

Index of Issues

1. Introduction	2
2. Creating the Climate of Compliance	5
A. Information Powers	6
B. Investigation of Returns	8
C. Payment and late payment	9
3. Definition of Residence	14
4. The Tax Charge	15
5. Basis of Assessment	17
A. Basis of Assessment- Person other than Companies	17
B. Basis of Assessment for Companies	18
6. Rules for Ascertaining Profit or Gains	19
A. The measure of profits or gains	19
B. Deductions allowed and those not allowed	20
C. Capital Allowances	20
D. Interest as a trading receipt	23
7. Self Assessment	24
8. Payment of Taxation/Payments on Account	26
9. Trusts	27
10. Higher Rate Tax	28
11. Securing the PAYE Base – Benefits in Kind	29
A. Expense Payments	29
B. Vouchers and Tokens	30
C. Living Accommodation	30
D. Car, Vans and Related Expenditure	30
E. Loans	31
F. Sweeping Up- Residual Charge	32
G. Dispensations	33
12. Combating Tax Avoidance	33
A. Generic Anti-Avoidance Clause	34
B. Specific Anti-Avoidance Provisions	36
C. A Scheme requiring Notification of Arrangements	42
13. How we get there – Transitional Provisions	44
Annex I – Transitional provisions example for self employed individuals	49
Annex II – Transitional provisions example for Company A	50
Annex III – Transitional provisions example for Company B	51
Annex IV – Transitional provisions example for Company C	52

1. Introduction

The Government has already announced that the company tax rate in Gibraltar will fall from the present 22% to 10% (it has already fallen from 35% over the years since 1996) with effect from 1st January 2011. This coincides with the final termination of the historical Tax Exempt Company regime in accordance with the agreement to that effect with the European Commission.

This new rate will apply across the whole economy (save for utilities which will attract an additional tax of 10% thus totalling 20%). All historical concepts distinguishing between “onshore” and “offshore” are eliminated, thus definitively ending the last remaining vestiges of “tax haven” in Gibraltar and concluding the Government’s 15 year programme to reposition Gibraltar’s finance centre, in every respect, into the mainstream of EU financial services.

The new company tax rate has been set at a level that will both provide the Government with the revenues that it requires and also stimulate and sustain quality economic activity in a fiscal climate which, while conventional in its structure and content, is competitive as to rate of taxation. These lower rates of company tax for everyone must be (and are) accompanied by an improved culture of compliance and also by strong anti avoidance provisions to ensure that the all chargeable economic activity is effectively captured thus producing the intended revenue yield to the Government. The existing Income Tax Act is many decades old and is therefore of a different age and world to that which exists today. However, the Government has decided to keep the old legislation and the majority of its taxation principles, but to overhaul it, by a series of far reaching

amendments to make it fit for the modern age. Nevertheless, in order to facilitate good understanding and administration of the Act, the Government has decided to proceed by means of a New Act which consolidates the retained provisions of the Old Act with the changes now introduced.

The proposed text of the New Act is attached to this Pre Legislative Briefing Paper. The proposed New Act is the product of well over a year's worth of intense joint works between the Government and its extensive group of advisers drawn from the local legal and accountancy profession. It also reflects fundamental policy decisions necessarily made by the Government at the start of the process and during the formulation and development of the text of the proposed new Act. These principles enshrined in the Act will not therefore be changed.

However, and despite the extensive consultation with and input of local professionals through the Tax Working Group, the Government is publishing this Pre Legislative Briefing Paper, for a short period of time, to give those that have not participated in this work an opportunity to peruse the proposed text of the New Act before it is formally published as a Bill, and to make to the Government any points thereon that they may wish to make.

The Government intends formally to publish the Bill as a Bill by mid August, so that it may undergo and complete the legislative process during October. Accordingly, any comments invited by this Paper must be received, in writing, by 23rd July 2010, addressed to the Minister of Finance, at No 6 Convent Place.

The remainder of this Paper describes, in narrative form, the main new principles of, and changes introduced by the New Act.

This Paper, and its attachment (the text of the Bill for the proposed New Income Tax Act) is available on the Government's website : www.gibraltar.gov.gi

The Government is acutely aware that a perceived fairness in the way tax is imposed both in terms of structure and effect is essential to the willingness of the taxpaying population to pay the tax imposed on time.

The New Act therefore also seeks to establish a fiscal environment in which the Government can continue with its well established programme for cutting personal tax rates as well by creating fairness and certainty in taxation, and a climate of compliance in which all pay their share in a timely and full manner.

Where before the employed individual was taxed on his current year income and the self employed and companies were taxed on their previous year income, all will now be taxed on their current year income.

The employee was in the position that he paid his tax week by week while the self employed and companies had a long gap between earning, assessment and ultimate payment. The self employed and Companies will now have to make payments on account to put their position on a more even keel.

Self assessment is introduced to make sure that those other than employees have to pay their tax due without assessment.

Clarity is introduced into the methods of computing profits and allowances for businesses so that questionable liabilities can be resolved quicker.

Significant and comprehensive anti-avoidance measures are introduced to prevent the escape of tax by legal means.

Surcharges and penalties are introduced together with effective information powers to ensure that the Commissioner can not only catch those who abuse the system but also that there is a considerable fiscal impact (financially meaningful penalties) when they are caught.

New offences are introduced to deal with the most serious abuses on a criminal basis.

The principles of taxation remain the same but the new Act will ensure that the principles are applied effectively and fairly.

2. Creating the climate of compliance

Historically there have been problems in collecting arrears of tax and enforcing the collection of PAYE and Social Insurance.

There have also been problems with evasion of tax through the understatement of or failure to disclose profits.

The tax leakage involved was never morally sustainable in that it results in an uneven playing field detrimental to compliant taxpayers. Fiscally the continuation of the leakage would be an unacceptable burden where the Government is

reducing the take from corporate tax to 10% and moving towards lower rates of tax for all others.

