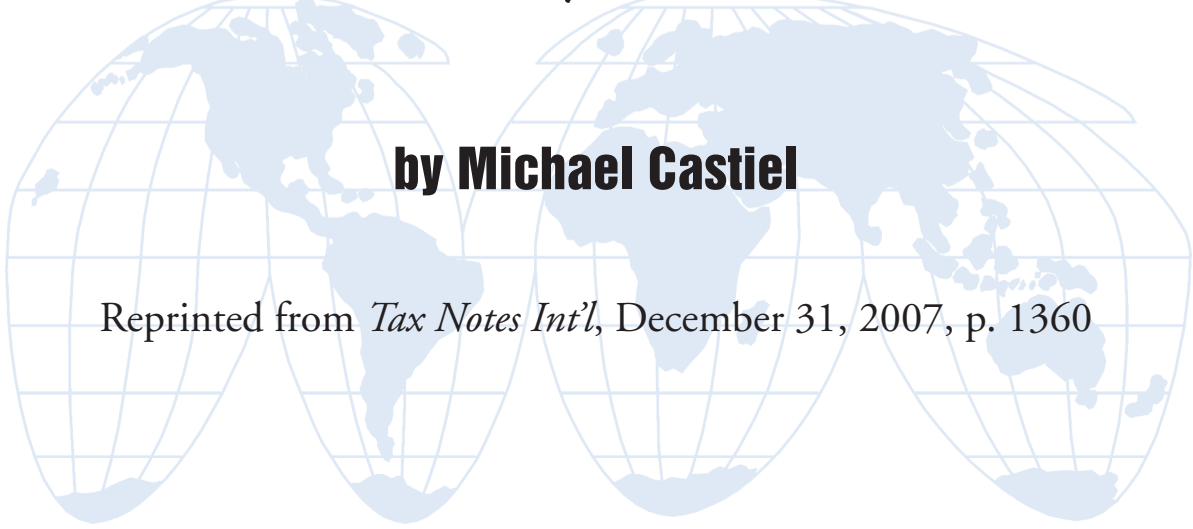


Gibraltar: 2007 Year in Review

by Michael Castiel

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Spurred in part by the fiscal requirements of the European Union, Gibraltar's decision to pursue a policy of "low tax" rather than "no tax" has continued to make the jurisdiction attractive to international investors, and its appeal was enhanced by the announcement in the 2007 fiscal budget of plans to steadily reduce corporate taxes over the coming three years to an eventual target level of between 10 percent and 12 percent.

The timetable to reduce corporate taxes, announced by Chief Minister Peter Caruana, whose party, the Gibraltar Social Democrats returned to power for an historic fourth term in October, could even be accelerated. However, there has been disappointment in Gibraltar's financial and commercial communities that the bold new reduced flat corporate tax rate of approximately 12 percent that had been widely anticipated was not delivered in the 2007 fiscal budget.

Instead, corporate taxes for 2007-2008 are to be reduced by only 2 percentage points — from 35 percent to 33 percent — with additional reductions to 30 percent the following tax year and, finally, to 27 percent in the 2009-2010 tax year. The flat corporate rate that is expected to be put in place by mid-2010 will be no higher than 12 percent, bringing Gibraltar on a par with other beneficial tax regimes in Europe, such as those in Malta and Ireland.

While the financial services sector had hoped for a bolder approach to the corporate tax question, the government clearly has felt constrained by pressure to phase out tax-exempt companies by 2010 and the anticipated decision of the European Court of Justice on Gibraltar's appeal against the European Commission's ruling on regionality in relation to Gibraltar's broader corporate tax proposals. (For prior coverage, see *Doc 2007-6595* or *2007 WTD 52-4*.)

Though 2006's helpful ECJ judgment in *Portugal v. European Commission* (C-88/03) (see *Doc 2006-*

18627 or *2006 WTD 173-9*) has strengthened Gibraltar's optimism about the eventual outcome of its legal challenge, the uncertainty that the litigation has engendered and continues to fuel is one of the few clouds on the jurisdiction's financial horizon. The ECJ was expected to issue a ruling in the Gibraltar case in September 2006. However, the ECJ's dealings with the high-profile Microsoft case have delayed its deliberations on Gibraltar's proposed tax structures, and a decision now is not expected before the first quarter of 2008.

The legal clash between Gibraltar and the European Commission stems from Gibraltar's decision in 2002 to set a zero rate of corporation tax for all companies, but to introduce new taxes on staff employed and premises occupied, with a proposed cap of 15 percent of profits. There would also be an annual company registration fee of £300 for companies generating income, or £150 for companies with no income. Subject to EU clearance, two sectors of the economy — financial services providers and utility companies — would also pay a new tax on profits.

The new taxes were to take effect in 2003, and in March of that year the EU Council of Economic and Finance Ministers confirmed that the proposed reforms did not constitute harmful tax measures. However, in April 2004, the European Commission argued that, in terms of "regional selectivity," the new tax regime would give Gibraltar-domiciled companies an unfair advantage over their counterparts in the United Kingdom. It also argued that because the taxes were based on payrolls and the occupation of business premises, offshore companies registered in Gibraltar would be unlikely to incur any tax liability. It rejected the reforms and, in effect, suggested that for tax purposes, Gibraltar should be regarded as part of the United Kingdom.

In January 2005, in an action targeted at making its corporate tax legislation compliant with EU state

aid rules, Gibraltar abolished its qualifying companies tax regime (under which companies were able to elect the tax rate that applied to them). That move cost the Gibraltar government an estimated £1.5 million in annual tax revenues. The government allowed the remaining 80 qualifying companies to switch to the exempt companies tax regime. However, later the same month, it was announced that Gibraltar had been given until December 2010 (2007 for new exempt companies) to phase out its exempt companies tax regime after the European Commission ruled that the scheme also violated EU state aid rules.

Grandfathered companies will be able to continue to enjoy their tax exemptions with the blessing of the EU Commission for three more years before tax-exempt companies are phased out at the end of 2010. Accordingly, the government went out of its way in the 2007 fiscal budget to stress that to sustain a successful economic model post-2010, Gibraltar will have to adopt a very competitive tax model. On the basis that it is no longer acceptable to have one set of taxes applicable to resident companies and a different one to nonresidents (as has been the case under the exempt companies regime), the government has made it clear that it is firmly committed to a system of low taxes for all companies.

Any suggested exit of foreign companies — at least on a scale that could severely damage Gibraltar's economy — is highly unlikely, regardless of the

outcome of the pending ECJ judgment. Nevertheless, it is clear that the ECJ's decision will have a significant impact on Gibraltar's economy, particularly on its thriving finance center. Even if the anticipated global economic slowdown does materialize, a favorable ruling from the ECJ is expected to open the doors to an unprecedented inflow of international investment in the fast-growing funds industry, in insurance and financial services, and by numerous global banks seeking to use Gibraltar in increasingly complex structured finance transactions.

In the unlikely event that the ECJ rejects Gibraltar's arguments, the government is believed to have an alternative plan, though it is understandably reluctant to be seen as anything but confident about the outcome. Apparently, there are legislative loopholes that, despite a negative ECJ decision, would permit the introduction of an alternative tax structure providing a tax regime slightly higher than that of Dublin, Ireland.

The first few months of 2008 should bring about the highly anticipated ECJ judgment that will hopefully clear any lingering doubts about the future development of Gibraltar's finance center and help to further enhance Gibraltar's competitiveness in international finance. ◆

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