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Vistra News

Edition 11 - December 2009

Vistra celebrates its third anniversary



Last month, it was three years since the Vistra brand was launched. During this time Vistra has grown into a truly Global provider of trust and corporate services, present in twelve jurisdictions. The articles in this edition underscore Vistra's Global reach in dealing with diverse issues related to different jurisdictions.

In the previous edition of our newsletter, we discussed the changing face of fund administration. In this edition, we have a closer look at a recent decision of the European Court of Justice, which gives a significant **boost to the Luxembourg fund market.**

Furthermore, we have an **update of recent changes to UK tax legislation,** including residence and domicile and the extension of the New Disclosure Opportunity to 4th January 2010. In addition the relevant points of the Pre-Budget Report (9th December) are highlighted.

Also, we debate some improvements to **Cyprus tax legislation,** which makes the jurisdiction an even more attractive place to establish intermediary holding companies. Finally, we put the spotlight on **Hong Kong Double Tax agreements,** making the jurisdiction the perfect gateway between Asia and Europe.

I wish you all a Merry Christmas and all the best for the exciting year to come.

Bart Deconinck
Chief Executive Officer

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A new boost for the Luxembourg fund market



By the implementation of the law on Specialized Investments Funds ("SIF") in 2007 the Luxembourg fund market was given a real boost (see Newsletter April 2009).

SIFs have no withholding tax, are exempt from Corporate Income Tax and Net Wealth Tax and are subject to a taxation of only 0,01% on the Net Asset Value. This was received with great enthusiasm by the Fund market.

By the middle of 2009 over 900 SIFs had already been registered in Luxembourg. This represents an increase on the average growth of 400 funds per year. In total, approximately 9000 funds have been setup in Luxembourg to date.

Due to a recent decision of the European Court of Justice ("ECJ") in the Aberdeen case, the Luxembourg fund market has once again been boosted.

"...a number of funds had been transferred to Luxembourg from other offshore jurisdictions such as Cayman or BVI."

In this case, the ECJ decided that the Finnish tax regime was discriminatory since a dividend distribution to a Finnish fund by a Finnish company was NOT subject to withholding tax in Finland while a distribution by the same company to a foreign EU investment fund (a Luxembourg SIF incorporated as a SICAV, a variable capital investment company) is subject to withholding tax.

As a result of this decision, dividend distributions to Luxembourg SIFs should be treated equally from a tax perspective as distribution to local EU entities for example should be exempt from withholding tax in the distributing country.

Microfinance funds

In the draft law stating the budget for 2010, the Luxembourg government proposed to exempt Microfinance Investments funds from subscription tax. Research illustrates that 45% of the assets held worldwide in Microfinance are domiciled in Luxembourg.

"45% of the assets held worldwide in Microfinance are domiciled in Luxembourg."

Onshore trend

The list of newly incorporated registered funds in Luxembourg reveal that whilst some are newly established funds, a number had been transferred to Luxembourg from other offshore jurisdictions such as Cayman or BVI.

This trend for onshore incorporation can be attributed to the present market and highlight that:

- (i) investors prefer regulated funds in an onshore jurisdiction above non regulated funds in an offshore jurisdiction;
- (ii) investors seek transparent structuring;
- (iii) investors seek investor protection.

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Onshore trend (continued)

By re-domiciling a fund to Luxembourg, the well informed investor is able to find a solution in one place that offers, a (lightly) regulated vehicle, suitable for a wide range of investors and offering the possibility to invest in all kinds of assets. The other benefits are that it is relatively easy to set up and can be considered a "regulated fund" in Luxembourg with an attractive tax regime.

For more information about the re-domiciliation of a fund or the services we can offer in Luxembourg, please contact:

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UK update & Pre-Budget Report 2010



Residence and Domicile

Over the last twelve to eighteen months there have been a number of changes to the residence and domicile rules. Recent tax cases have clarified some points and more responsibility has been put on the taxpayer.