These problems have in large part arisen because both the statutory powers to obtain the information to enable the Commissioner to investigate returns and the powers to penalise those who do not pay on time have been inadequate.

The revisions to the Act are targeted at empowering the Commissioner to obtain information both in advance of and after the submission of a return and to penalise in a clear and simple way those who pay tax late or attempt to cheat the system.

That the Commissioner will have such powers will be consistent with the sea change in the attitude to secrecy in such matters throughout the civilised world and will demonstrate Gibraltar's commitment to be at the forefront of the modern breed of finance centres.

A. Information Powers

The key to the effective investigation of the returns of the taxpaying population is the ability to obtain the information necessary to enable the Commissioner to target his investigative resources effectively and then to arm those resources with the ability to obtain answers to their enquiries.

Sections 6 to 8 are aimed at allowing the Commissioner to issue notices to obtain documents from a taxpayer himself or from a third party who may have particulars or evidence in documentary form relevant to a taxpayer.

The Commissioner may force production of documents or particulars which he believes have information relevant to the liability or quantum of liability of a taxpayer. The Commissioner may also seek documents or particulars to satisfy any international exchange of information obligations.

The power extends to the obtaining of information in relation to a taxpayer or class of taxpayers whose individual identity may not be known but the Commissioner believes may be evading tax.

The definition of documents and particulars is deliberately wide but does not include items covered by legal privilege.

Other than legal privilege, the only ground for appeal against a notice issued by the Commissioner is that replying to a notice would be onerous for the recipient. Appeal would be to the Tribunal.

There will be occasions when the Commissioner becomes aware that serious tax fraud, (i.e. fraud which will lead to substantial financial gain to the taxpayer or seriously prejudice the proper collection of tax), has been or will be committed and that the penalties for destruction, etc of documents will not deter a taxpayer from removing evidence. To cater for this possibility the Act introduces a power under section 9 to enable the Commissioner to approach the Supreme Court to obtain a warrant to enter and search premises.

This is a power which will be reserved for very serious cases only and the Commissioner will have to be in the position of having sufficient evidence

available to him to convince a Supreme Court judge that such a measure is justifiable.

The Act outlines the procedure to be followed on such occasions and, again, excludes access to documents covered by legal privilege.

B. Investigation of Returns

The Commissioner has the power to investigate a return which has been made under sections 31 and 32.

When a return is delivered to the Commissioner he will have the chance to either accept it or, within a period of a year from the later of the delivery of the return or the date it should have been delivered, challenge it. If the return is challenged the Commissioner has the power to demand whatever documents or particulars he regards as necessary to complete his examination of the return.

There is a right of appeal against such a demand by the Commissioner but the grounds for such an appeal are limited to the reasonableness of the request for the document or particulars.

The falsification, concealment, destruction or disposal of a document which is the subject of a notice under either of the provisions in A and B above is regarded as an extremely serious matter and as a criminal offence.

In addition to a custodial sentence any person guilty of the offence or of causing the offence is liable to a fine based on the tax lost by their offence.

In the case of section 32 the offence is extended to the giving of false information in response to a notice.

A failure to comply with a notice under section 6 or section 32 will result in an automatic fine of £200 on the date of failure and a continuing daily penalty of up to £500 for the next 3 months. After the third month after failure the person who has been served with the notice will be liable to prosecution and custodial sentencing in addition to a fine based on the tax lost or potentially lost.

C. Payment and late payment

Clearly in any effective and fair tax system compliance should be the norm and those who do not wish to comply should be subject to cost which will not only negate any advantage they would obtain by late or non-payment but also actively dissuade from the temptation to delay or refuse payment.

To achieve this, changes have been made in six areas-

- (i) Date tax is due and payable.

At present those who are under the PAYE system are obliged to pay their tax weekly during the year in which they earn their taxable income, the self employed and companies pay their tax eight months after the end of the year in which they earn their profits.

The mechanisms to switch from a past year to a current year basis for the self employed and companies are described below.

The date on which the payment of tax is due for the self employed will be advanced to 30 November after the end of the tax year and for a company to six months after the end of the accounting period of the company.

(ii) Payments on account.

In addition, to reduce the advantages which they have over those subject to PAYE, both the self employed and companies will be obliged to make payments on account of their liabilities in the year in which the profits are earned.

The self employed will be expected to make payments on account on 31st December and 30th June of an amount equivalent to 50% of the tax paid in the previous year. Companies will be obliged to make similar payments on account on 28th February and 30th August again being 50% of the tax paid in the previous accounting period. (Section 39).

(iii) Surcharge on late payment.

If any of the payments or payments on account specified in the Act is not made on time, an immediate surcharge of 10% of the amount unpaid will result.

If the amount or part thereof remains unpaid 90 days later a further surcharge of 20% of the amount of the tax and surcharge unpaid is

levied and a further surcharge at the rate of 10% per annum compounded on a daily basis will begin to accrue. (Section 64)

The surcharge imposed will be treated as part of the tax and recoverable in the same manner as the tax.

(iv) Penalties for False Returns etc.

It is the view of the Government that the provision of false information on a tax return or in response to a request for information is a matter which cannot escape fiscal consequence or penalty.

Although the view is that such penalties should apply whether the incorrect information is provided deliberately, recklessly or negligently, it is accepted that the fiscal cost should vary in accordance with the consequences of the failure to apply correct information and the course of conduct which gave rise to the failure.

It is also the view that the calculation of the penalties should, not only, be, but also, be seen to be on a fair and equitable basis and to achieve this end the Commissioner should have little discretion in the application of such penalties.

The penalty regime is applied by Section 66 supplemented by Schedule 8.

In calculating the penalty the Commissioner shall consider all the years under investigation and the total amount of tax lost or paid late and calculate the penalty in consideration of three criteria; the overall tax lost, the gravity of the offence and the co-operation given by the taxpayer. The Commissioner applies the facts of the case to the levels identified within the three criteria and the aggregate of the percentages at the levels becomes the percentage penalty charged.

