TAXE: Gibraltar briefing 25-05-15

Highlight of some of the harmful tax practices of Gibraltar:

- There is no withholding tax on dividends, royalties and interests.
- There is no capital gains tax, wealth tax or estate tax.
- There is no tax on dividends. Royalties and interests are subject to tax, but exemptions occur under specific circumstances.
- Carry forward of losses is unlimited (with some very narrow exceptions).
- The corporate income tax is 10% (before 2010/11 it was 22% so that indicates a quite recent turn for the worse).
- Gibraltar uses a territorial tax system where *"profits or gains of a company or trust from any trade,* business, profession or vocation are only taxed if the income is accrued in, or derived from *Gibraltar."*[i] It is this controversial part of its tax system that is subject to a current State Aid investigation, as the EC and Spain argue that this leads to a de-facto favouring of offshore companies and trusts.
- A special ring-fenced Personal Income Tax system is available for high-net worth individuals and investors with payments. "Anyone with £2million net assets who buys an approved property for their exclusive residential use and hasn't lived in Gibraltar within five years may qualify for the prestigious Category 2 status, resulting in paying no greater than £24,500 on their worldwide income."[ii]
- Trusts are allowed and while domestic beneficiaries of trusts are taxed at 10% all non-resident beneficiaries are tax exempt from any income associated with a trust in Gibraltar (except income from a trade which has accrued in and derived from Gibraltar) in line with the territorial tax system. According to the OECD, as of March 2014 there were 4,308 trusts in Gibraltar for whom trustee services were provided by licensed entities in Gibraltar.[iii] There are 45 licensed professional trustee groups. This indicates a sizeable trust sector, although not a major one (for comparison, Jersey is said to have "tens of thousands" of trusts, and have 180 companies that manage offshore trusts).
- VAT is not levied in Gibraltar. As a result, Gibraltar has a major tobacco import and is often accused by Spain of acting as a route for importing black-market cigarettes to Spain and the EU. The Spanish government has pointed out that Gibraltar imports 117 million packets of cigarettes which would imply that every citizen – man, women and child - of Gibraltar would be smoking nine packs of cigarettes per day if it was only for domestic consumption.
- A limited liability company can be set up in one day against a fee of 150 GBP.[iv] According to the OECD there are approximately 17,200 active limited private companies in Gibraltar. [v] This is quite high compared to the population of Gibraltar which is approximately 30,000. This indicates that Gibraltar is used as a holding and routing destination by foreigners.
- Shell companies based in Gibraltar have routinely been linked to corruption, tax avoidance and dubious deals. For example, the so-called "Halliburton bribery scandal" involved an anonymous shell company in Gibraltar, which was used to funnel USD132 million which in part was used to bribe Nigerian officials in the oil sector. A Gibraltar based company was also involved in extreme irregularities in the extractive industry of the Democratic Republic of Congo. In another case, the daughter of the President of Uzbekistan squeezed an estimated USD 1 bn. out of foreign

telecommunication companies in a vast network of corruption involving an elaborate network of offshore companies. One of the vital pieces in the offshore shell company structure was a company – Taliant – that was incorporated in Gibraltar. It is thought that the President's daughter was the beneficial owner of the company, but while the company was held in the name of one of her employees. These cases most likely involve Gibraltar due to its lack of taxation on dividends, interests and royalties and capital gains, combined with the ease of setting up shell companies where the beneficial ownership is obscured.

- Gibraltar has become notorious for challenging those that claim the island is a tax haven. Whether it is a British MP that singles out Gibraltar as tax haven, interference in the UK election, or a Spanish newspaper that calls the island a tax haven, officials on Gibraltar take swift action against these statements. The last example is perhaps most worrying and telling. In 2015 Gibraltar sued a Spanish newspaper (ABC) for defamation for printing a cover story depicting Gibraltar as a tax haven. This can be seen as part of the same attempt to stifle free speech as that of the Luxembourg government and the prosecution of whistleblowers.

Recent developments:

The good:

- Gibraltar has signed up to the global system of automatic exchange of information. Gibraltar outlawed a particularly harmful form of secrecy (bearer shares) in 2013. The most recent OECD Global Forum review of Gibraltar seems indicate that Gibraltar keeps relatively good records of companies, with some information being public. The review did not find any major failings in record keeping on owners and anti-money laundering rules in relation to companies. On trusts there is less official record keeping (that is the nature of trusts), but the OECD review did not find any major failings.
- Overall it would seem that Gibraltar is embracing some level of transparency, following at least the bare minimum of international standards.

The bad:

- While the worst forms of secrecy are being phased out it seems that Gibraltar has taken steps within the last few years to adopt lower tax rates and generally shows no indication to break with its low-tax model tailored for foreigners. Most prominently the Income Tax law introduced in 2011 is being challenged on the grounds of state aid, and also includes the 10% corporate income tax rate (the lowest rate in the EU, shared also with Bulgaria). This seems to indicate an increased turn towards an offshore model.
- Even with the recent move towards transparency a recent European Anti-Fraud Office (OLAF) report warned of a rising organised crime and money-laundering problem on Gibraltar, related to tobacco and other merchandise.