Domicile

Domicile must now be claimed on the tax return, even if previously agreed in writing. The previous regime, whereby the Inland Revenue would specifically agree domicile, has been abolished. In addition, it does appear that there is a certain amount of confusion over the "fee" of £30,000 and whether and when it is payable.

To clarify: once an individual who has claimed non-domicile has been resident in the UK for seven years, if he/she then wishes to be taxed on the remittance basis (ie upon funds sent to the UK), a fee of £30,000 is payable. This decision can be made on an annual basis and does not affect the actual non-domicile status. There is a de-minimus limit of offshore income less than £2,000, so in some years the fee may not be payable at all.

Careful planning via trusts and loan arrangements can avoid the £30,000 payment for some years.

Residence

The UK is still a very attractive jurisdiction for non-UK persons. The non-domicile rules remain intact for the first seven years (see above) and even after that continue to represent a very good option.

The new residence ("ordinarily resident") rule seeks to tax frequent visitors to the UK (more than 90 days on average over a four year period). The change now is a midnight rule and days of departure do not count.

"The UK is still a very attractive jurisdiction for non-UK persons."

Those concerned with being caught out by the rules, need not be. Most business visitors are resident in countries with which the UK already has a tax treaty. Most treaties are clear on residence and it will, in the vast majority of cases not be an issue where the person is resident.

The rule is intended to deter the frequent visitor from offshore island tax havens, with whom the UK does not have a treaty.

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Leaving the UK

The UK Revenue has also now become much tighter on the rules governing leaving the UK. Previously, the general rule was that to become non-resident, the individual could simply leave the UK and not return for a period of five years. The individual had to ensure that their visits to the UK did not exceed more than 90 days on average over a four year period and no more than 183 days in any year. Given the previous rule of days of entry and days of departure not being counted, this was not particularly onerous.

The Inland Revenue has now split this rule into two categories these are leaving to be employed abroad and leaving without employment.

For an individual who leaves to take up full time employment abroad, he/she is not required to sever all ties with the UK whereas, the individual who seeks to leave without arranging for full time employment needs to sever such ties if he/she wishes to convince the Inland Revenue that he/she is genuinely non-resident. In most cases, this will not be an issue, but careful planning will be necessary for the individual who leaves merely for tax reasons and does plan to return at some stage.

Pre-Budget Report (PBR) (09/12/09)

The PBR is a pre-cursor to the main budget which will be announced in March 2010. For overseas investors and non-domicile resident individuals the changes will not affect either their status or the tax regime, apart from the proposed increase in the higher rate tax to 50% from 40% on income over £150,000 per annum. For most resident non-domiciled individuals either they are not affected at all or the changes will make little impact to their affairs.

In the small print of the PBR, mention was made of the intention to introduce a reduced rate of corporation tax (10%) on patent income after April 2013.

Whilst this may well make the UK attractive for licensing patents, given its extensive treaty network, the date of implementation is still some way off and circumstances may change to mean that it may not be enacted.

Liechtenstein and the New Disclosure Opportunity (NDO)

The NDO notification deadline has been extended to 4th January 2010 and mainly targets UK residents and domiciled individuals.

Due to banks and other institutions not being selective, non-resident and non-domiciled individuals have received letters warning of the deadline, but having offshore accounts is of course perfectly legitimate and part of tax planning.

“ Liechtenstein and the UK have signed a Memorandum of Understanding to jointly launch the Liechtenstein disclosure facility.”

UK residents and domiciles are the only individuals that have to disclose and pay tax on these accounts; unless a non-domiciled person chooses after seven years to pay tax on offshore accounts (see Domicile above).

Liechtenstein and the UK have signed a Memorandum of Understanding to jointly launch the Liechtenstein disclosure facility. This is a new process which allows UK resident individuals to settle taxes on previously undisclosed funds.

Depositors who had accounts in Liechtenstein as at 1 August 2009 were initially targeted, but interestingly from 1 December 2009, these special terms have been opened up to depositors with accounts in any other jurisdiction if they establish a connection with Liechtenstein. The disclosure period will only go back ten years instead of the usual twenty and provides immunity from prosecution.

