



Government of Gibraltar  
Ministry of Finance  
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Intended Bill for a new Income Tax Act  
Pre-legislative Briefing Paper:  
The Government's response to comments received

2 September 2010

**INTENDED BILL FOR NEW INCOME TAX ACT  
PRE LEGISLATIVE BRIEFING PAPER  
COMMENTS RECEIVED: THE GOVERNMENT'S RESPONSE**

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In June 2010 the Government published a draft of an intended Bill for a new Income Tax Act. The draft was accompanied by a pre legislative briefing paper that summarised in narrative form the main changes to the current legislation introduced by the intended draft Bill.

The Government invited comments to the draft intended Bill, and received comments from:

- The Finance Centre Council
- The Gibraltar Society of Accountants
- The Association of Trust & Company Managers
- STEP
- The Gibraltar Insurance Association
- The Gibraltar Bankers' Association
- The Gibraltar Funds & Investments Association
- The Gibraltar Chamber of Commerce
- The Gibraltar Federation of Small Businesses
- Several individual firms and companies

A substantial number of points were raised, some seeking clarification or interpretation, and others seeking modification of the intended Bill. All have been carefully considered. The Government has accepted the overwhelming majority of the points made, as a result of which changes have been made to the intended draft Bill. These changes are shown marked up on the attached copy of the intended Bill.

The Government is grateful for the helpful and constructive responses received to its invitation for comments, as a result of which the Bill that will be submitted to Parliament has been considerably improved.

The Government intends to publish the Bill during the week commencing 30<sup>th</sup> August, with a view to it completing its passage through Parliament before the end of October 2010.

It is the Government's policy, consistent with its desire to ensure that Gibraltar is positioned within mainstream financial and business jurisdictions that this legislation should comply with the EU Code of Conduct on Business Taxation, even though the Code does not have legal effects.

The remainder of this document comprises a brief summary, in narrative form, of the main changes made to the intended Bill in consequence of Government's acceptance, in whole or in part of points made by those who have commented on the draft intended Bill.

## **1. Administration, enforcement, penalties, sanctions etc**

### **1.1 Moratorium**

The Government has already made clear that the creation of a 'climate of compliance' is a necessary condition for the continued reduction of tax rates for those who pay their dues. However, the Government accepts that the intended Bill creates a significantly different technical and legal obligations environment and that it is fair to allow people an appropriate period of time to become familiar and adjust. Accordingly, the Bill will contain a moratorium until 30 June 2012 before which fines and penalties will not be incurred. The moratorium will not apply to interest on unpaid tax.

### **1.2 Discretion for innocent error**

The Bill will contain a provision giving the Commissioner discretion to waive, reduce or discharge any penalties under the Act in cases of inadvertence where he is satisfied that there was no intention to avoid, evade, delay or defer tax.

### **1.3 Publication of defaulters ( so called 'Name and Shame') provisions**

The so called 'name and shame' provisions will apply only to cases where payments have not been made in respect of sums deducted from or due on account of a third party, i.e. PAYE and Social Insurance contributions. These are also preferential debts and other traders have pressed the Government for transparency to aid creditworthiness assessment. The provisions will not apply to the

persons' own tax liabilities. In addition the Bill will require Commissioner to give 14 day's written notice of intention to name and shame, thus giving yet a further final opportunity for payment and the avoidance of publication.

#### **1.4 Amnesty**

In order to allow taxpayers to begin the new regime with a 'clean slate' the Bill will make provision for the implementation of an amnesty scheme in respect of past non compliances.

#### **1.5 Notification of Arrangements**

Non notification of notifiable arrangements will continue to incur a penalty but will not incur a criminal offence. The penalty will thus be financial only, amounting to up to £200 per day. This will also be subject to the aforementioned moratorium on penalties.

For clarification, it is stated that the notification obligations only apply to arrangements post the commencement of the new Act, and the Commissioner will issue Guidance Notes as to the nature of arrangements that will be notifiable.

#### **1.6 Service by post**

The period for deemed receipt by post will be increased to 7 days. See also Commissioner's new discretion in relation to penalties for innocent default.