For instance an innocent error which is sorted out immediately and has a tax effect of less than £100 will attract 0% for the gravity criterion, 0% on the co-operation criterion and 5% on the total amount of tax lost criterion; total penalty 5% of the tax lost or delayed.

A taxpayer who deliberately omits to declare profits which over the years amount to a tax loss of £100,000 and then fails to co-operate in correcting his return which takes the Commissioner a year to resolve will attract 50% for gravity, 30% for amount and 50% for co-operation; total penalty 130% of the tax lost or delayed.

(v) Criminal prosecution.

Some issues go beyond the position where the investigation is driven by the anticipation of the imposition of civil penalties and

where criminal prosecution (in addition to civil penalty) is appropriate .

Criminal prosecution in addition to recovery of tax, surcharge and penalty will be available under Section 67 in respect of an offence where a person is knowingly concerned in the fraudulent evasion of income tax by himself or another and in those cases where a director or shadow director is involved in the failure to pay over to the Commissioner any tax withheld or collected under the PAYE system or the various other withholding provisions of the Act (including sub-contractor deductions).

Compounding of such offences will be available at the discretion of the Commissioner and only where there is full disclosure, full payment and an agreement to allow publication of details of the offence.

- (vi) The view of the Government is that the failure to pay across to the Commissioner PAYE and similar amounts deducted from an employee or sub-contractor is a particularly serious offence and that the community in general and the employees of such an employer in particular should be made aware of those who are guilty of such offences.

As such, the Act introduces a power to name and shame those who are three months in arrear of their liabilities to withhold and pay

over to the Commissioner where the amount involved is or is estimated to exceed £5,000.

Publication will be in the Gazette and any subsequent broadcasting of the details published (unless they have been publicly retracted by the Commissioner) will be protected from defamation actions or other actions for damages.

3. Definition of Residence

The definition for ordinarily residence of a company has not changed and remains consistent with the existing legislation. The position as regards an individual has changed to update it from the rather archaic definition that existed making references to the Campo district and Her Majesty's vice consulates at La Linea and Algeciras. The definition, according to the Act, makes an individual ordinarily resident in Gibraltar if they are present in Gibraltar during any year of assessment for at least 183 days or in a year of assessment when considering 3 consecutive years of assessment an individual has been present in Gibraltar for more than of 300 days. For the purposes of this definition of ordinarily residence any presence in Gibraltar in any 24 hour period commencing at midnight shall be counted as a day irrespective of whether accommodation in Gibraltar is used or not.

For an individual the effect of residence is important when it comes to the charge to tax as under the charging section individuals who are ordinarily resident in Gibraltar are taxable on their worldwide income in accordance with Section 11(2) of the Act.

4. The Tax Charge

As stated previously, the philosophy of the bill is to retain the principles of the tax system we have (excluding of course the exempt company provisions) while retaining and extending the process of the freeing of passive income from taxation.

Similarly the territorial basis of taxation is retained but for greater clarity and certainty this is now enshrined in the Act rather than rely on common law principles and precedent as before.

The method adopted to achieve these objectives is the creation of a schedule which divides income into three classes (“tables A, B and C”). The sources of income in the tables are taxed in accordance with Section 11.

The application of section 11 preserves the principle that all income accrued in or derived from Gibraltar is taxable. This principle is, however, softened for infrequent visitors to Gibraltar whose presence is only incidental. Section 19 negates the charge to tax of a visitor if the activities undertaken are ancillary to an employment or self employment elsewhere and total less than 22 days in the year.

The tables preserve the taxation of the profits or gains of a company from any trade, business, profession or vocation and the taxation of rents but only if the profits, gains or rents are accrued and derived in Gibraltar.

In the case of ordinarily resident taxpayers, other than companies, the profits or gains from any employment worldwide are taxable.

The activities of an ordinarily resident individual in self employment are taxed on a worldwide basis where the activities taking place outside Gibraltar are related to the activities in Gibraltar. This effectively codifies the persuasive case *Davies v Braithwaite* [1931] 2 KB 6 and the principle that a self employment is indivisible.

Table C imposes a worldwide charge on unquoted dividends paid to a Gibraltar ordinary resident individual, to funds, income from schemes not marketed to the general public and shares or securities not issued by open-ended investment companies and to pensions, charges and annuity income, in so far as they are not relieved in the ADE Rules.

Table C also sweeps up the worldwide liability caught by the anti-avoidance provisions which is not taxed elsewhere.

The opportunity has been taken to remove from tax further classes of passive income, i.e. interest (other than trading interest mentioned elsewhere in this Paper), income from debentures, debenture stock, loan stock, etc whether from quoted companies or not and royalties. Much investment and other passive income was already not subject to tax. The Bill extends that principle to other streams of passive income.

5. Basis of Assessment

In order that companies that cease to enjoy tax exempt status on 31st December 2010 are incorporated into the normal taxation system (including the new administrative self assessment provisions) the basis of assessment has been revised. Under the Act there is a different basis of assessment for companies as distinct from non-corporates (i.e. sole traders or partnerships). This is dealt with under Sections 15 and 16 of the Act.

This section of this note needs to be considered in conjunction with the sections on transitional provisions and those on filing of accounts and self assessment.

A. Basis of Assessment for Persons other than Companies (Section 15)

Assessment for persons other than a company is now dealt with on an actual basis requiring sole traders and partnerships to prepare accounts to a 30th June year end coinciding with the tax year. The taxation for any year of assessment is now based on the profits earned in that year of assessment (as is currently the case for employees), thus for example in the year of assessment 2011/2012 (i.e. the tax year 1st July 2011 to 30th June 2012), the profits for an established and continuing sole trader or a partnership will be assessed on the 12 month period ending 30th June 2012.

There is, of course, flexibility to cater for commencement, which will require accounts to cover the period from the date of commencement to the 30th June, or cessation which will cover the period from 1st July in the final year of assessment to the date of cessation.

