MILESTONE
TAX NEWS

ISSUE 38
11 March 2013

Clear. Concise. Commercial.

Introduction

Welcome to the March edition of the MTN.

Fire and brimstone are the order of the month. Angst has been rife in the office of late: the Public Accounts Committee has been a target for much our spleen-venting as was the driver of a silver Range Rover who carved Miles up on his trusty Vespa on Marble Arch this morning. The culprit, like so many drivers these days, was using his smartphone to text while negotiating rush hour traffic (note, it was a "he" not a "she" which so shocked Miles he almost fell off the Vespa with no help at all from the Range Rover). Words were, we believe, exchanged with the Range Rover driver scuttling off with Yorkshire expletives ringing in his ear. Using the power of social media Miles decided to tweet the registration number after verifying it using the CC London website. Cunning if you ask us.

Social media has, it can't be denied, changed the way in which we access news, communicate with others and to be fair how we live. It has been central to the current tax debate with Twitter and other on-line mediums allowing lefties, activists and bloggers and blaggers all to get their views across…which is a good thing in a democracy. But the problem is that the debate is debased; it becomes meaningless because the media are interested in only extreme points of view rather than considered opinion – it is for this reason campaigners like Richard Murphy are given so much (hot) air-time. Tax is, by definition, extremely complex, so dumbing down the avoidance debate and failing to appreciate the fifty shades of grey that exist will never result in a sensible outcome. With the help of politicians (Margaret Hodge and the PM being unlikely bedfellows) and journalists, neither of whom are seemingly interested in understanding tax law or even the most basic of principles, the tax avoidance debate rumbles on without achieving a great deal. The rule of law is also at risk of being undermined (let alone the UK's standing on the world stage) and in this regard Sally has written an excellent article on this issue.

Miles has been asked to speak at the Chartered Institute of Taxation's European Branch meeting in Paris on 22 March. The half day seminar will be held at the offices of Bureau Francis Lefebvre and Miles will be speaking about the controversy of internet companies in the UK – Amazon, Google, Ebay and so on! For more information please click here.

We have included a whole heap of goodies relating to tax efficient investment schemes, US citizenship issues and of course because a MTN would not be complete otherwise, new international and domestic tax legislation.

Happy reading!
The Milestone Tax Team

Why not follow us on Twitter?
http://twitter.com/MilestoneTaxUK

ALSO IN THIS ISSUE...

DEAL OF THE WEEK

Retirement Planning using a Qualifying Non-UK Pension Scheme

We have recently advised a client who is in the throes of returning to the UK (why we hear you ask…!) on the use of a QNUPS for his retirement planning. The acronym stands for Qualifying Non-UK Pension Schemes (QNUPS). This pension scheme was introduced on 15 February 2010 pursuant to Statutory Instrument 2010/51.

A QNUPS allows an individual to make post-tax contributions with the return on investment rolling-up tax free. It should be noted that a QNUPS is an unapproved pension scheme and as such the tax deferral benefits are subject to HMRC interpretation. The biggest risk being that the pension scheme is used for tax avoidance purposes rather than pension / retirement planning. If this is the case, the QNUPS would be considered to be a settlement and taxed accordingly (i.e. income and gains would be attributed on an arising basis to the settlor).

To qualify for QNUPS status the overseas pension scheme should:

- be established in a country or territory that regulates pension schemes
- not provide benefits to the member before the normal retirement age (circa 50)
- be 'recognised for tax purposes' in the country or territory that it is established
- be open to residents and non-residents in the country or territory in which it is established

Assuming the QNUPS looks and operates like a pension scheme, it is flexible enough to make a wide range of investments, including:

- stocks
- bonds
- structured products
- private company shares

In terms of contributions, there are no specific limits or indeed guidance as to what is reasonable. The risk is that, if the contributions are unusually large or disproportionate to the individuals overall wealth then HMRC could argue that the purpose of the arrangements was tax avoidance rather than retirement planning. This would, as stated above, bring in to play a raft of unpleasant anti-avoidance provisions rendering the arrangement…useless.