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Company Law Changes

The three key changes for Company Law are:

- (i) Private companies cannot now have a sole corporate director.
- (ii) There must be at least one individual director.
- (iii) There is no longer a requirement to have a company secretary.

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Improvements to tax legislation in Cyprus



Improved tax system

On October 22, 2009, the Cyprus Parliament passed important amendments to the Income Tax Law (ICT) and the Special Contribution for Defence of the Republic Law (SDT) both of which will further improve the Cyprus tax system and aim to attract additional investors. The main amendments are: (i) a relaxation of the conditions for the dividend exemption for dividends received from foreign subsidiaries and (ii) a reduction of the tax burden on so-called passive interest.

(i) Amendment to the dividend exemption

Prior to these amendments dividends received on foreign shareholdings of less than 1% were subject to SDT at a rate of 15%. The 1% minimum shareholding has now been abolished so that Cypriot companies holding portfolio investments can now benefit from the dividend exemption regardless of their percentage of shareholding, as long as one of the two set criteria are met.

These criteria are:

- (i) The foreign income tax burden on the profits of the foreign shareholding should be 5% or more; **or**
- (ii) Less than 50% of the subsidiary's activities result, directly or indirectly, in investment income.

“Cypriot companies holding portfolio investments can now benefit from the dividend exemption regardless of their percentage of shareholding.”

In situations where the direct shareholding is not subject to an effective income tax rate of 5%, mostly the activity test (2nd option) will be met and therefore in almost all cases dividends received by a Cypriot company remain tax exempt. The dividend exemption will only not apply if the ultimate activities consist of passive investments.

With regard to capital gains on securities, these were already fully tax exempt without any conditions and this exemption remains unchanged.

(ii) Amendment to the taxation of passive interest

Interest earned by a Cypriot company derived from the ordinary course of business or closely related thereto is subject to 10% income tax.

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Before the amendment of the ICT, other interest income, meaning passive interest as interest earned on deposit accounts and bonds, would normally have been subject to SDT at the rate of 10% and would also be taxable with ICT (effectively at the rate of 5%, as for 50% an exemption would be granted), total rate therefore 15%.

“ Both passive and non passive interest are both now taxed at 10% with retroactive effect from 1st January 2009.”

However, since the amendment passive interest will be entirely out of the scope of ICT and therefore the effective tax rate of passive interest is also set at 10%.

As a result, both passive and non passive interest are both now taxed at 10%, with the small difference that passive interest is taxed with SDT (and no ICT) and non passive interest is taxed with ICT (and no SDT).

Both amendments have been introduced with retroactive effect from 1st January 2009. This means that those companies already established in Cyprus can benefit from these amendments from that date.

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Spotlight on... Hong Kong Double Tax Agreements



Hong Kong has established Double Tax Agreements (DTAs) with China, Thailand, Belgium and Luxembourg. Its desire to extend further its double tax agreement network, has lead to it also signing an agreement with Vietnam although this is awaiting approval.

The tax system in Hong Kong is very straightforward and the key advantages of this system remain the same under the new DTAs. The favorable offshore tax regime stays intact and is respected, and income from shareholdings or investments in the respective countries is free of tax, whether it is remitted dividend or capital gains income.

“ Hong Kong has established Double Tax Agreements (DTAs) with China, Thailand, Belgium and Luxembourg and it is signing an agreement with Vietnam.”

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In addition for those signing a DTA with Hong Kong, they will also benefit from that fact that it does not impose any withholding tax on paid out dividend or interest payments, again this will not change under the new DTAs.

A closer look at these DTAs

Belgium

Under the treaty with Belgium, if a Hong Kong holding company holds at least 25% shares in a Belgian company, dividend payments are not subject to any withholding tax, and neither are they taxed in Hong Kong.

Furthermore, the 15% interest withholding tax in Belgium is reduced to 10% if paid to a Hong Kong Company, and the withholding tax on royalty payments is reduced for both countries to 5%.

