

MGI OVERSEAS ASPECTS

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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.

JERSEY CONSIDERS TAX INCREASE

Could this be the end of an era?

Jersey, one of the most popular and famous low tax jurisdictions, is considering a 50% increase in income tax for the wealthy.

The island is currently grappling with a shrinking economy and falling tax revenues which are directly attributable to the global downturn in financial services. It also faces fierce competition from rival low tax territories and pressure from larger countries that view their tax systems as predatory.

The proposal is to raise the income tax rate to 30% for those earning more than £100,000 per annum. This would be huge leap on the flat 20% rate levied since the 1940s.

However, the Jersey Government fears that levying higher taxes on those earning more than £100,000 could trigger the departure of high earners in the financial services industry. This would lead to a ripple effect as the jobs and businesses they support are impacted.

In tandem with the potential income tax increase, the Jersey Government has also proposed £50m of annual spending cuts.

Despite the recent announcement on a proposed increase, a number of commentators believe that such an increase is still unlikely because of the substantial negative effect it would have on the island. However, if such a change was introduced it is also likely that ways of mitigating ones exposure would prove difficult because of Jersey's long-standing general anti-avoidance rule.

One point worth noting is that it is not envisaged that such an increase would impact ultra wealthy



tax exiles moving to Jersey who can secure flat tax deals of at least £100,000 a year. However, the Jersey Government is reviewing the system for some long-term foreign residents who pay less.

As a final point, Jersey is also considering reforms of its business tax system after some European

governments claimed the current system breached the spirit of EU rules. The public consultation on the island's fiscal strategy suggested that some combination of increased value added tax, social security contributions, domestic property rates and income tax was most likely.

WHY TAX EXILES FIND IT HARDER TO CONTROL THEIR KIDS

And why it is vital that anyone with overseas property gets appropriate advice in relation to inheritances and inheritance tax.

A client recently moved to the Channel Islands. His company remains in the UK and his shareholding in it is very valuable. For many years he had (jokingly?) been in the habit of waving his Will at his kids and threatening to disinherit them if they weren't nice to him.

“Common law spouses have no rights at all.”

Imagine his horror when he realised that under the Jersey Laws of Succession, he can no longer enforce his threat. No matter what provisions he makes in his Will, his wife and children are each entitled, as of right, to a third of the shares.

Similar pitfalls can face those with overseas property. For example, in France, an individual has no discretion, regardless of the provisions of any Will, as to who inherits the element of his estate that is defined by French law as the “Reserved” element.

The Reserved element can be as much as 75% of the total. It will be available to children, parents or spouses in accordance with the French Laws

of Succession, which would hardly win an award for contemporary political correctness. Children conceived in an adulterous relationship have their rights reduced by one half and common law spouses have no rights at all.

One option commonly used to circumvent French succession laws is to acquire property through a French entity called a Société Civile Immobilière or SCI.

Alternatively, it is also possible to hold assets in trust to achieve specific desired objectives. However, difficulties can then

arise if property is held in a jurisdiction that does not recognise the concept of a trust. Spain is an example of such a jurisdiction. Accordingly, an English Will that leaves Spanish real estate to a UK trust can be very difficult, if not impossible, to implement.

For anyone with overseas interests, it is imperative that reliable advice is obtained in relation to inheritance issues. Appropriate planning is essential if unpleasant surprises are to be avoided.

The key is to take a two-pronged approach



to planning. Clients have to understand the consequences in the UK of tax planning strategies that are adopted overseas and, equally, they have to understand the consequences overseas of tax planning strategies that are adopted in the UK.

Clients of MGI member firms in the UK are ideally placed in this regard. They benefit from not only specialist advice on UK tax also from the local knowledge of foreign tax provided by the MGI association worldwide.

OBSCURE TAX AMNESTY

An HM Revenue & Customs loophole may allow some taxpayers to benefit from an obscure tax amnesty – “The Lichtenstein Disclosure Facility”.

The UK tax authorities have for a number of years realised that offshore tax evasion is a significant drain on tax revenues and have taken many steps to tackle this. These have included more information sharing agreements with other territories, and “tax amnesties”.

In 2009, HM Revenue & Customs introduced the New Disclosure Opportunity (“NDO”) to allow UK taxpayers to disclose previously unreported offshore income sources and pay a reduced 10% penalty. The NDO closed on 31 March 2010, although an opportunity does still exist for certain individuals to access the reduced penalty rate.

The Lichtenstein Disclosure Facility (“LDF”) was introduced in the autumn of 2009 and will be operational until 2015. In essence it is open to all taxpayers with Lichtenstein assets or income sources.

The benefits of the LDF include:

- A 10% fixed penalty on underpaid liabilities

- The assessment period can only go as far back as 1999/2000
- A single composite rate can be used to calculate one's liability if calculating the actual liability proves administratively burdensome
- A single point of HMRC contact for the disclosure

What is unusual about this disclosure opportunity is that a taxpayer with no current Lichtenstein assets can, under certain circumstances, still take advantage of the LDF by simply acquiring a Lichtenstein asset. For example, a UK taxpayer who has held a Swiss bank account for many years (and on which he has not declared any income to HMRC) can open a new bank account in Lichtenstein and then use the LDF to disclose the Swiss bank account. This allows the taxpayer to take advantage of the benefits which the LDF offers.

Unfortunately, in order to qualify for the LDF the Liechtenstein asset can only be acquired using funds which have not originated from the UK.

With the introduction of the LDF, and the previous other disclosure facilities, HM Revenue & Customs believe they have given UK taxpayers ample opportunity to get their offshore tax affairs in order. Therefore in the future UK taxpayers can expect significant increases in the penalties imposed on hidden offshore income.