The benefits of a QNUPS are there for all to see. We hope and pray that scurrilous IFA's and scheme-merchants don't mis-sell or abuse the rules as this is a sure fire way to get HMRC to amend the rules. If we're honest, it's only a matter of time…

DEAL OF THE WEEK

Use of a Luxembourg Finance Company for real estate mezzanine funding

As a result of the pick-up in activity in the real estate sector we have been advising a non-UK fund on how best to finance UK property acquisitions. Because of HMRC's attack on what constitutes "UK source", careful drafting of loan agreements is not, in our view, sufficient to ensure interest is payable without deduction of withholding tax. The National Bank of Greece case, which has often been cited (perhaps erroneously in our view) as authority for non-UK source loan planning, is dangerous territory leaving two options open for consideration.

The first is to structure the debt as a deeply discounted security. The analysis here is that the discount is not interest and as such is not caught by the withholding tax rules. The alternative is to rely on a double tax agreement (DTA). However, using a DTA structure is subject to the beneficial ownership test and in this regard typical in and out (or back to back) financing arrangements are, in our view, fraught with danger. We have mentioned the Indofood and Prevost cases many times in the MTN and remain unconvinced that the "beneficial owner" of interest in a back-to-back arrangement is the intermediary company.

For several years we have advised clients to structure debt via an intermediary finance vehicle (FinCo) we have access to in Luxembourg. FinCo is owned and operated by an independent third party and whilst similar to an intermediary finance company, FinCo issues bonds in consideration for funds advanced (say £2mn). The bonds pay a quarterly coupon (on either a simple or compounding basis) with the rate determined by reference to comparable market mezzanine rates. The actual coupon rate applied to the bonds should be verified by an independent third party.

FinCo uses the proceeds of the bond issue to provide a 'plain vanilla' mezzanine loan facility to the borrower. It is likely (and, in fact, is a condition of Luxembourg tax law) that the interest rate applied to the mezzanine loan facility is higher than the coupon applied to the bond.

The advantages of using an independent financing vehicle based in Luxembourg to provide funding to UK transactions are as follows:

i) the coupon applied to the financing provided to the borrower should meet the bona fide commercial tests contained in the UK's transfer pricing rules (should these subsequently become relevant); and
ii) interest paid on the finance facility will reduce the amount of the borrower's profit assessed to tax;
iii) the interest paid on the mezzanine finance facility ought to be free from UK withholding tax under the UK / Luxembourg double tax treaty;
iv) the coupon on the bond paid by FinCo is not subject to Luxembourg withholding tax.

Please contact us if you would like to discuss debt structuring in this way.

UK

HMRC Guidance determining residency under treaties with non-standard tie-breakers

Most double tax agreements (**DTA**) that follow the OECD Model Convention contain a tie-breaker provision designed to determine tax residency (and therefore the primary taxing rights) of persons who are technically resident in the respective states under domestic tax law. The standard corporate residence tie-breaker focuses on the place of effective management – a concept that is well-recognised and followed in international law.

However, in some circumstances, the tie-breaker is dependent on mutual agreement between the respective states (such as the DTA between the Netherlands and the UK). HMRC has published new guidance contained in INTM120085 listing criteria that will be used to determine corporate residence to ensure business profits are not liable to double taxation:

- place of incorporation, central management and control and effective management
- place of the company's business and its economic links to each state (including the location of premises, employees, doing business and customer service providers); and
- what is administratively the simplest route for the company.

These are very practical considerations to be viewed in the round and should be of assistance to companies operating in jurisdictions where no tie-breaker exists.

UK

Preparing for FATCA and banking difficulties for "US persons"

We have recently been advising several US clients on the impact of the US Foreign Account Tax Compliance Act (**FATCA**). This draconian new law will impose extremely broad withholding and reporting requirements on many non-US financial institutions and certain other non-US entities.

One individual was born in the US when her British parents were on secondment to the US for a 6 month period in the 1950's. She left the US at the ripe old age of 4 months and has never lived there since let alone possessed a Green Card or US passport. Despite this, and having lived all her life in the UK, she is a US citizen.

The effect of this is that our client is subject to annual reporting and filing requirements of her worldwide income (in excess of $18,450 per annum) to the US tax authorities. If US citizens do not file tax and information returns, they are subject to penalties and interest. In addition to reporting requirements, US citizens have to comply with "Foreign Bank Account Reporting" for financial interests in pretty much any type of financial account; and also report information about the creation of, and transfers to or distributions from, any trust they are connected with on an annual basis. Penalties of up to 35% of the amount transferred may be applied for failure to report or late reporting.

