EXPLANATORY MEMORANDUM TO

THE DRAFT TAX INFORMATION EXCHANGE AGREEMENT (TAXES ON INCOME) (GIBRALTAR) ORDER 2006

1. This explanatory memorandum has been prepared by HM Treasury and is laid before the House of Commons by Command of Her Majesty.

It contains information for the Select Committee on Statutory Instruments.

2. Description

This draft Order brings into effect the arrangements for the exchange of tax information specified in the Agreement set out in the Schedule attached to the draft Order.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 Type of resolution

This draft Order is subject to the affirmative resolution procedure.

3.2 Details of the Agreement

Further details of the Tax Information Exchange Agreement scheduled to the draft Order are annexed to this memorandum.

4. Legislative Background

4.1 This Order is made under section 815C of the Income and Corporation Taxes Act 1988 (c.1), as amended by section 88(2) of the Finance Act 2002 (c. 23) and section 198 of the Finance Act 2003 (c.14).

Section 815C of the Income and Corporation Taxes Act (ICTA) 1988 provides the mechanism by which arrangements made with overseas territories (including dependencies and overseas territories of the United Kingdom) for the exchange of information necessary for carrying out the domestic laws of the United Kingdom concerning income tax, capital gains tax and corporation tax and taxes of a similar character in the other territory are given effect in the United Kingdom.

The relevant Convention or Agreement is scheduled to an Order made under section 815C ICTA 1988.

5. Extent

The draft Order applies to the whole of the United Kingdom.

6. European Convention on Human Rights

The Paymaster General (Dawn Primarolo) has made the following statement regarding Human Rights:

"In my view the provisions of the draft Tax Information Exchange Agreement (Taxes On Income) (Gibraltar) Order 2006 are compatible with the Convention rights."

7. Policy background

This Agreement with Gibraltar is intended to close an unintended gap in what is otherwise pan-European coverage of those measures contained in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments ("the Directive"). Gibraltar has fully implemented the Directive but the Directive only applies to payments between Member States. As Gibraltar and the United Kingdom are part of the same member state the Directive does not apply between them.

The Agreement is concluded in the form of a Tax Information Exchange Agreement (TIEA). These instruments are designed to facilitate the exchange of information between tax authorities for direct tax purposes, in order to help the authorities counter cross-border tax evasion and avoidance.

The Agreement includes safeguards to ensure both the confidentiality of the information exchanged and that such information is used only for tax purposes.

8. Impact

8.1 A unique Regulatory Impact Assessment has not been prepared for this instrument. This is because the impact of implementing the specific changes required of relevant bodies by this Agreement are marginal, and should not require system changes beyond those that were necessary to the implementation of the Directive. Paying agents in the United Kingdom are already required under UK domestic law to collect the information that the United Kingdom will exchange under the Agreement.

The detailed Regulatory Impact Assessment (RIA) for the Directive can be found at http://www.hmrc.gov.uk/ria/eusd-ria.pdf.

8.2 Tax Information Exchange Agreements enable countries to obtain information to assist them to properly enforce their domestic tax laws. Agreements do not generally have an Exchequer cost; rather they improve HM Revenue and Customs' ability to tax UK residents on their world-wide income and gains and collect the proper amount of tax due.

The impact on the Exchequer of this Agreement will be positive and a factor of the overall benefits to the Exchequer of the implementation of the Directive (also covered in the Directive RIA mentioned above).

9. Contacts

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can answer any queries regarding the instrument.

AGREEMENT ON THE TAXATION OF SAVINGS INCOME BETWEEN GIBRALTAR AND THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND

GENERAL

This Tax Information Exchange Agreement between the United Kingdom and Gibraltar secures application between Gibraltar and the rest of the United Kingdom of the same measures as are contained in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments ("the Directive").

The Agreement provides for a reciprocal arrangement between the United Kingdom and Gibraltar allowing information to be exchanged by each party on savings income in the form of interest payments made cross-border to individuals resident in the other Contracting Party. For a transitional period corresponding to the transitional period in the Directive, however, Gibraltar will levy a withholding tax corresponding to transitional withholding tax that will be levied by three Member States under the Directive, unless the owner of the income opts for exchange of information.

As the Agreement enshrines all the provisions of the Directive, it not only prescribes the information covered by Agreement and the mutual obligations of the competent authorities, but also the mechanisms to be followed by the agents who make interest payments for collecting the relevant information.

NOTES ON DETAILS

RECITALS

The recitals explain the genesis of the Agreement in relation to the Directive. They confirm that Gibraltar will apply a transitional withholding tax corresponding to the transitional withholding tax to be applied by three Member States under the Directive.

ARTICLE 1 - WITHHOLDING TAX BY PAYING AGENTS

Article 1 provides for a transitional withholding tax to be applied in Gibraltar on payments made cross-border from Gibraltar to United Kingdom residents. The start of the transitional period is governed by Article 16 and corresponds to the start of the transitional period under the Directive.