In fact, the most serious cases of evasion will now carry a 200% penalty which is double the maximum penalty which could have been imposed previously.

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In summary, those who have previously not taken advantage of the tax amnesties will now find themselves operating in a much more rigid penalty structure than before. However there is

an opportunity for certain individuals to still take advantage of the reduced 10% penalty rate if disclosure is made under the LDF.

It is not uncommon for clients to want to “come clean” about their affairs but the prospect of large penalties can be a significant deterrent. Happily the LDF may offer a solution.

DOUBLE TAX RELIEF AND THE UNITED STATES LIMITED LIABILITY COMPANY (“LLC”)

HM Revenue & Customs has traditionally worked on the basis that a UK taxpayer in receipt of profits from an LLC will not be eligible for double tax relief. A recent first-tier tax tribunal case, *Swift v HMRC*, has suggested that this approach may not always be correct.

The case is of significance to any clients who have interests in US LLCs.

The *Swift* case looked at whether the LLC's UK resident members were entitled to double tax relief on tax paid in the US. The decision went in favour of the UK taxpayers and against HMRC's published guidance and practice about the UK tax treatment of US LLCs. Not surprisingly, HMRC have now appealed the decision and do not accept that they need to change their current practice.

HMRC's published guidance states that a US LLC is a separate taxable entity for UK tax purposes regardless of how the LLC is taxed in the US. In the US an LLC is usually (although not always) treated as a transparent entity which means that tax is imposed on the members of the LLC and not on the LLC itself.

This has resulted in a “mismatch” of the types of income being taxed in the two countries and so double tax relief has not been available to UK members of the LLC who are individuals and not companies.

Income treated as the individual members' income as it arises in the US has been treated in the UK as a distribution or dividend from a company. An individual receiving a dividend from an overseas company is unable to claim double tax relief in the UK for the foreign tax paid on that income.

The taxpayers in the *Swift* case challenged this treatment by treating the income from the LLC as partnership income on their UK tax returns and claiming double tax relief for the US tax paid.

The tribunal looked at the facts of the case and concluded that the treatment adopted by the UK taxpayers was correct. The profits of their Delaware LLC belonged to the members as they arose and therefore the income should be treated as partnership income for UK tax purposes and not company distributions. They were therefore entitled to claim double tax relief for the US federal and state taxes paid on the LLC's income which together exceeded 40% and therefore covered their UK tax liabilities in full.

The tribunal has made it clear that the *Swift* decision rests on the particular facts of the case and would not apply to all US LLCs. The key facts were that Delaware law allows for an LLC agreement to determine how the profit is allocated to its members and in this case the tribunal agreed that the profits belonged to the members as they arose rather than on distribution to them.

This case has highlighted the fact that the UK tax treatment of income from a US LLC is not as clear cut as the HMRC would have us believe. UK individual members of a US LLC might be entitled to double tax relief to reduce or eliminate their UK tax liabilities on their income from the LLC.

We wait for further developments on this as HMRC appeal the decision. In the meantime, UK resident members of US LLCs should review how the *Swift* case affects their UK tax position.



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BANKRUPTCY TOURISM

European visitors to the UK aren't just packing their buckets and spades, they're bringing their credit card debts too – and then leaving them behind!

Thanks to the UK's relatively 'lax' personal insolvency regulations, we are now a net importer of bankruptcy and recent press reports have highlighted an influx of EU nationals entering the UK to avail themselves of our debtor-friendly laws.

The extent of the "migration" has almost certainly been exaggerated but there is little doubt that a number of our more canny EU cousins have crossed the Channel with the sole purpose of availing themselves of our benevolent bankruptcy regime.

Under EU regulations bankruptcy and other insolvency proceedings are recognised across all the EU jurisdictions. Consequently, a UK bankruptcy order will extinguish a Spanish debt in just the same way as it clears a UK debt. What's more, the length of time that an individual remains bankrupt depends on the rules that apply in the country in which the bankruptcy order is made and not the country in which he has most of his debts.

Thanks to the free movement of European Citizens within the EU it is relatively easy for individuals and businesses to choose which EU country they want to deal with their insolvency.

So why are so many choosing to go bust in the UK? Under UK bankruptcy legislation, an individual is discharged (released from his debts) within a period of no more than 12 months.

This can be compared with a corresponding period in Germany and Ireland which could be as long as nine or 12 years respectively, so it is clear to see why it is worth shopping around for a friendly jurisdiction.

However, it is not as simple as driving off the ferry at Dover, finding the nearest County Court and submitting a bankruptcy petition. For a company or an individual to commence its proceedings here it needs to show that its Centre Of Main Interest ("COMI") is in the UK.

Unfortunately, the European legislation does not provide clear guidance as to how the courts should determine an entity's COMI.

In practice, the courts have generally accepted that an individual will have a COMI in the UK if he can show that he has been "settled" in the area for at least six months. In some cases judges appear to have accepted a copy of a standard six month assured shorthold tenancy agreement and little else as sufficient evidence of UK residence for COMI purposes.

More recently, the courts have started to take a much closer look at debtors' circumstances in an attempt to avoid this apparent abuse of process.

Another attraction of jurisdiction shopping for unscrupulous debtors is that it can make it harder for their assets to be identified and realised for the benefit of creditors. In theory, a bankrupt is obliged to disclose his worldwide assets to his trustee in bankruptcy but, in practice, if they are not voluntarily disclosed, it can be difficult for a UK trustee to discover the existence of foreign property.

That said, trustees are getting ever more experienced in this area. Indeed, membership of MGI means that member firms in the UK have access to invaluable local knowledge of and expertise in foreign jurisdictions which vastly improves the prospects of successful tracing and recovery of undisclosed overseas assets.

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For further information on MGI please call +44 (0)1825 872113 or visit www.mgi-uk.com