



Recent Developments in the Gibraltar Tax System

The last months of summer were a busy time for tax professionals in Gibraltar and, in particular, for Chris White and Albert Mena, the senior partners of Hassans' Tax and Overseas Property Team.

On 16th of June the long awaited text of the new Income Tax Act was published as a draft for public comment. Shortly after, on 1st of July, the 2010 budget was announced. In the first week of September following the consultation period, the revised Income Tax Bill was published. The Bill is expected to come before Parliament in the middle of October. Although Chris and Albert had little to do with the budget, they were in the thick of the legislation being instructed by the Government to lead on the drafting and dealing with addressing the issues arising from the consultation process.

10% Corporate Rate

The publication of the draft Income Tax Act signaled the commitment of Gibraltar to compliance with the ideals of the Organisation for Economic Co-operation and Development's code of practice and the end of Gibraltar as a tax jurisdiction which relied on administrative or statutory ring fencing and exemption of the liabilities of inward investors to attract those investors. By creating a level playing field for both local and inward investors, Gibraltar swept away the last obstacles to it taking full membership of the company of respectable jurisdictions which no other jurisdiction had grounds to black list or censure.

Although the European Court of Justice had not denied Gibraltar the opportunity to implement the payroll/penalty tax regime which had previously been prepared and submitted for EU approval, the decision taken by the Government was that it would be a more responsible approach and more consistent with the modern requirements for the acceptability of Offshore Finance Centres to retain the principles of the current Act, modernise it and reduce the rate of tax chargeable on corporate entities from 22% to 10%. The only exception to this low rate of tax would be a surcharge of an additional 10% on utility companies (electricity, telecommunications, water, petroleum and sewage) and any company which has a dominant market position and abuses it.

Overall advantages

The Government has been able to retain the territorial basis of taxation and will only tax income which accrues in or derives from Gibraltar. It is interesting to note that the new UK Government has recently launched a consultation paper exploring the possibility of also moving parts of its own tax system to a territorial basis.

The opportunity has been taken to advance the Government's program of reducing the taxation of savings and passive income by removing from chargeability to tax all non-trading interest and royalties. This adds to the extensive list of unearned income which is not taxable including any part of a dividend which arose from the non taxable profits of a company and any receipt from a fund marketed to the general public. The liability to tax of a recipient of a distribution from a fund not open to the general public follows the liability of the entity underlying the fund and, in those cases where the underlying entity has a Gibraltar liability, the recipient will enjoy any tax credit attached to that liability.



Ability to deliver the rate

That the 10% tax rate is sustainable over the long term was demonstrated by the details of Gibraltar's economy announced in the budget.

In the year to 31 March 2010, economic growth was 5.4%, the budget showed a surplus of £29.4 million on a Gross Domestic Product of £848 million. Public debt represented 15.2% of GDP. The comparison is that the UK and much of the rest of the developed world have suffered significant deficits following the global downturn economic crisis; debt is about 70% of GDP in the UK and in many countries of the developed world, approaching 100%.

This state of the economy has enabled not only the reduction of the corporate tax rate to 10% but also has several subsidiary effects.

When combined with the lack of Capital Gains Tax or any sort of Estate/Wealth tax, the abolition of taxation on virtually all investment income, is a powerful attraction for those, whether individuals or companies, who wish to relocate from a high tax jurisdiction.

For those individuals who have earned income and elect to be taxed without allowances (the "Gross Income Basis") the top rate of tax for earnings up to £353,000 will be 29%. Above that level tax rates begin to fall. The effective rate of tax on earnings of £1m is 20%, anything above that is charged at 5%.

Allowances for those still claiming them rather than using the Gross Income Basis system will rise by 2.8%.

The quid pro quo for the significant reductions in the levels of corporate and personal taxation is that the Government has ensured that it will be able to collect the tax it intends to collect. To this end, it has introduced a number of measures to modernise the assessment and collection of tax and to encourage a climate of compliance which will minimise the avoidance or evasion of tax and bolster the level playing field between taxpayers.



Albert Mena and Chris White

Fairness

The majority of tax in Gibraltar is paid by employees subject to the Pay as You Earn system and the employee pays the tax due on their income in the month they earn it. Previously the self employed and companies paid tax on their profits of the previous year and were given 8 months or more after the end of the tax year to pay their tax.

The view of the Government was that this was unfair to employees and that it was necessary to switch the self employed to taxation based on their current year profits and companies to taxation based on the profits of their accounting period.

To remove the late payment advantage the Government has introduced not only self assessment but also a system of payments on account.

Two payments on account of the liability, based on the previous year's tax, are due before the tax return is made and payment of the balance on the nail is due when the tax return is made.

Commissioner's powers

To deter late payment and late compliance, the new Act introduces a structure of interest and penalties for failure to comply with tax obligations to ensure that anyone who does not fulfil his legal obligations will pay heavily.

The Commissioner of Income Tax is also armed with a series of information powers which enable him to demand information from the taxpayer or any other person who has information relevant to the taxpayer. The aim of the powers is to put the Commissioner in the position that, if he feels that a tax return is not accurate, he can gather the necessary information and documents to prove his point.

Again heavy penalties await those who do not comply with the Commissioner's demands and those who the Commissioner discovers to have been cheating the system. In the worst cases the Commissioner has access to criminal law to prosecute those who have cheated on their tax or who refuse to give him information. These measures are consistent with and complimentary to the Tax Information Exchange Agreement powers and emphasise the commitment of the Government to complying with the OECD code of practice.



Conclusion

There is a lot more detail to the legislation but, all in all, its aim is to create a corporate low tax environment and lay the foundations for not only the security of the corporate environment but also the continued lowering of the tax burden on individuals.

On the one hand, the environment created by the new legislation not only places Gibraltar amongst those jurisdictions who comply with all international codes of conduct relating to tax behaviour but also leaves it as an attractive and tax efficient location for individuals and businesses who wish to locate either in whole or in part to a pleasant, tax efficient new home.

On the other hand, the new Act is more complicated than the old Act and both local and international Gibraltar taxpayers will need good guidance to ensure that they do not fall foul of the compliance requirements and avoidance restrictions.

For any further details on or assistance with the new Act or how the Gibraltar legislation has developed over the last ten years please contact Chris White or Albert Mena.

Anti-avoidance

The new Act not only attacks the illegal evasion of tax but also combats avoidance.

The major planks of the anti avoidance legislation are a General Anti Avoidance Provision ("General Provisions") and legislation relate to countering the loss of tax by the transfer of assets abroad and by transfer pricing.

The General Provisions allow the tax authorities to act against avoidance generally and is coupled with a requirement to disclose the planning of tax schemes so that unacceptable schemes can be legislated against before they become a drain on the government finances.

The legislation on the transfer of assets abroad is modelled on the UK legislation. It shares the intention of taxing any income arising abroad on a structure which transfers out of the jurisdiction profits which should be taxed in Gibraltar

The third major element is legislation against transfer pricing. Gibraltar has introduced legislation consistent with the need to eliminate the unacceptable manipulation of prices where transactions take place between entities in different jurisdictions.

Clearance Procedure

A clearance procedure has been put in place to enable those who are planning their tax liability to check that they are not crossing the avoidance line and, in consistency with international best practice, any rulings on application for clearance which have the potential of application to persons other than the applicant will be published (in an anonymous form).



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