if enacted in the US, it might not be long before a similar provision was introduced in the UK.

There is likely to be a lively congressional debate about the proposed changes to the US tax code and it is not clear what provisions will make it onto the statute book. However, one thing that is almost certain is that the changes will be sufficiently wide-reaching that very few UK clients with US tax-related affairs will be unaffected.

The message is therefore clear - anyone acting for US-related clients needs to keep abreast of the developments in case urgent steps have to be taken before the provisions are brought into force.



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|--------------------------------------|---------------------------------|---------------------|
| Carter Backer Winter | www.cbw.co.uk | +44 (0)20 7309 3800 |
| Copsey Murray | www.copseymurray.ie | +353 (0)1 661 0144 |
| Harrison Beale and Owen | www.hboltd.co.uk | +44 (0)1926 422 292 |
| Midgley Snelling | www.midsnell.co.uk | +44 (0)1932 853 393 |
| Milsted Langdon | www.milsted-langdon.co.uk | +44 (0)1823 445566 |
| Rickard Keen | www.rickardkeen.co.uk | +44 (0)1702 347 771 |
| The Rowleys Partnership | www.rowleys.biz | +44 (0)116 282 7000 |
| Seymour Taylor | www.stca.co.uk | +44 (0)1494 552100 |
| Watson Buckle | www.watsonbuckle.co.uk | +44 (0)1274 516 700 |

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RESIDENCY RULING LEAVES THOUSANDS EXPOSED

A Court of Appeal ruling has dealt a major blow to many UK citizens living overseas.

The court upheld an earlier ruling that Robert Gaines-Cooper, a British businessman who has claimed to be resident in the Seychelles since 1976, should be taxed as a resident of the UK.

Mr Gaines-Cooper had adhered to spending less than 91 days a year in the United Kingdom; however the court ruled that this alone was not sufficient. Mr Gaines-Cooper continued to have a house in Oxfordshire and it was contended by HM Revenue & Customs that for residency purposes this continued to be his main home, despite him not exceeding the 91 day rule.

HM Revenue & Customs supported their argument by showing that Mr Gaines-Cooper's wife and son resided in the property on a permanent basis. In addition his son had attended an English school in 2002 and Mr Gaines-Cooper's will was drawn up under UK law. HM Revenue & Customs contended that this all pointed to an individual who still regarded the UK as the 'centre of gravity for his life and interests'.

It is likely that Mr Gaines-Cooper will appeal to the Supreme Court; however what this case does tell us is that simply spending less than 91 days a year in the UK no longer automatically establishes a person as non-resident in the eyes of HM Revenue & Customs. It is necessary to show a person has actually 'left' the UK on a

permanent basis and, looking at the facts of this case, Mr Gaines-Cooper arguably never did.

The case, if upheld in the supreme court, has far-reaching implications for thousands of UK citizens now living abroad. Not only will celebrities like Lewis Hamilton (resident in Switzerland) have to prove they really have left the UK, so will less high-profile individuals such as those who have moved to Spain following their retirement.

In a time of increasing pressure on tax streams, this could prove a lucrative source of additional revenue for HM Revenue & Customs; therefore an increase in enquiries into residency status would not be a surprise.

A CARIBBEAN ACTIVITY HOLIDAY WITH A DIFFERENCE –

Try your hand at being a liquidator!

This year has seen the introduction of a host of new insolvency rules in the Cayman Islands which have highlighted some local quirks in the legislation.

Chief amongst these is the fact that, in the Cayman Islands, anyone can act as the liquidator in a solvent voluntary liquidation of company, including its directors, shareholders or even an unconnected third party.

So, for those adrenaline junkies who are bored of scuba diving, para-gliding, and snow boarding, there is now the chance to spend a week on the beach, winding up a company!



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