B. Basis of Assessment for Companies (Section 16)

Companies will no longer be taxed by reference to a year of assessment but rather on the accounting period for a company. This system avoids complexities on commencement and cessation as well as those that arise on change of accounting period as there is one continuous uninterrupted series of accounting periods from the commencement of business to its ultimate cessation.

Depending on the circumstances, an accounting period begins when the company first becomes resident, or starts to acquire income, or from loss of tax exempt status or from commencement of the Act.

Similarly an accounting period ends on the earlier of the expiration of 12 months from the beginning of an accounting period, on an accounting date of the company, where there is a change of accounting period or upon the company ceasing to be charged to taxation.

Subsection 7 of Section 16 allows the Commissioner to issue assessments where it appears to him that the beginning or end of an accounting period is uncertain. In these circumstances he may issue an assessment for a period not exceeding 12 months as appears appropriate to him. Where subsequently the company submits accounts reflecting clear accounting periods, those assessments can be appropriately adjusted/allocated to the correct accounting period.

Where a company decides to opt for an extended accounting period (i.e. one that is longer than 12 months as may be the case on cessation or change of the accounting date) the Commissioner shall make his assessment by either taking a pro rata approach to this extended period to arrive at the profit or gains for a period of 12 months or making such adjustment for 12 months in any way that he, in his discretion, thinks fit.

6. Rules for Ascertaining Profit or Gains (Schedule 3)

The Act now incorporates rules for ascertaining the Profit or Gains of any person. Again this represents a tidying up of the existing ADE Rules and existing practices. This schedule addresses the measure of profits or gains, the deductions that are generally allowed as well as those specifically not allowed, capital allowances and treatment of interest as part of trading income.

A. The measure of profits or gains

The starting point for taxation is that profit or gains for any year or period shall be determined in accordance with international accounting standards. Provision exists for amending these accounting standards by Regulation only for the purposes of this Act and the provisions of the Act amend the accounting profit further. The Act reiterates the status quo that capital gains and losses shall be excluded in arriving at the profit or gains.

B. Deductions allowed and those not allowed

In recognition of the existing practice, expenses or disbursements shall be allowed where these have been wholly, necessarily and exclusively expended for the purposes of the trade, business, profession or vocation.

There then follows a specific list of items that are not allowed as deductible and these to a large extent replicate the provisions of the ADE Rules. The list includes items that are disallowed such as, losses unconnected with the trade, capital items, depreciation, taxation and business entertainment unless this falls within specific rules to be published by the Commissioner. There is provision to allow the Minister to amend this list in whatsoever manner is necessary.

C. Capital Allowances

Capital allowances replicate existing provisions in the ADE Rules as regards the provision of initial allowance of £ 50,000 for computer equipment and £ 30,000 for plant and equipment which is not computer equipment. The position of motor vehicles, whether for personal or business, continues whereby these do not attract initial allowances.

In order to make capital allowances easier to compute for the taxpayer and the tax office, the concept of pooling has been introduced. Under this concept the value of assets that attract capital allowances are pooled (after deducting any initial allowance granted) and a writing down allowance is calculated by applying the appropriate rate to this amount, 10% for most companies and 20% for utilities or persons other than companies.

For example

Consider the following hypothetical example whereby a company with no other assets purchases £ 70,000 of computer equipment in year 1 together with £ 50,000 of plant and machinery. The capital allowance computation for that year will work as follows:

	Computer Equipment	Plant & Machinery	Total
Amount purchased	£ 70,000	£ 50,000	£ 120,000
First year allowance	£ 50,000	£ 30,000	<u>£ 80,000</u>
Balance transferred to pool			£ 40,000
Writing down allowance at 10%			<u>£ 4,000</u>
Written down value of pool carried forward			<u>£ 36,000</u>

Total allowances in year 1 are £ 84,000 (initial allowance £ 80,000 plus writing down allowance £ 4,000).

In the following year, year 2 assume that the same company has not purchased any assets but sold its entire plant and machinery for £ 24,000. Under the current system it would be necessary to calculate the written down value (in this case £ 18,000) and work out a balancing charge (in this case at 10%, £ 6,000) and therefore keep track of assets, their individual written down value and when they are sold. However under the Act all that is required is to deduct the sales proceeds from the pool. Thus the allowances for this year are as follows :

Written down value of pool brought forward	£ 36,000
Less proceeds of sale	<u>£ 24,000</u>
Balance transferred to pool	£ 12,000
Writing down allowance	<u>£ 1,200</u>
Written down value of pool carried forward	<u>£ 10,800</u>

In the third year, year 3 the company sells the computer equipment for £ 11,500 and purchases no further assets. Thus the balancing charge for this year is as follows :

Written down value brought forward	£ 10,800
Less proceeds of sale	<u>£ 11,500</u>
Balancing charge	<u><u>£ 700</u></u>

The above example is clearly designed to show how purchases and sales of assets are recorded. It is unlikely any business would sell all its assets without replacing these, however this has been done to show how a balancing charge could arise.

Provision exists to explain how the allowance/charge is arrived at for accounting periods shorter than 12 months.

D. Interest as a Trading Receipt

Over recent years most passive income has not been subject to tax. The Act extends this principle to interest income. However where interest income is not passive, i.e. it is an integral part of a company's revenue stream, as opposed to an ancillary passive by product of a trade, (for example for banks, finance companies or insurance companies) it will be treated as trading income and subject to taxation. This continues but the Act clarifies the concept of trading receipts under S 6(8) of the existing Act whereby it shall apply to a company –

- (a) which carries out the activity of money lending to members of the general public or who advertises or announces itself or holds itself out in any way as carrying on that business or actually carries on that business whether solely or jointly with any other business, trade or vocation; or
- (b) which is in receipt of interest on funds-
 - (i) derived from deposit taking activities other than with related counterparts or the proceeds of investment of that interest, which has been placed on deposit with, invested with or loaned to any person; or
 - (ii) derived from insurance premiums or the proceeds of the investment of insurance premiums which has been placed on deposit with, invested with or loaned to any person.

Expenses associated with generating interest income which is not taxable are not deductible.