#### **1.7 Penalty for failure to provide documents**

The maximum prison term is reduced from 5 to 2 years.

#### **1.8 Postponement of tax payment pending appeal**

The commissioner's discretion to allow postponement is increased from 1 month to 3 months, and the Minister's proposed power to allow longer periods is removed.

### **1.9 Penalty for non production of document relating to a third party**

A right of appeal against the imposition of a penalty has been included.

### **1.10 Advance Payments**

The Government has accepted the view expressed that the new system of payments on account may cause hardship to companies and self employed persons who have seasonally variable income or who suffer a material deterioration in income from one year to the next. Accordingly, the intended Bill has been modified to allow the Commissioner discretion to waive or reduce the payments on account when he is satisfied that they would exceed the eventual liability to tax. To avoid abuse of this facility, interest will be payable from the date on which the payments on account were due on any greater amount which is eventually established to be due by a person who avails himself of this facility.

## **2. Charging Provisions**

### **2.1 Territorial Basis of taxation**

The intended Bill retains the existing basis of taxation, namely the territorial basis. This was under scored by the deletion of the words "received in" from the charging section which added nothing to the interpretation of the existing legislation.

This basis is now further under scored by the inclusion of a definition of the term "accrued in and derived from" based on the principles established by the Hang Seng Case, ie by reference to the location of the activities which give rise to profits.

The Bill will also include a provision to the effect that in determining location for these purposes, where an entity is licensed and regulated under Gibraltar law, the preponderance of activities which give rise to the profits of the business shall be deemed to take place in Gibraltar and accordingly be taxable in Gibraltar.

These provisions will subject to tax in Gibraltar the profits of a Gibraltar branch of an overseas entity established in Gibraltar through the use of EU passporting rights, whose activities will be deemed to be located in Gibraltar.

These provisions will not subject to tax in Gibraltar the profits of an overseas branch of a Gibraltar licensed entity, whose activities will be deemed to be located in the country where its overseas branch is located.

These provisions are brought about by the addition of defined terms in the interpretation section.

## **2.2 Infrequent Visitors**

The day count that triggers liability of infrequent business visitors has been increased from 22 to 30 days.

## **2.3 Dividends**

The intended Bill unintentionally subjected to tax the dividend received by a company from unquoted shares in non EU subsidiaries. The draft Bill will be modified to rectify this by deleting the words “ordinarily resident in Gibraltar” from sub paragraph (a)(i) of Class 1, Table C in Schedule 1. Accordingly there is no charge to tax on receipt by a Gibraltar Company of dividends from any of its subsidiaries.

Some Respondents have sought clarification as to whether the Act is intended to charge to tax the dividends received by a resident of Gibraltar from a private holding companies which derived from a dividend paid to it by a listed company. Under the current legislation as well as under the intended Bill, dividends received from companies listed on a recognised stock exchange constitute passive income and are not chargeable to tax. The intention of Schedule 1 Table C Class 2(b) is to put the recipient of the dividend in the same position as if they would be if they held the underlying listed shares themselves, thus allowing the shares to be held through a corporate structure without tax implications.

Accordingly, dividends paid by a Gibraltar company from non chargeable income (including dividend from listed companies) will not be chargeable to tax in the hands of even a Gibraltar resident recipient.

The cited provision allows a dividend from such a Gibraltar company to be split between its underlying constituent elements. To the extent that the Gibraltar company has income chargeable to tax in Gibraltar under the Acts Charging Section (territorial basis) as well as income from sources not chargeable to tax (eg dividends from a listed company), the element of the dividend corresponding to the former source will be taxable in the hands of the Gibraltar resident recipient, but not the latter part.

Dividends will be deemed to have been paid first out of taxed or taxable profits or reserves thereof.

## **2.4 Interest**

Consistent with the principle already established in the existing legislation, interest is only chargeable to tax if it is not passive income, that is, if it is trading income, i.e. a trading receipt. This is defined. That definition (in the intended Bill) included interest income earned by insurance companies on cash deposits of premium income.

