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A fresh look at the taxation of banking and financial vehicles

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In recent years, the legislator of San Marino has been remarkably active in the area of incentives to the financial and banking sector. New tax treaties have been signed, a new Trust Law has been enacted, company law has been reformed, new tax incentives have been introduced and a new law on banking, financial and insurance services has been approved. The purpose of these steps is to transform San Marino into a complete international financial centre.

As for the tax treaties, those with Austria, Belgium, Croatia, Luxembourg and Malta have entered into force. Ready to enter into force are those with Italy, Hungary, Cyprus and Romania. Discussions are taking place with the Czech Republic, Latvia, Libya, Montenegro, Portugal, Serbia and Singapore. In due course there will be negotiations with other treaty parties.

Tax treaties

Treaties in force have allowed the flow of income from abroad to suffer little or no withholding tax in the foreign country. On dividends paid to a San Marino company by a foreign company under its control, the treaty partners apply no withholding tax in most cases and a 5% withholding tax in a few cases. On dividends paid to other San Marino shareholders, the withholding tax is 10% in most cases and 15% in a few cases.

Most treaty partners do not tax interest paid to San Marinese creditors; those that do charge a maximum 10% withholding tax. Treaty partners do not generally tax royalties paid to San Marinese holders of intellectual property, but some levy a withholding tax at a maximum 5% rate. In most cases, treaty part-

ners do not tax capital gains realised abroad by San Marinese residents.

Once income has found its way to San Marino, the income of companies resident there is taxed at an ordinary rate of 17%. Foreign tax credit is available, and special regimes may be applicable which reduce the tax rate to 6.5%. When San Marinese companies pay dividends to non-residents there is no withholding tax. Except in cases where a tax treaty provides a lower rate, interest carries a withholding tax of 13% (10% on bonds and, of course, for physical persons resident in the EU, the EU Savings Directive withholding tax) and royalties carry a 15% withholding tax. There is no withholding tax on capital gains.

Special tax regimes

As mentioned, special tax regimes exist in San Marino. Their effect is to reduce both the domestic tax rate and the withholding tax rates. They merit some attention. A special regime applies to companies holding and licensing intellectual property. This regime allows a tax-free increase up to the market value of the tax base of the IP asset for depreciation purposes and also for capital gains purposes. This increase does not produce taxable income in San Marino (95% exempt).

The condition for benefiting from this regime is to retain the gain in the company without distributing it to shareholders for a couple of years and invest 70% of it in business assets. When distribution occurs, only 30% of the income distributed is taxed.

Another special regime applies to companies providing services (most types of services) to foreign companies belonging to the same group. In this case, only 5% of income arising from dealings with foreign companies belonging to the same group is taxed. Tax deferral is applicable for 95% of such income and is granted until the income is distributed to shareholders. Even in this case, when income is distributed to shareholders, it is taxed at only 30% of the standard rate.

The condition, again, is that distribution must not occur within two years and, in this period, 70% of the income must be invested in business assets. Moreover, if the San Marinese company pays interest, royalties or considerations for services to a foreign member of the same group, no withholding tax applies.

A third special regime applies to holding companies and provides that dividends and capital gains on shares are exempt from corporate tax. The only requirement is that the holding company holds the shares of the subsidiary for a period of at least one year. When the special regime applies, no withholding tax is charged on the distribution of dividends from the holding company. But this is not really an advantage because the general rule is so far the same for all the companies - that no withholding tax is paid on outgoing dividends.

A fourth special regime is applicable to investment funds. Both traditional and hedge funds can be created. They are not taxed on the income of the fund or on distributions to investors, except the EU withholding tax, when applicable. The income of the company managing the fund is taxed at the rate of 12.5%, and this can be further reduced thanks to tax credit available to the company for withholding tax paid on staff remuneration.

New Trusts Law

Vehicles for asset management and private foundations and trusts - with a major preference for trusts because of the tax regime in San Marino - are very attractive. In 2004, San Marino enacted a new Trusts Law. This Law is an example of trust regulation in a civil law country, and is one of the few. As a member of the local commission, I had the opportunity to observe that this Law was the outcome of years of work and research while looking for the best balance between common law experience and civil law tradition.

Furthermore, since Roman law and common law are still in force in San Marino, testamentary trusts already existed and, as several studies have recently confirmed, this made the task of the draftsman much easier. There is no clash between the new Law and the principles of the San Marino legal system. Trusts can be both testamentary and between the living. They should be created by a notarial deed. Most of the rules of the Law follow international standards, and both beneficiary and purpose trusts can be created.

One important feature is that the duty of trustees concerning conflicts of interest and accounting carries criminal sanctions protecting the interests of the beneficiaries. Trust income is taxed at an effective rate of 1.7%. There is no tax on the transfer of assets from settlors to trustees or from trustees to beneficiaries.