“ For those signing a DTA with Hong Kong, they will also benefit from that fact that it does not impose any withholding tax on paid out dividend or interest payments.”

Luxembourg

As with Belgium, there is no withholding tax on dividends out of Luxembourg under the condition that the shareholding is at least 10% or the acquisition cost was at least 1.2 million EUR.

In addition, capital gains derived by Hong Kong companies from disposal of shares in a Luxembourg company are tax exempt, regardless of the percentage of shareholding. The only exception is the disposal of shares in a real property holding company.

There is no withholding tax on payments of interest from both sides and in respect of royalties, Luxembourg does not withhold any tax and Hong Kong will only apply 3% for payments to Luxembourg.

An interesting feature in this DTA is that Luxembourg companies doing business through a permanent establishment in Hong Kong are fully exempt from tax on the income in Luxembourg.

Thailand

There are no real advantages gained in the withholding tax rates applying to dividend, royalties or interest as they remain the same in most cases, although there are a few exceptions from Thailand to Hong Kong.

The main advantage is for Hong Kong investors in Thailand that benefit from the full exemption from the 15% withholding tax usually imposed on any gain from the disposal or transfer of shares in a Thai company (except when real estate is involved), and the exemption from the 15% withholding tax on service fees where there is not a taxable presence in Thailand.

Vietnam

The DTA between Hong Kong and Vietnam has similarities with the one with Thailand including the fact that the main advantages are not to be found in the withholding taxes of dividend, royalties or interest.

However, because Vietnam is considered an increasingly important country in Asia for production, the reduction of royalty payment WHT presents an interesting element of the DTA - the 10% WHT of Vietnam will be reduced to 7% for royalties paid on the use, or the right to use, of any patent, design or model, secret formula or process.

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As with the Thailand DTA, the agreement with Vietnam will provide tax exemption, usually imposed on any gain from the disposal or transfer of shares in a Vietnam company to Hong Kong residents, provided that the sale does not exceed 15% of the Vietnamese Company and that this Company does not hold 50% or more of its assets directly or indirectly in immovable property in Vietnam.

Furthermore, under the DTA a Hong Kong resident Company without having a legal entity will be exempt from the Business Income Tax component provided it does not carry on business in Vietnam through a permanent establishment.

Under the DTA there is also the possibility to offset or credit Vietnam business income tax against Hong Kong profits tax on the same income in case this occurs. An interesting feature is that this includes the Vietnamese tax that would have been paid, but for an exemption or reduction granted as tax incentive for foreign investments (the so-called 'sparing provision').

Hence, the main advantages in the latter two lie in the use of Hong Kong as a location for a holding company when investing in Thailand or Vietnam.

China

In essence the DTA grants Hong Kong favorable treaty concessions comparable to many other jurisdictions.

Under the DTA, dividends out of China to Hong Kong are subject to a 5% withholding tax, while for other treaty countries in most cases this is 10%.

Withholding tax on interests and royalties from China to Hong Kong is 7%, while all other countries are subject to 10%, including almost all treaty countries.

Given the additional benefits of Hong Kong's location and cultural connections, Hong Kong has a clear advantage as a holding jurisdiction for investing into mainland China.

Conclusion

The European treaties make Hong Kong a perfect gateway for investments into Europe, as under the European Parent-Subsidiary Directive, dividends between two European companies are exempt from dividend withholding tax.

Reversed this also brings several advantages for business in or with Asia, certainly when dealing with China, Thailand or Vietnam.

“ The European treaties make Hong Kong a perfect gateway for investments into Europe.”

Hong Kong's strength is that it does not impose any withholding tax on dividends paid to foreign companies and dividends / capital gains derived from sale of capital assets by Hong Kong companies are not subject to tax in Hong Kong. The Luxembourg/Belgium-Hong Kong holding structure can possibly make profits repatriation and exit of investment more tax efficient for European investors wishing to invest in Asia.

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