7. Self Assessment

The Act has introduced the concept of self assessment such that both individuals and companies are now required to make returns of their taxable income and calculate their own tax liability for any year. The return to be submitted to the tax office together with the estimated liability must be accompanied by payment. These provisions are covered under Sections 28 to 30 of the Act.

Section 28 deals with the obligation of taxpayers other than companies to make returns. It requires those taxpayers (i.e. individuals, partnerships, sole traders) to submit the return by 30th November of each year. This follows on from the change of the basis of assessment (see Section 4) that now requires accounts for taxpayers other than companies to be drawn up to 30th June of each year.

Section 29 deals with the obligation of companies to make returns. Since there is no longer a reference to the year of assessment, but rather to the accounting period, the requirement is to submit accounts within 6 months following the month in which the accounting period has ended. Once again, as with individuals, companies are required to complete the return of their income and, where there is taxable income, of their liability to tax.

The legislation envisages returns/forms to be made available to facilitate self assessment. Section 30 requires that returns be submitted in accordance with the form specified by the Minister by notice in the Gazette and that these be accompanied by such information and documentation as specified in these forms.

Given that taxpayers will now be submitting a return with a computation of their liability, they are also expected to accompany the return with a payment of the tax due.

Although the Commissioner may issue returns to those persons he believes are subject to a liability, the obligation is on the taxpayer to complete a return as specified above. The fact that the Commissioner does not submit a return to a taxpayer does not diminish that person's obligation (Section 30(2)).

As part of self assessment it is envisaged that the Income Tax Office will need to process the returns for individuals other than companies and companies as these come in by 30th November or within 6 months of the year end accounting period. As a result of the penalties introduced the Income Tax Office envisage the receipt of returns for the entire tax base almost at the same time.

Section 30 provides that individuals that are on PAYE, and have other income, will treat all their other income at the highest marginal rate of tax. This will facilitate the calculation of liability as this will take place at the highest marginal rate and any adjustments to PAYE payments by the employer can be made at a later stage.

8. Payment of Taxation/Payments on Account

Section 39 reinforces the obligation to submit payments with the returns, on 30th November for persons other than companies, or within 6 months of the year end accounting period for companies. Section 39 also deals with the concept of payments on account. Persons other than companies are required to make two payments on account on the 31st December and 30th June in each year of assessment based on the previous year's assessment. Companies are required to make payments on account for their future liabilities on the 28th February and 31st August in each calendar year. These payments on account should equate to two equal instalments of 50% of the tax as payable for the previous year of assessment or accounting period as appropriate. Examples of transitional provisions and how payments on account work are provided as an annex to this note.

Payments on account can be off-set against the tax due when the return is filed and paid for persons other than companies, and in the case of companies, payments made in an accounting period against the liability for that accounting period with any excess being repayable.

How the system works:

Example: assume a company has a year end of 31st March 2013 (transition provisions are dealt with separately). These accounts need to be filed with the Tax Office by 30th September 2013 (6 months after the year end) together with a return that includes an estimate of the tax due and a payment of the amount due. During the accounting year to 31st March 2013 two payments will have been made, one on 31st August 2012 and one on 28th February 2013. The August 2012 payment will be equivalent to 50%

of the liability for the accounts for the year ended 31st March 2011 whereas the February 2013 payment will be equivalent to 50% of the liability for the amount to the year ended 31st March 2012. Since these amounts are paid during the accounting period 31st March 2013 these payments on account can be off-set against the liability for the year to 31st March 2013. Therefore when a cheque is submitted on the 30th September 2013 this will equate to the total liability for that period less the two payments on account made in August and February.

The position for persons other than companies is similar except that the payments are on 31st December and 30th June.

9. Trusts

There are two issues involving trusts and taxation.

The first is the taxation of the trust itself on its income, the second is the taxation of the beneficiary on the dispositions from the trust received by him or her.

Section 13 clarifies the taxation of trustees where there is more than one trustee and, at least one of the trustees is non resident in Gibraltar by stating that where the trust is settled by an ordinary resident of Gibraltar (which excludes a Category 2 individual), the non resident trustee will be treated as resident. For this purpose a settlor is someone who has put value into the trust.

Under Section 12(1) the income from a trust received by a beneficiary ordinarily resident in Gibraltar is charged to tax. The new section 12 taxes said distributions by a process of matching the distributions with the income and gain received by

the trust and then taxing the distributions which match with taxable income. If the match is to a non taxable source, then the distribution or benefit is not taxable.

In the event that there is a source of taxable income which has been matched, any tax paid by the trust on the income would be available as a set off against the liability.

10. Higher Rate Tax

There are various enterprises in the utility field which by their nature have a monopoly or near monopoly position in Gibraltar and whose profitability benefits from that position or who operate in the energy field

The former are enterprises which are dominant in their particular market and take advantage of that position to increase their profitability at consumers' expense

The view of the Government is that such entities should put back into the community part of the profitability generated by their position by way of taxation at a higher rate than the normal run of companies, i.e. 20%.

Schedule 6 in its first Part identifies specific instances of companies who will pay tax at the higher rate: Telecommunication, Electricity, Water, Sewage and Petroleum companies.

Part II of the Schedule introduces the proposition that a company with a dominant market position which the Commissioner sees as abusing that position will pay tax at the higher rate.

The concepts used to define dominance and abuse are those used in EU Competition law and, as such, the Commissioner will be able to rely on judgments of the ECJ in making his decision and arguing a case.

11. Securing the PAYE Base - Benefits In Kind.

Employers sometimes attempt to reduce the tax charge on their employees by remunerating them in many forms other than the straightforward payment of money.

The sole tool available to the Commissioner against this practice in the previous Act was the inclusion of the words “benefits in kind” in the definition of emoluments for the purpose of taxing employments. The Commissioner has, as a result, had difficulty in imposing a charge in appropriate cases in the past.

As part of the creation of the climate of compliance, it is necessary to ensure just as fair and equal treatment between PAYE taxpayers as between PAYE taxpayers and others.