Some Respondents have commented that such interest income does not derive from the trading activities of an insurance company and its inclusion is inconsistent with the Bill's underlying principle relating to the non charging to tax of passive interest income.

The Government accepts this view and the Bill has been modified to exclude reference to insurance companies from the definition of interest that is deemed to arise as a trading receipt.

## **2.5 Funds Income**

Schedule 1 Table C Class 2 is not intended to subject to tax income distributed by a Fund which would not be taxable when distributed by a Company. The Bill is thus being modified to make clear that any income from funds will be taxable on the basis of the structure of the fund i.e. on the basis of the structure underlying the Fund.

## **2.6 Trusts**

The Bill has been modified to avoid the unintended consequence that a different taxation outcome arises where the underlying circumstances are identical and the only difference relates to the nature of the structure holding the asset.

This, together with the need to accommodate certain historical issues, has led to the Bill being modified so that the residence of trusts is determined by the residence of its beneficiaries, and not of its settler or trustees.

Trusts will thus be classified either as resident or non resident trusts. The Spouse and issue of Category 2 individuals are deemed non resident for these purposes. Non resident trusts (i.e. trusts with non resident beneficiaries) will be taxable on their Gibraltar source income only.

Furthermore, in order that asset holding structures should not have tax consequences different from the underlying position, such income (i.e. income by trustees of a non resident trust that accrues and derives in Gibraltar) will not be liable to any further Gibraltar tax where the underlying income from which it derives has already suffered income tax in Gibraltar at source (eg company tax in the case of a dividend).

The Bill has been modified to exclude from the definition of Trusts Bare Trusts, whether they arise by declaration, constructively or resulting.

The definition of Trusts includes any disposition, agreement or arrangement of like nature. This would include things such as Foundations.

Where a Trust is liable to Gibraltar tax it shall be payable at the standard rate for persons other than companies, namely, 29%.

### **3. Filing of Tax and Dividend Returns & Accounts : Companies and Trusts**

### 3.1 Companies

Companies will not be required to file tax return or accounts unless they have assessable income (i.e. income accruing in or derived from Gibraltar).

Similarly, companies will only be required to submit dividend returns when they have a shareholder ordinarily resident in Gibraltar, and then only details in respect of dividends paid to such a person or to a Gibraltar company need be provided. Since dividends paid by companies listed on a recognised stock exchange are not taxable, those companies will not be required to make a return of dividends paid to ordinarily resident persons.

Companies with a turnover of less than £500,000 will not be required to submit **audited** accounts. They will however be required to submit unaudited accounts with a certificate from an independent accountant to the effect that the accounts are drawn up in accordance with the Act. The commissioner will retain a power to require production to him of audited accounts if he feels that it is appropriate in the course of an investigation into the liability to tax of a company.

The Government is willing to increase the £500,000 threshold and it is for further consideration whether it should be increased and to what level. There is a difference of views among those who have commented on this question.

Companies with a turnover above the minimum threshold and which must therefore submit audited accounts will have **9** months in which to do so. However they must submit a tax return and the corresponding tax payment within **6** months of their year end.

### 3.2 Trusts

Only resident trusts and non resident trusts with income accruing in or derived from Gibraltar will be required to submit accounts or file tax returns.

However, licensed Trustees will be required to submit an annual declaration stating that they have not provided trustee services to any trust that is a resident trust or to any non resident trust that has Gibraltar accrued/derived income except those trusts identified in the declaration.

## **4. Computation of Profits**

### **4.1 Accounting Standards**

The Bill has been modified to also allow for other Generally Accepted Accounting Practice approved by the Commissioner or UK accounting standards to be applied for the purposes of computing profits.

### **4.2 Capital Allowances**

The normal corporate rate will be **15%** rather than 10%. The Bill has also been modified to introduce the simpler 'Pooling' system. This system frees companies from the administrative burden of computing balancing allowances/charges by reference to allowances granted to date.