The rate of withholding tax parallels the rates of withholding tax under the Directive, rising to 35% by 2011. As in the Directive, provision is made for individual owners to choose reporting of income instead of withholding tax (Article 4).

ARTICLE 2 – REPORTING OF INFORMATION BY PAYING AGENTS

Article 2 concerns reporting of information.

Paragraph 1 summarises the information to be reported by United Kingdom and Gibraltar paying agents to their competent authority for the purposes of exchange of information. This includes details of

- the individual owner's identity and residence;
- identity of the paying agent;
- the account (where the interest is paid) or the security giving rise to the interest;
- the type of interest payment in accordance with the rules at Article 4(1).

Paragraph 2 confirms the timetable for exchange of information from the United Kingdom competent authority to the competent authority of Gibraltar.

ARTICLE 3 – EXCEPTIONS TO THE WITHHOLDING TAX PROCEDURE

Article 3 states that Gibraltar shall provide for one or both of two procedures to enable an individual to avoid withholding tax being applied to their savings income.

Paragraph 1 sets out the two procedures: they permit the individual either

(a) to authorise a paying agent in Gibraltar to make a report on the interest payment; or
(b) to authorise gross payment of the interest on the basis of a certificate drawn up by the competent authority of the territory in which the individual is resident. (This demonstrates that the competent authority is aware of the payment.)

Paragraph 2 sets out the details the certificate must contain, if the certificate procedure is used.

Paragraph 3 confirms the timetable for the exchange of information from Gibraltar to the United Kingdom under the voluntary disclosure procedure in paragraph 1(a).

ARTICLE 4 – BASIS OF ASSESSMENT FOR WITHHOLDING TAX

Article 4 sets out the basis for withholding tax in Gibraltar in respect of each type of interest payment.

Paragraph 1 identifies the amount that is subject to tax for each of four types of interest payment. (This parallels the equivalent provisions on withholding tax in the Directive and also serves to identify the amount of interest that has to be reported under the voluntary disclosure procedures for the purposes of Article 8.)

Paragraph 2 confirms (in line with the Directive) that the tax is to be applied pro rata to the length of period of ownership by the individual. There is a default rule where this information is not available.

Paragraph 3 confirms that the levying of withholding tax shall not prevent the normal operation of other taxes on that income in the United Kingdom.

Paragraph 4 confirms that where the payment of interest is made from Gibraltar to a residual entity in the United Kingdom (as identified in Article 7), the Gibraltar paying agent shall levy the withholding tax unless the residual entity formally communicates information in accordance with Article 7 of this agreement.

ARTICLE 5 – DEFINITION OF BENEFICIAL OWNER

Article 5 provides the definition of individual beneficial owner relevant to the Agreement. This follows the definition in the Directive.

Paragraph 1 confirms that an individual is to be regarded as the beneficial owner unless specified condition apply, for example, that he provides evidence that he is acting himself as a paying agent.

Paragraph 2 notes that if the paying agent has information suggesting the purported owner may not be the beneficial owner, he is to take reasonable steps to identify the beneficial owner.

ARTICLE 6 – IDENTITY AND RESIDENCE OF BENEFICIAL OWNERS

Article 6 sets out the rules to be followed for identifying individual beneficial owners.

Paragraph 1 confirms that the rules provide minimum standards for the identification of individuals by paying agents in each Contracting Party.

Paragraph 2 sets out the rules for confirming the beneficial owner's identity.

Paragraph 3 sets out the rules for confirming the beneficial owner's residence.

ARTICLE 7 – DEFINITION OF 'PAYING AGENT'

Article 7 provides the definition of paying agent relevant for the Agreement. The definition corresponds to the definition of paying agent in the Directive.

Paragraph1 gives the basic definition of paying agent, as the economic operator that makes the payment of interest cross-border to the individual owner.

Paragraph 2 provides that certain entities shall also be considered paying agents on receipt of interest payments. (These are entities that could otherwise be used by individuals to shield their identity.) Paragraph 2 (together with paragraph 5) defines the entities – known as "residual entities" - and provides that economic operators paying interest to them should make a simplified report of the payment.

Paragraph 3 states that the contracting parties must make provision for residual entities in their jurisdiction to be treated as UCITS, rather than residual entities.

Paragraph 4 states that the Contracting Parties shall take any necessary measures regarding the case where the economic operator and residual entity are both in their own jurisdiction.

Paragraph 5 refers to exemptions from sub-paragraph (a) of paragraph 2.

ARTICLE 8 – DEFINITION OF 'INTEREST PAYMENT'

Article 8 reproduces the definition of interest from the Directive, with amendments to incorporate relevant Gibraltar products.

Paragraph 1 provides the definition of interest. The definition includes certain payments that derive directly or indirectly from interest payments.

Paragraphs 2 and 3 provide rules to help paying agents, where there is no information on the exact amount of derived interest.

Paragraph 4 deems interest made to a residual entity to be interest paid by a residual entity.