It has been necessary, therefore to clarify the meaning of those three words “benefit in kind” by Schedule 8 of the new Act such that the benefit provided can be easily quantified and taxed accordingly.

A. Expense Payments

Any payments for expenses which the employee receives and which exceeds the amount he actually has to spend for the purpose of the employment is a taxable benefit. (Paragraph 6).

B. Vouchers and Tokens

Paragraphs 7 to 11 cater for the possibility that an employer may pay his employees in a non cash form by giving him or a member of his family, by voucher, token or arrangement, the ability to obtain cash, goods or services elsewhere.

The value that the taxpayer obtains from the voucher, etc is treated as a benefit in kind at the point the benefit is obtained.

C. Living Accommodation

The taxation of the benefit of the provision of living accommodation to an employee or a member of his family is clarified by Paragraphs 12 to 16.

The benefit assessed on the employee is the equivalent of the rental value of the property less any amount made good by the employee.

There is an exclusion from the benefit if the employee (not being a director) is obliged to live in the property to do his job properly and “secondment” or “re-location” employees and directors are generally excluded from being taxed on the costs of their moving locations by paragraphs 52 to 69.

D. Cars, Vans and Related Expenditure

Where the use of a company car is made available for private purposes to an employee or member of his family, tax on the benefit is imposed by paragraphs 20 to 27. The benefit to be taxed will be either 25% of the cost of the car to the

provider of the benefit or the cost of provision of the car if the provider has not bought it outright.

If the employee also has his fuel paid for, either by re-imburement or other arrangement, he will be taxed on 90% of the cost to the provider as a benefit. (Paragraph 28).

E. Loans

- (i) Loans to employees other than directors, shadow directors or connected persons.

Where a loan is made to an employee and interest is charged on the loan is charged at less than the rate he would have paid to a bank or building society (“the market rate”), the employee will be treated as in receipt of a taxable benefit equivalent to the difference between the market rate and the amount he pays (if any). The difference will not, however, be treated as a benefit where the interest would be deductible in computing profits to which he is charged or allowable as a relief under the ADE Rules.

If the loan is a reasonable amount on account of expenses which are subsequently expended, no benefit charge will be levied.

- (ii) Loans written off or made to directors etc.

Any loan made to an employee and subsequently written off (other than at his death) is treated as a taxable benefit in the amount of the

loan written off at the time it is written off.

Any loan made to a director, shadow director or person connected with either is treated as a taxable benefit at the time it is made or at the time the person becomes a director, shadow director or connected. This will also apply to loans currently outstanding at the date the Act becomes effective.

F. Sweeping Up – Residual Charge

Paragraph 37 allows for the taxation of the value of any facility or benefit made available to an employee which is not otherwise covered in legislation. The amount of the benefit is valued at the cost to provider of the benefit less any amount made good. Paragraphs 41 to 47 define how the benefit is computed.

Paragraph 48 ensures the taxation of contributions made to pension schemes which have not been approved by the Commissioner.

Paragraphs 49 and 50 include payments or valuable consideration for restrictive undertaking as benefits.

Paragraph 51 treats as a benefit any amount expended for a party or parties for the employees as a benefit if the total expended in the year exceeds £75 per head.

The position of those for whom it is necessary to move accommodation due to a change of employment or location of duties within the original employment is dealt with in Paragraphs 52 to 67 which, in summary exempt from the benefits

charge any reasonable cost which is incurred by the change of residence, the travelling and subsistence costs incurred while the move is finalised.

If an employment causes a period of absence from Gibraltar the cost of travel and subsistence is excluded from the benefits legislation as is the cost of visiting spouse and children during a prolonged period of absence caused by the employment. (paragraphs 68 and 69).

G. Dispensations

The normal state of affairs is that the employer is obliged to make an annual report to the Commissioner of all benefits in kind his employees enjoy. If the Commissioner is satisfied that the benefits enjoyed will not result in a tax liability, e.g. an expense paid in advance and caught by the legislation may be offset by an equal claim for deduction, then the Commissioner may give the employer dispensation from reporting that benefit.

Equally if the Commissioner becomes aware of any abuse of a dispensation he may withdraw it either with immediate effect or *ab initio*. (Paragraphs 70-76).

12. Combating Tax Avoidance

The previous Act was based on very antiquated principles and provisions and seems to have been based on the presumption that the population who were subject to the Act would simply comply. Times have changed. The taxpaying population is much more sophisticated and more aware of the advantages of seeking loopholes and gaps in the law.

In addition the increased differential between corporate tax rates and individual tax rates which will be introduced with the revised Act will increase the temptation to use the system to minimise tax liabilities through the use of corporate vehicles.

The actions specified above to combat evasion will also increase the appetite for legal avoidance.

The responsibility of the legislature is therefore to ensure that the law gives clear statutory authority to impose the intended tax and to ensure that tax avoidance solutions are not available.

Three routes have been taken to create and maintain that position-

- A generic anti-avoidance clause;
- Specific anti-avoidance provisions; and
- A scheme requiring notification of arrangements.

A. Generic Anti- Avoidance Clause

Section 40 re-states section 13 of the previous Act in a way which strengthens the intent of the previous Act and allows the Minister to make regulations to give effect to that intent.

The Section also introduced Schedule 4 which contains specific anti-avoidance legislation.

Sections 42 and 43 are introduced to give the taxpayer a level of certainty by creating a clearance in advance procedure and ensuring clarity when the Commissioner decides to use Section 40 or Schedule 4 by obliging him to identify who he is assessing and why when he invokes the anti avoidance legislation.

The clearance in advance procedure enables the taxpayer to approach the Commissioner before or after a transaction to seek the agreement of the Commissioner that he will not invoke the anti-avoidance provisions on the basis of the information provided. The Commissioner is free to request further information on the transaction before he makes a decision.