Background on the EC state aid case

Attached to this briefing is a 2 page summary on the State Aid case that was brought against Gibraltar/UK in 2004 and concluded in 2011. This case is of interesting as it provides the back-drop to the current ongoing investigation. The outline of the case is as follows:

- 2002: Gibraltar proposes a reform of its corporate income tax system with highly favourable tax treatment of companies that have little or no substance (employees, real estate etc.) on Gibraltar.
- 2004: The Commission announces that it finds the reform in conflict with state aid principles, in part due based on an argument that the reform would greatly favour Offshore Companies with little or no substance.
- 2008: The General Court annuls the Commission finding in a case brought by the UK/Gibraltar, arguing that the Commission had not proved that the benefits granted were selective. Spain and the Commission appealed the decision.
- 2011 (November): ECJ rules that the reform did indeed constitute a breach of state aid, pointing out that the de-facto effect of the reform would be to favour only offshore companies.

The case is interesting for two purposes:

- It establishes the principle that a tax system can be selective in outcome even if it is based on clear criteria in the official tax code that would seem to treat all corporates similarly (paragraph 101 of the ECJ ruling). The ECJ notes that this is due to *"the fact that offshore companies are not taxed is…* the inevitable consequence of the fact that the bases of assessment are specifically designed so that *offshore companies… have no tax base under the bases of assessment adopted in the proposed tax reform."*[vi] In plain English this means that a tax system must be judged not only on the tax code, but also on the effect of the tax code. It is on the same basis now that Spain and the EC is challenging the Gibraltar tax system, as it de-facto would favour passive income held by foreigners in Gibraltar.
- In some ways the case is however also a healthy reminder of the limitations of the state aid system: This case was carried for almost 10 years and in the process the Commission almost lost its case. Although the Commission did win the case eventually, Gibraltar went ahead and lowered their Corporate Income Tax rate from 22% to 10% the same year they lost the case. The effect of that reform is similar to what Gibraltar sought to achieve with their 2002 reform (e.g. an "attractive" tax regime), but this time the Commission could not challenge their reform as it applies to the whole corporate sector and is therefore not selective. For the cynical it would seem that 10 years of investigation and legal tangles were wasted, as the state aid tool cannot address "legal" tax competition, even if it is just as damaging and has the same outcome. The current state aid case against Gibraltar does not challenge the 10 percent corporate income tax and it is yet unclear whether the EC will be able to win the case and whether the process will once again take close to 10 years to be concluded.

The current EC state aid investigation:

- Was initiated in 2013.

- Initially looked into the Income Tax Act of 2010 which introduced favourable taxing of interests and royalties on passive, intra-company loans.
- In 2013 Gibraltar amended its Income Tax Act to allow for the taxation of interests. EC has stated that with this change it does no longer consider there to be a state aid problem in relation to interests, but that the problem still persists in relations to royalties.
- The investigation was expanded in 2014 to also cover tax rulings.

Possible questions for Gibraltar officials:

- Gibraltar has the lowest corporate income tax in the EU, does not tax capital gains, does not apply withholding tax, seek to attract high-net worth individuals through favourable tax treatment, and at the same time allows for extremely favourable regulation of both limited liability companies and trusts that allow non-residents to get away with hardly paying any taxes through these corporate vehicles. Taking these things into consideration would you say that it is fair to depict Gibraltar as a tax haven?
- In March 2015 Gibraltar sued the Spanish newspaper ABC for defamation for calling the island a tax haven. We find it highly irregular that a country sues a newspaper for defamation and see it as a practice that conflicts with the basic freedoms granted the press in the EU. Can you explain how Gibraltar sees the role of the media in a free and democratic society and how this lawsuit fits into that understanding?
- There are a number of well documented cases of shell companies incorporated in Gibraltar that have been an integral part of high-scale corruption and money laundering (see page 1 of this briefing on the stories on Nigeria, Democratic Republic of Congo, and Uzbekistan). Taking into account these stories, does Gibraltar plan to adopt fully public registers of the beneficial owners of companies and trusts during the transposition of the fourth Anti-Money Laundering Directive?
- Was the introduction of the 10 percent corporate income tax rate in 2011 in any way a response to the fact that Gibraltar was not allowed to introduce its previous corporate income tax reform that was challenged through the EU's state aid system?
- Having been at the receiving end of a state aid investigation, how does Gibraltar see the usefulness and effectiveness of this system?

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[i] EC C(2013) 6654 final, p.3
[ii] http://www.dailymail.co.uk/property/article-1244444/Why-taxing-Gibraltar.html
[iii] OECD Global Forum Phase II evaluation of Gibraltar, p.43
[iv] https://www.gibraltar.gov.gi/new/companies-house
[v] OECD Global Forum Phase II evaluation of Gibraltar, p.20
[vi] http://www.nortonrosefulbright.com/knowledge/publications/120029/tax-rulings-on-transfer-pricing-may-violate-eu-state-aid-rules