As we have seen, the reporting requirements are onerous and penalties can be heavy. Accordingly, our clients have had to take a decision whether or not to renounce their US citizenship (thus, easing the way forward in the future) or retain their US citizenship and be subject to automatic information disclosures to the US once FATCA comes into effect. Purely from a tax perspective, we advised our clients that they should renounce their US citizenship to avoid future US reporting, filing and liability problems. In this case, the US exit charge on individuals' assets did not apply.

Do come and see us if you have any similar issues and we can assist with the renunciation process.

THE NETHERLANDS

Dutch exit charge deemed incompatible with EU freedom in European Commission v Kingdom of the Netherlands

From one exit tax to another….the ECJ gave its decision on 31 January 2013 that the Dutch exit charge that imposes a charge on unrealised gains on companies and individuals emigrating from the Netherlands infringes the freedom of establishment principle.

In response to the ECJ's judgment in National Grid Indus (the first case that ruled the Dutch exit charge incompatible with EU freedoms) the Netherlands has published draft legislation to comply going forward. Controversially, although the new legislation allows emigrants to defer payment of tax on unrealised gains, such deferral will attract interest and be subject to strict conditions relating to financial guarantees (so as to protect the State's position). It remains to be seen whether the ECJ accepts the new legislation or whether it is disproportionate and in breach of the TFEU.

SINGAPORE / JERSEY – GUERNSEY

Income Tax Treaty 2012

Following slowly on the heels of its arch rival the Isle of Man, both Jersey and Guernsey have started to recognise the importance of double tax agreements (not the same as TIEAs!). A new, comprehensive DTA has been signed by Singapore and Jersey, the main features of which are as follows:

- 0% withholding tax on dividends
- 12% withholding tax on interest payments (subject to an exception)
- 8% withholding tax on royalties
- a credit method to avoid double taxation
- a Singapore indirect tax credit for underlying corporate tax by a subsidiary in Jersey if it owns directly or indirectly more than 10% of the share capital.

One suspects that Channel Island companies will be used primarily to hold shares in Singapore sub-holding companies allowing tax efficient repatriation of cash upstream. One might also expect Guernsey image right companies (using the now legendary image rights registry) to exploit such IP via a Singapore company to mitigate source withholding tax on royalties and license fees.

The treaty also contains various deviations from the OECD Model. Of particular interest is the deviation to the definition of "permanent establishment". However, the Singapore / Jersey treaty contains a broader definition such that a permanent establishment exists where consultancy services are provided by an enterprise through employees or other personnel. There is an important caveat, however, that consultancy activities will only constitute a PE if they continue (for the same or a connected project) for a period or periods aggregating more than 365 days within any 15 month period.

FEATURE COMMENT

PAC undermining the rule of law

“A man may with us be punished for a breach of law, but he can be punished by nothing else”, so the saying goes. Famous theorists from as far ago as the days of Plato, Aristotle to Dicey, Raz and Hayek all upheld the utmost importance of the rule of law. Essentially, the rule of law is that law should govern; no one can be punished or made to suffer except for a breach of law proved in a court, no one is above the law, and judicial decisions determine the rights of persons. Indeed, Cicero stated that “we are all servants of the law in order that we may be free”.

However, the approach of the PAC in recent months to the Big 4, Starbucks, Google, and Amazon strikes an uncomfortable chord. For anyone who has watched the committee and cringed with embarrassment or squirmed with frustration at the PAC’s lack of basic understanding of commercial and tax principles, finger-pointing and accusatory remarks (indeed, including phrases such as “but that’s unfair”, etc) might be concerned by the PAC’s ability to undermine the rule of law.

Bearing this in mind, it is interesting to note that the PAC’s official purpose is “for the examination of the accounts showing the appropriation of the sums grants by Parliament to meet the public expenditure” (Standing Order No 148). Further, by their own admission, the PAC states that it “does not consider the formulation or merits of policy” (their emphasis added). It is somewhat contradictory that their approach to the Big 4 and multi-nationals has been to invoke a substantial amount of moral judgment.

Such arbitrary power is a danger to the rule of law. Personal whims and lefty prejudices of those in the PAC do not create a steady, level playing field in which to consider the tax planning methods of large multinationals. Arguably, Starbucks has been made to suffer (note, anti-avoidance protests, campaigning and damage to reputation) but not as a result of any illegality. Indeed, there has been no breach of law and if campaigners wish to change international tax laws, they should focus on doing so within the rule of law.

See our Milestone Comment on the PAC hearing of 12 November 2012 for more of our thoughts on the PAC’s approach and stay tuned with us on Twitter for further developments.

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