The Commissioner may, of course, notify the applicant that he feels that the anti-avoidance provisions apply; if so the taxpayer can take this as a warning that the arrangements will be challenged and he will have to put a case when he is inevitably assessed by the Commissioner. The Commissioner may, on the other hand, agree that the anti-avoidance provisions do not apply and providing that there is no variation on the facts in the execution of the arrangements, the decision of the Commissioner will protect the taxpayer.

If following the necessary period and a further reminder by the applicant taxpayer, the Commissioner fails to respond to the request for clearance, the applicant taxpayer may take the failure to respond as an acceptance that the anti-avoidance provisions will not apply provided that the disclosure of facts is complete and accurate.

B. Specific Anti-Avoidance Provisions

(i) Thin Capitalisation.

Paragraph 2 of Schedule 4 is aimed at the situation where a company (other than a credit institution or deposit taker) avoids tax by generating deductible interest payments by introducing equity in the form of loans rather than share capital.

The section applies to convert the loan interest paid to a dividend payment where the loan capital to equity ratio of the company is greater than 5 to 1 and the loans are made by a connected individual or a connected individual provides security for the loan.

(ii) Deemed dividends.

The disparity between the corporate rate of tax and the rate of tax for individuals gives rise to the opportunity of using the corporate vehicle to defer tax by retaining profits which would otherwise be distributed or, even, avoiding tax by waiting until those profits can be distributed in a tax effective form (e.g. in a liquidation).

Steps are, therefore, necessary to ensure that profits are converted to dividends at the appropriate time to ensure that tax is not deferred or lost. (Paragraph 3, Schedule 4).

The mechanism adopted to achieve this is that the Commissioner is given the power to deem profits which have not been distributed to

be dividends paid to the shareholders on the date which appears reasonable to the Commissioner.

In coming to his decision regarding the amount of retained profits to be deemed to be dividend the Commissioner is obliged to take regard of genuine reasons for the retention of profit to meet foreseeable expenses or the costs of development or expansion of a business. The *quid pro quo* for this is that if the expenditure which a company claims will be made is not made within a period agreed by the Commissioner, the relevant amount will be then treated as a deemed dividend.

Where the company is a subsidiary the position of its parent will be considered when it is deemed to be in receipt of a dividend. This process will continue through a chain of companies where this exists.

The liability to tax in respect of a deemed dividend will initially lie with the individual to whom the dividend would be paid but, if there is a failure to pay by one or more of the shareholders the Commissioner may exercise his discretion to transfer the liability for all or part of the amount due to the Company.

To ensure that tax is not imposed twice, a deemed dividend will be available for set off against a later dividend.

Either the Company or any of its shareholders will be able to appeal the decision of the Commissioner.

(iii) Transactions with connected persons.

Paragraph 4 of the Schedule is aimed at transfer pricing abuse.

Put simply transfer pricing is the manipulation of profits by connected parties who are able to fix their pricing between each other or intervening parties to minimise their tax burden by leaving or dropping off the profit in the transaction in a low tax jurisdiction.

In the case of interest payments between parties, any payment of interest between parties which exceeds the amount which would have been charged were the transaction to be at arm's length, will be deemed to be a dividend.

The issue is more complicated when it goes beyond interest into the provision of goods, intellectual property, services etc. The ideal is to replace the price charged or obtained with the price which would be charged or obtained on the open market.

The Commissioner has neither the resource to undertake transfer pricing studies or the critical mass of taxpaying population to make such a study meaningful. As such a halfway house has been

designed to ensure that no advantage is taken of the unusual position of Gibraltar as a market.

Where the Commissioner is aware of the possibility of price manipulation which reduces tax take, he will limit any amount of expense to a sum obtained by a formula which takes the least of the sum claimed, a percentage of turnover and a percentage of net profit pre the relevant expense.

The Government accepts that the solution is not perfect but it is reasonable given the resource available to the Commissioner and the uniqueness of Gibraltar as a market.

The concepts used in this and others of the anti avoidance provisions are defined in paragraphs 8 to 11.

(iv) Back to back loans.

Given that there is no taxation of the receipt of interest (other than interest which is trading income) it would be possible to obtain borrowing for which either a deduction or relief would be allowable which would be secured on a deposit made with the lending institution.

This is countered by paragraph 5 which negates the deduction.

(v) Dual employment contracts.

The territorial based tax system maintained by this Act would make it possible for a taxpayer to gain an unfair advantage by having one contract of employment for activities taking place in Gibraltar and another contract for activities outside Gibraltar.

If two (or more) such contracts are entered into by a taxpayer and the employers are connected persons, Paragraph 6 acts to treat all the activities as taking place in Gibraltar.

With the exception of deemed dividends, showing that the arrangements are *bona fide* and not entered into for the purpose of tax avoidance is a defence to the imposition of the above anti-avoidance provisions.

(vi) Transfer of assets abroad.

Previous to this Act there had always been the possibility of transferring assets abroad where they can be used to accumulate income outside the scope of the previous Act. This is clearly in contradiction to the spirit of the previous Act and the intention of the legislature.

For example previously a taxpayer could set up a company in another jurisdiction and provide the services of himself and his wife

in an activity wholly unrelated to his Gibraltar activities and escape taxation on the profits generated by the offshore operation.

Paragraphs 12 of Schedule 4 introduces the protection of imposing taxation on income arising to a foreign entity which results from a transfer of assets abroad by an ordinarily resident taxpayer and which is or would be available to the ordinarily resident taxpayer. The section also applies to capital sums arising from the transfer which can be matched with income which arises before or after to the foreign entity.

The income is only taxable if it would have been taxable if it were received in Gibraltar.

The section relates to the transfer of any assets and can range from a large sum of money through the minimal sum required to finance the share capital of a company to a bundle of assets such as a contract for or of services. So in the example above the section would be triggered in respect of the taxpayer by both the transfer of the money to set up the offshore company and the transfer of the rights represented in the service contract.

The income caught by this section is the income of the offshore entity and not the part which results directly to the taxpayer.

Paragraph 13 covers the situation where the transfer of assets is made by another person and the ordinarily resident taxpayer

receives benefit or income which would be taxable if received by him in Gibraltar.

