Gibraltar

Gibraltar is not only a member of the EU, but the phasing out of its tax-exempt company regime means it now enjoys access to the European Subsidiary Directive. By James Lasry

Recent reforms in tax and fund legislation have made Gibraltar a particularly attractive jurisdiction for the incorporation of European private equity and property funds.

The phasing out of the Gibraltar tax-exempt company regime, as a result of pressure from the EU, has granted Gibraltar companies access, at least in some jurisdictions, to the benefits of the European Parent Subsidiary Directive.

Gibraltar's Experienced Investor Fund regime is fast proving to be a simple and effective way to structure funds for experienced and high-net-worth investors. It is this combination of the tax and fund regime reforms that has, somewhat unexpectedly, made Gibraltar a jurisdiction of choice in the structuring of European funds.

Alternative jurisdictions
The classic dilemma is how does a fund, or any investment structure for that matter, extract dividends from its European investee companies without being subject to the double taxation of withholding tax at the investee company level and corporate tax at the holding company level? While this can often be minimised through the use of tax treaties, and in particular the Parent Subsidiary Directive, it is difficult to find a solution whereby the profits from the investment will not be taxed at the holding company level.

Jurisdictions such as Luxembourg, the Netherlands and Cyprus have been used with some success, but there are certain inherent difficulties in each solution. The 'Netherlands Antilles Sandwich' used to be a very effective way of extracting dividends from the European structure without any withholding or corporate tax leakage. But changes in the Dutch and Netherlands Antilles tax regime some years ago do cause some tax leakage in the structure at present.

Luxembourg can be an effective solution, but there is the difficulty of the Luxembourg withholding tax on dividends. Luxembourg companies must pay withholding tax on dividends to shareholders. Although there are partial solutions to this, they require the often unacceptable delay of one year for the extraction of dividends, costly dual and triple Luxembourg company structures or the complicated profit participation loans.

The Channel Islands, not being within the EU, do not have access to the Parent Subsidiary Directive and thus must resort to the somewhat cumbersome solutions referred to above.

Cyprus's position is similar to that of Gibraltar's. Many clients, however, seem to opt for the Gibraltar option due to the effective fund regime and Gibraltar's reputation as a well-regulated finance centre. Indeed, in May 2007 the International Monetary Fund praised Gibraltar as a well-regulated jurisdiction that is superior to many of its larger competitors.

EU benefits
Part of the quid pro quo with the EU for the phasing out of Gibraltar's tax-exempt company regime was that the European Commission communicated to the member states that the Parent Subsidiary Directive should be applied to Gibraltar tax-resident companies in the way that it would be applied to companies that are tax resident in any other member state.

Gibraltar is, of course, within the EU by virtue of Article 299(4) of the Treaty of Nice. Until recently many jurisdictions took the view that, since Gibraltar is not an actual member state, they would not apply the directive to Gibraltar companies even though European directives apply to Gibraltar and must be transposed into internal legislation.

At present some jurisdictions are unaware of this development and some have even decided not to apply the directive to Gibraltar companies in contradiction to the Commission's notice. However, certain jurisdictions, including Luxembourg, have taken a view that, if the Gibraltar company is properly tax resident in Gibraltar, and if it has a relevant participation in a Luxembourg company, the Luxembourg authorities will not tax dividends paid from a Luxembourg company to its Gibraltar parent.

This opens up substantial opportunities for private equity or property funds. If the fund is incorporated in Gibraltar and incorporates a wholly owned subsidiary in Luxembourg, it will effectively have the benefits of Luxembourg's tax treaties as well as access to the Parent Subsidiary Directive.

For example, if the fund invests in a German company (as a wholly owned subsidiary, or at least with a relevant participation as per the Parent Subsidiary Directive) then the German company, after paying any German taxes on its income, whether it be rental income on a commercial property or commercial income from a business, can pay its dividends to its Luxembourg parent without paying any German withholding tax.

Once the dividends reach the Luxembourg parent, those profits can be sent as dividends to the Luxembourg corporation's Gibraltar parent without suffering any Luxembourg withholding tax. In Gibraltar, the dividends will not be taxed as they are generated from the proceeds of a European parent subsidiary relationship. There is no capital gains tax, wealth tax or estate duty in Gibraltar.

Furthermore, there is no Gibraltar withholding tax on dividends paid to non-Gibraltarian shareholders of a Gibraltar company. The profits, therefore, of the German investment will have been effectively repatriated to the investors in the fund without any tax leakage, other than German internal tax on the company's earnings.

Experienced investors

Gibraltar's Experienced Investor Fund (EIF) regime is a quick and efficient way to structure a fund, whether a hedge fund or a private equity/real estate fund, where the intention is to market such a fund to experienced high-net-worth investors. Experienced investors are defined in Gibraltar as investors who are demonstrably experienced in making investments, investors who have a net worth in excess of e1m (£680,000) besides their principal place of residence, or investors who have invested e100,000 (£67,600) or equivalent.

The fund's board must include two Gibraltar-based directors who are authorised by Gibraltar's regulator, the Financial Services Commission (FSC), to act as directors of such funds. In practice this requirement is also necessary to ensure that there is sufficient substance in Gibraltar to avoid the fund being caught by the tax net of any other jurisdiction. An EIF must have an authorised Gibraltar-based administrator and it must be audited annually by a Gibraltar-registered auditor.

Custody of the assets is not restricted to Gibraltarian service providers and the fund's assets may be kept with any authorised depository or broker that is deemed acceptable to the FSC. In certain cases, however, there are distinct legal advantages to using a Gibraltar-based custodian. A closed-ended private equity or real estate fund will hold is own assets other than the fund's cash.

The combination of Gibraltar's effective EIF regime and the access of Gibraltar funds to the Parent Subsidiary Directive provides a strong solution to private equity and real estate funds that plan to invest in Europe, or indeed in countries within Luxembourg's formidable treaty network. In the last few months structures worth more than e6bn (£4.06bn), including a $1bn (£500m) property fund for Patron Capital, have been structured in Gibraltar. This trend is anticipated to increase significantly over the next few years.

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