### **4.3 Deductions Allowable**

Para 1 of Schedule 3 has been modified to require the expense to have been for the purposes of the production of the income of the trade etc, as is the case under the existing legislation. The word 'necessarily' has been removed. The Commissioner will issue Guidance in relation to the classes of expenditure which will be allowed as deductions.

### **4.4 Apportionment of deductible Expenses**

Where a person has a mixture of taxable and non taxable income, deductible expenses must be attributed to each on a pro rata basis. Accordingly, expenses are deductible in the proportion that taxable income bears to total income.

#### **4.5 Entertainment Expenses**

The intended Bill does not disallow entertainment expenses outright but creates a regime that will allow the Commissioner to better police against abuse. The Commissioner will be able to distinguish between entertainment expenses incurred in winning and retaining business, and that which is not. The Commissioner will be issuing Guidance as to what he considers a deductible business entertainment expense.

### **5. Anti-Avoidance**

#### **5.1 Transactions with connected parties**

The anti avoidance provisions in Schedule 4 Para 4 will not apply where it can be demonstrated that the arrangements with a connected party are on bona fide, arms length commercial terms and thus their purpose is not to avoid tax. In these cases the exemption in para 7 will apply. This is so whether the arrangement involves intra group function outsourcing, reinsurance, insurance claims handling/settling/sales, related party lending/financing or any other arrangement of business.

Thin capitalisation provisions do not apply to payments between companies and thus do not apply to capital provided by a holding company.

#### **5.2 Deemed Dividends**

These provisions have been withdrawn from the intended Bill pending further consideration. They have been replaced by an enabling power to regulate and prevent the abuse of corporate structures to avoid or defer the incidence of personal taxation.

#### **5.3 EU Code of Conduct on Business taxation**

In order to underscore the Government's policy commitment to adhere to the EU Code of Conduct on Business Taxation, the intended Bill has been modified (at section 40) to make clear that the anti avoidance provisions, particularly those relating to transfer pricing, must be applied in manner consistent with Article 9 of the OECD Model Treaty and the OECD Transfer Pricing Guidelines.

Similarly, in relation to the procedure for advance clearance of arrangements by the Commissioner, the intended Bill has been modified to provide for the necessary degree of transparency, administrative process and other requirements of the Code of Conduct Group.

#### **5.4 Dual Employment Contracts**

Paragraph 6 of Schedule 4 has been modified to make clear that dual contracts with the same employer are caught by those provisions.

### **6. Benefits in Kind**

#### **6.1 Tax Free Allowance**

Where benefits in kind to an employee have an aggregate value of £250 or less per annum, no tax is payable on those benefits in kind and there is no obligation to declare or disclose them.

#### **6.2 Scheme whereby employer may opt to pay the tax on benefits**

The intended Bill has been modified to insert a scheme under which the employer or provider of the benefit in kind may opt to pay the tax in lieu of the employee. In such case the employee will not be required to gross up his income to include the value of the benefit or of the tax thereon defrayed on his behalf by the employer. If the total value of benefits in kind provided to an employee does not exceed £15,000 per annum, the employer shall pay tax thereon at 20%. In respect of any excess over £15,000 tax would be payable by the employer at 29%.

The value of benefits provided will be calculated in accordance with the provisions of Schedule 7.

This scheme is optional. The benefits provider may report under the conventional system leaving the employee liable for the tax.

Benefits in excess of an aggregate of £250 per annum must be reported to the Commissioner.

### **6.3 Motor Vehicles**

Wear and Tear allowances will be allowed on private motor vehicles. In addition, once the value of the vehicle has been fully assessed no further benefit in kind will be assessable for its use.

### **6.4 Company Loans**

Some of the comments received suggest a misunderstanding of the provisions. The provisions that loans to directors (including shadow directors) and shareholders (including connected persons) shall be treated as income do not apply to members of staff who are not directors or shareholders as defined above.

### **6.5 Trust Loans**

Loans made from the capital of a trust will continue not to be treated as income of the beneficiary under section 12(2).

### **6.6 Definition of Close Company**

This applies to five or fewer participators and any number of directors who are participators, i.e. the five or fewer does not refer to participators who are directors.

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