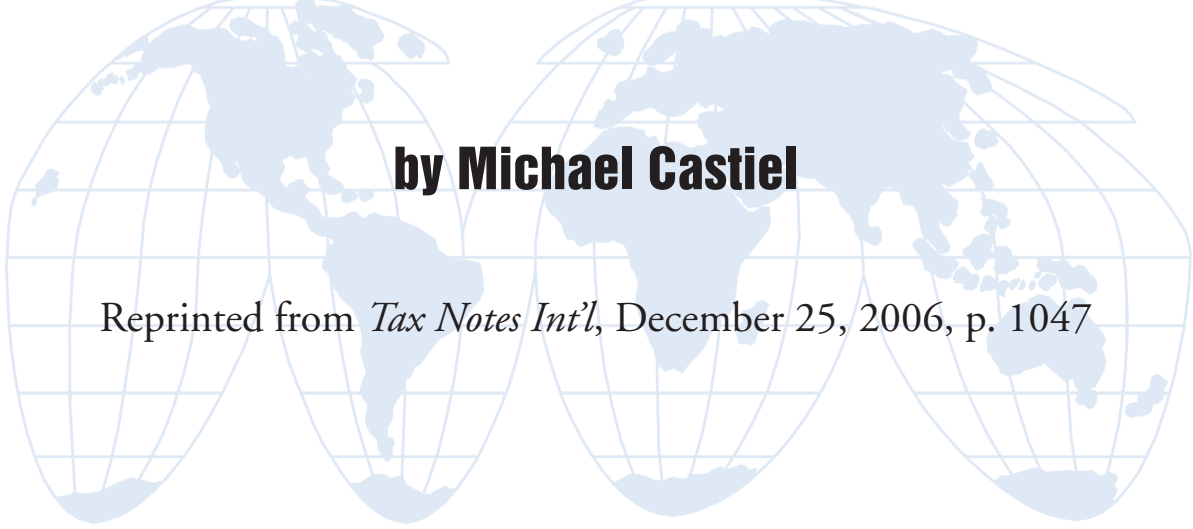


# Gibraltar: 2006 Year in Review

**by Michael Castiel**

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Continuing economic stability, substantially improved relations with neighboring Spain, and sound prospects for success in a European Court of Justice ruling on proposed new tax measures are creating a climate of optimism in Gibraltar as 2006 comes to an end. Combined with existing legislation, those factors will continue to strengthen the jurisdiction's attraction as a tax-friendly base of international business.

The fiscal climate, encouraged by a 2006 budget designed to promote economic growth, has already attracted promised inward investment of more than US \$1.5 billion.

That has strengthened the Gibraltar government's fiscal hand, allowing a 2006 budget marked by tax reductions and cuts in rates based, according to the government, on an economy that's "healthy, prosperous, and growing." A list of favorable records announced during the budget — including an all-time-high surplus of more than GI £22 million and record capital reserves of GI £93.6 million — point to "an economy which is bigger than ever before," according to government sources.

The year 2006 also saw the last registration of companies under the old exempt companies tax regime. That is gradually being phased out and will end in December 2010, following protracted negotiations between Britain, Gibraltar, and the European Commission. In 2005 an agreement was reached to end the Gibraltar tax-exempt company regime, which had been challenged by the European Commission on the basis that the regime breached EU state aid rules. The formal agreement provided for any tax-exempt companies in existence before the date of the agreement to continue to benefit from their status until December 31, 2010. The agreement also allowed a limited number of new tax-exempt companies to be established until June 30, 2006. Those companies would be able to benefit from their tax-exempt status until December 31, 2007. And since July 1, 2006, no more tax-exempt certifi-

cates have been issued under the Companies (Taxations & Concessions) Ordinance. Existing certificates will therefore lapse — either by the end of 2007 or the end of 2010.

However, although no more tax-exempt companies will be registered and all other companies are now subject to 35 percent corporate tax, under the current regime those companies are taxed only on Gibraltar-sourced income so that there are still distinct tax advantages for international companies with no Gibraltar-derived income to using Gibraltar corporate entities. Gibraltar has no VAT, and for personal investors, there are no death duties. It is also a jurisdiction where there are no stamp duties on share transactions.

One of the most significant developments in recent years has been the growing sophistication of the income tax authorities, which can and will now look in advance at proposed tax structures and issue an advanced tax ruling, providing an element of certainty from the outset.

Another major development is Gibraltar's position as an attractive EU holding company jurisdiction, particularly for corporations based outside the European Union (for example, the United States and Canada) that may have investments or subsidiaries within the European Union and that may want to repatriate dividends back to the parent's jurisdiction, free of EU withholding taxes. Several major U.S. corporations have recently used Gibraltar to set up corporate structures that will benefit from the EU parent-subsidiary directive and allow repatriation of funds back to the United States free of EU dividend withholding taxes.

Although Gibraltar still awaits the outcome of its challenge to the European Commission ruling on aspects of the proposed new tax system, there is cause for optimism in two recent judgments delivered by the ECJ. Jointly they serve to consolidate

Gibraltar's position as a center that offers tax-efficient solutions to international clients.

Although the ECJ has not yet handed down its decision on Gibraltar, local lawyers argue that the recent Azores judgment "paves the way for the introduction in Gibraltar of a new corporate tax code to replace the exempt company regime." In September 2006 the ECJ confirmed Portugal's right to make separate tax arrangements regarding the Azores without infringing EU state aid rules. The case is significant because, in a parallel action, the European Commission is questioning Gibraltar's right to have a corporate tax structure different from that of the United Kingdom.

Although the Azores relationship with Portugal is different from that of Gibraltar and Britain, the legal portents are good. While the Azores forms an integral, though autonomous, part of the Portuguese state, Gibraltar is not part of the United Kingdom. Although a proposed new constitution approved by Gibraltar's electorate in a referendum on November 30, 2006, creates a revised postcolonial relationship between the U.K. and Gibraltar, it remains — at least for the time being — an overseas territory of the United Kingdom under the existing 1969 Constitution.

Although legal arguments could never be the same in both instances, the ECJ's finding that Portugal does possess the right to make separate tax arrangements for the Azores (as part of the Portuguese state) without infringing EU state aid rules suggests that the United Kingdom should equally possess such a right in the case of Gibraltar, which does not form part of the United Kingdom. Gibraltar's case should be significantly strengthened now that Gibraltar has adopted the new constitution.

The second judgment — part of a wider series of litigation between Cadbury Schweppes and the U.K. Commissioners of Inland Revenue — answers a referral for a preliminary ruling from the U.K. Special Commissioners of Income Tax. The significance of the case is that it casts light on the circumstances in which international clients can shop for jurisdictions offering a favorable tax regime without being penalized for it by the home jurisdiction. In a landmark ruling, the court held that an EU national cannot be deprived of his rights under the EU treaty simply because he seeks to profit from some tax advantages. Similarly, a company cannot be deprived of its rights of establishment under the EU treaty just because it seeks to benefit from a favorable tax regime.

That judgment means that investors wishing to benefit from Gibraltar's favorable tax regime can now safely do so without fearing penalties from home jurisdictions, provided that their presence in Gibraltar is not "artificial" and that they are carrying on "genuine economic activities."

With the development of better relations with Spain, an agreement with Spain regarding the economic development of Gibraltar's airport, which will result in direct flights between Gibraltar and Madrid, and the anticipated resolution of any remaining uncertainties over Gibraltar's right to have a competitive tax regime distinct from that of the United Kingdom recognized by the European Commission as being fully compliant with EU law, 2007 will likely see further consolidation of Gibraltar's position as a leading European-based financial. ♦

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