In the above example paragraph 13 would catch any other person the taxpayer decided to benefit.

The sections are not invoked if it can be shown that the transfer was a *bona fide* commercial transaction and that tax avoidance was not one of the purposes for making the arrangements.

Paragraphs 15 to 17 define the terms used in paragraphs 12 to 14 and make provision to ensure that no double charge results from the operation of the legislation.

C. A Scheme requiring Notification of Arrangements

As mentioned before, it is trite law that taxation can only be applied by clear words of statute. The practical effect of this is that as soon as this Bill and Paper are published there will be tax professionals who will be looking for loopholes to be exploited and to reduce the liability of their clients below that intended by Parliament.

The nature of the Gibraltar Act is that it is not as extensive as comparable legislation in other jurisdictions, There is no appetite for the production of legislation as long, complicated and comprehensive as, say, the UK tax legislation. There will, therefore, be loopholes. If those loopholes are capable of generating a significant loss of Revenue, the government will wish to stop that loss and to

create the statutory provisions necessary to stop the loss at the earliest possible time.

To facilitate this process Section 41 has been introduced to ensure that practitioners (for the purpose of the section “promoters”) are obliged to notify the Commissioner of arrangements or proposals they put (or in respect of which they facilitate the putting) to a taxpayer for the reduction of the tax due from him.

The section is drawn widely to ensure that it applies to any person who designs a plan for tax reduction, promotes it, recommends it or, indeed, in any way facilitates or broadcasts it. It goes beyond tax professionals to any person giving any sort of financial advice.

The nature of transactions to which the section applies is also widely drawn to cover any proposal which will reduce tax but the section enables the Minister to clarify its ambit and to amend that ambit as the result of the experience of operating the section.

A promoter will have thirty days from the date he makes a proposal or becomes aware of a transaction forming part of a tax saving proposal to notify the Commissioner of the details of the proposed arrangements (if the promoter is aware that the arrangements have already been notified, he does not need to repeat the notification).

If the promoter is outside Gibraltar, the duty of notification falls on the client.

The Commissioner will issue a reference number to the promoter which will be quoted by the client on his tax return and demonstrate that he is aware that the process invoked by the section has been followed.

The Commissioner and Minister will then be in the position to make an early decision as to whether a scheme or arrangement is within the spirit of the Act and whether or not legislation is required to prevent it.

A promoter who fails to observe the requirements of the section will be liable to penalties or prosecution under section 65 as mentioned elsewhere in this note.

This section goes hand in hand with the ability to obtain advance rulings under section 42 in that it is just as much in the interests of a taxpayer to ensure that a scheme or arrangement is not going to be challenged on the basis of an advance ruling as it is in the interests of the Commissioner to be apprised of and close down aggressive schemes at the earliest possible opportunity.

13. How We Get There – Transitional Provisions

The operational revisions to the original Act are considerable and the change over to the new Act will be a complex process for both practitioners and the Commissioner. The transitional provisions are aimed at making that process as painless as possible.

Given that at 31 December 2010, the taxpaying base was on a mixture of bases for taxation, employees on current year, former exempt companies and newly formed companies on current year, nearly everyone else on previous year, it was decided

that the commencement of the new Act should be deemed as a cessation of liability for the purposes of the old Act except for those already on the current year basis.

The Commissioner is empowered to make his assessment for companies for 2010/11 under the old Act as an estimate of the tax due on the cessation at the old tax rate and an estimate of the first payment on account due on 28 February 2011 under the new Act at 10%. Following this first payment on account by assessment, the new system of payment on account without assessment and self assessment will come into effect.

The payments on account for companies in the transitional years are not free of complication and the Act contains a table showing when and on what basis payments on account will be due for companies.

In the case of the self employed, the 2010/11 assessment will be made under the provisions of the old Act on a full year's profits and will be due and payable on 28th February 2011. The assessment will be treated as a payment on account to be set against the cessation assessment for the period to 31 December 2010 and the commencement assessment for the period to 30 June 2011.

Following this first payment on account by assessment the new system of payments on account without request for persons other than companies will come into effect with the payment on account due on 31 December 2011. (Paragraph 2).

For the purposes of calculating the opening pool value for the computation of capital allowances for previously exempt companies, the Commissioner, if he is satisfied that there has been no manipulation of values to gain a tax advantage, will take the closing net book value as the opening pool value. The opening pool value for a company which was not previously exempt will reflect the tax written down value of the assets to be put into the pool. (Paragraph 3).

Any losses which were available under the old Act will be carried forward to the new Act. (Paragraph 4).

The writing back of provisions which have been allowed under the old Act and which are recovered after the commencement of the new Act will continue but for previously exempt or qualifying companies the tax effect will be reduced to the tax relieved by the original writing off. (Paragraph 5).

The various appointments, delegations, etc made under the previous Act will continue as will the processing of assessments under the old Act (Paragraphs 6 and 1).

The information powers given in sections 6 to 9 of the Act will be allowed to extend back into documentation created or information relevant to the period covered by the old Act where the Commissioner is satisfied that he has discovered a pattern of behaviour which was in place prior to the commencement of this Act which would have resulted in the loss of tax under the old Act.

Continuity of relief is ensured for loans taxed in accordance with section 15 of the old Act which are followed by dividends which rectify the position. (Paragraph 9).

Recovery in liquidation of tax due under the old Act is secured by Paragraph 11.

Any amount of tax outstanding under the old Act is treated as being due and payable on 1 January 2011 for the purpose of the surcharge provisions of this Act. (paragraph 12).

The continuity of the Law is obtained by paragraphs 13 to 20.

The following Annexes provide worked examples for self employed persons and companies which may help explain how the transitional provisions work in conjunction with the system of payments on account.

Annex I Self Employed Individuals

Annex II Company A with year end of 30 June

Annex III Identical to Annex II but Company B has a 31 Jan year end

Annex IV Identical to Annex II but Company C has a 31 Oct year end