Paragraph 5 allows Contracting Parties to require annualising of certain payments, in line with the corresponding rule in the Directive.

Paragraph 6 provides for derogation from the definition of interest regarding funds that are largely invested in non-interest bearing instruments.

Paragraph 7 adjusts the rules for the definition of derived forms of interest from 2011 onwards.

Paragraph 8 provides further rules for determining whether payments from collective investment funds will be reportable or subject to withholding tax.

ARTICLE 9 – WITHHOLDING TAX REVENUE SHARING

Article 9 provides that 75% of the withholding tax collected by Gibraltar is to be shared with the United Kingdom. (The rules on revenue sharing mirror the revenue sharing rules for Member States applying withholding tax.)

Paragraph 1 provides the basic rule for withholding tax sharing.

Paragraph 2 provides that this same rule will apply for any withholding tax withheld by Gibraltar paying agents on payments to residual entities under Article 4(4).

Paragraph 3 confirms the timing for revenue sharing: this will take place annually, six months after the end of the tax year of the paying agent in Gibraltar.

Paragraph 4 confirms that responsibility for the smooth functioning of the revenue sharing system rests with Gibraltar.

ARTICLE 10 – ELIMINATION OF DOUBLE TAXATION

Article 10 deals with the elimination in the United Kingdom of double taxation arising from the imposition of withholding tax. The rules mirror the rules in the Directive.

Paragraph 1 sets out the requirements for crediting and repayment in relation to withholding tax applied on interest payments. Legislation for the elimination of double taxation relating to all withholding taxes connected with the Directive is contained in the Finance Act 2004.

Paragraph 2 provides an alternative option to the crediting procedure.

ARTICLE 11 – TRANSITIONAL PROVISIONS FOR NEGOTIABLE DEBT SECURITIES

Article 11 sets out transitional arrangements for certain debt securities, mirroring the equivalent provision in the Directive.

Paragraph 1 provides the basic rule that removes payments relating to certain negotiable securities from the definition of interest. This is to avoid the problem of "gross-up" that would otherwise have adversely affected the financial markets.

Paragraph 2 confirms that this rule does not affect any rules in the Contracting Parties concerning the taxation of income from these securities.

ARTICLE 12 – TRANSITIONAL EXCUSION OF CERTAIN INTEREST PAYMENTS

Article 12 sets out transitional arrangements, which affect Gibraltar paying agents only, for certain interest payments. Savings income paid or credited before 1 April 2007 on financial instruments issued on or between 19 December 2005 and 21 December 2005 will be exempt from withholding tax in Gibraltar.

ARTICLE 13 – MUTUAL AGREEMENT PROCEDURE

Article 13 provides for a consultation procedure, in the event of any disagreement between the parties as to the interpretation of the Agreement.

ARTICLE 14 – CONFIDENTIALITY

Article 14 contains confidentiality rules concerning the use and disclosure of the information exchanged.

Paragraph 1 provides that information received is to be treated as confidential.

Paragraph 2 provides that the information can only be used for direct taxation purposes although it may be used for other purposes if the relevant government authorities give written consent.

Paragraph 3 provides that information can only be disclosed to certain specified persons or authorities. Such information may be disclosed in public court proceedings or in judicial proceedings.

Paragraph 4 provides that if information is received that is thought to be useful to another EU Member State such information can be sent to that other Member State with the agreement of the competent authority who originally supplied the information.

ARTICLE 15 – TRANSITIONAL PERIOD

Article 15 confirms that at the end of the Directive transitional period, Gibraltar will move to full, automatic exchange of information under the Agreement.

In line with the provisions for Member States applying withholding tax under the Directive, however, Gibraltar has discretion to elect to apply automatic exchange earlier in the transitional period if it wishes.

ARTICLE 16 – ENTRY INTO FORCE

Article 16 provides that the Agreement shall enter into force and its provisions shall have effect from 1 April 2006.

ARTICLE 17 – TERMINATION

Article 17 provides for the possibility of termination. This is usual for an international agreement.

Paragraph 1 confirms that the Agreement will remain in force unless terminated by either Contracting Party.

Paragraph 2 specifies the procedures to be followed in the event that a Contracting Party desires to terminate; and the timetable that will follow for termination.

ARTICLE 18 – APPLICATION AND SUSPENSION OF APPLICATION

Article 18 sets out the conditions for the Agreement to apply. These conditions are intended to ensure that a level playing field is maintained between Member States and, on the one hand, all third countries applying “equivalent measures” and, on the other, territories applying “same measures”, as the Directive.

Paragraph 1 confirms the application of the Agreement is conditional on the adoption and implementation of all the international agreements and arrangements tied to the Directive, for the same date of implementation.

Paragraph 2 provides for the Agreement to be suspended temporarily or permanently by a Contracting Party following notification.

Paragraph 3 makes provision for suspension of the Agreement and the conditions and procedures governing any suspension.