Global tax newsletter

Welcome to the sixth edition of the Global tax newsletter.

In this edition of the Global tax newsletter we continue to report on regional tax developments in the EMEA, Asia Pacific and Americas regions, as well as tax developments with respect to transfer pricing, treaties and indirect taxes.

We continue to see the reactions of governments to the global financial crisis particularly in terms of restricting operating and capital loss carry forwards, the utilisation of loss carryovers post reorganisations or acquisitions, and the continued attack on debt vs. equity and thin capitalisation. Although we see some jurisdictions offering industry specific incentives, there is a trend of reducing or eliminating tax incentives in the name of tax competition.

One notable trend is being seen as a result of the US enactment of the Foreign Account Tax Compliance Act (FATCA). This tax legislation has a far reaching effect on the foreign deposits of US taxpayers. FATCA puts a tremendous burden on foreign financial institutions in meeting US reporting requirements on behalf of its US investors.

One result of FATCA is that some jurisdictions are stepping up and entering into FATCA model agreements with the US authorities in order to alleviate some of the burden on financial institutions in the foreign government's home turf. This is a significant development within the context of tax transparency and goes way beyond what double tax agreements accomplish.

And of course, since the US invented FATCA, transfer pricing and so many other somewhat arduous tax burdens, there is already FATCA type legislation being introduced in other jurisdictions which further exemplifies today's tax world of living in a glass house.

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Argentina featured article

The 'Central Bank of the Argentine Republic' (BCRA) has set out the requirements which will be requested by financial entities and/or agents (or exchange entities) of clients for prior consent requests to perform transactions within the local exchange trading system. These relate to 5295 'A' Note issued on 9 March 2012.

These requirements will be applied to every remittance of funds abroad related to:

- services – including interests of loans
- real estate rentals
- other type of income.

In addition, in the case of transactions performed with related companies, the intervening financial entity should indicate the documentation and information used, in order to verify that the transactions are performed at the market value and make economic sense. In the event that the beneficiary is domiciled at a jurisdiction considered to be a 'tax haven' (low or nil taxation), in accordance with the official 'black list' provided by the rules, additional information shall be required regarding the beneficiary s activities.

Requirements

As an example, the applicable requirements for services include, among others, the following information:

- client's tax identification (ID) number
- full name of the client
- full name of the foreign beneficiary
- country of residence of the foreign beneficiary
- foreign bank where the funds shall be transferred to the beneficiary
- date when the contract between the parties was entered into and the period of execution of the services
- calculation of the amount to be paid according to the contract (fixed sum or variable sum; based on the worked hours, sales, results, etc.)
- expiration date and amounts to be transferred (give detail of the expiration date of the amounts to be paid, date in which the invoice was issued by the resident)
- additional documents to the invoice and the contract which allow the intervening entity to verify the effective performance by the non-resident to the resident and the existence of a liability abroad, such as internal documentation of the firm, etc.
- describe the transactions between related companies
- legal persons should attach the 'comparative statements' corresponding to the last two audited annual financial statements available to the client

- give the contact person within the intervening entity: name, telephone and e-mail address
- in the event transactions are performed between related companies, complete the following: filed documentation and/or used information which allows the intervening entity to verify that the performances are made at market value and make economic sense for the client. In this case, establish the estimation method used and the sources of information used.

In the case where the beneficiary resides or has other legal domicile in associate jurisdictions, territories or states included in the list set forth in the Income Tax Law and other modifications, or in the case where the account is situated in those jurisdictions, the following information should be provided:

- in the case of transactions between related companies, the following statement from the bank : 'The entity (full name of the entity) does hereby state that the documentation and information has been checked, such information allows to verify the existence of foreign liabilities arising from transactions performed between related companies, such transaction was performed in similar commercial and financial conditions to those transaction performed between non-related companies; the transactions have economic sense to the client, in accordance with the entity, to be authorised under the terms required by the client'
- as indicated the documentation required by the financial entity in order to comply with the highlighted required items is extensive. In this sense, according to the requirement which is applicable to related companies regarding the application of market prices, the existence of a transfer pricing report filed with the tax authority shall be essential to achieve the authorisation required.

Mexico featured article

New invoice reporting for deductions

The Mexican tax authorities, through administrative rules, have established that since 1 January 2012 residents abroad (without a permanent establishment (PE) in Mexico) that make transactions with Mexican residents need to include the information below in their invoices in order for the corresponding deduction derived from such a transaction to apply:

- name of the company domicile, as well as the tax ID, or its equivalent, from whoever issues the invoice (resident abroad)
- place and date of invoice issuance
- the Mexican Federal Taxpayers Registry (tax ID number of the Mexican entity). If it cannot be provided it will be enough if the invoice includes the full name of the Mexican company.
- brief description of the kind of services rendered or the goods sold
- value per service and total amount invoiced in number or letter. In the case of the sale of goods the value per unit sold in number or letter
- for sale of goods or the temporary use or enjoyment of goods, the invoice must have the taxes withheld (value added tax or income tax) and the corresponding rates applied, if applicable
- in the specific case of granting the temporary use or enjoyment of goods, the invoice needs to include the property number in Mexico of such goods.

Notwithstanding that this rule is contained in an administrative tax regulation and that it cannot generate direct obligations to the taxpayers in Mexico and neither obligate a resident abroad to accomplish such requirements, Mexican tax professionals' recommend fulfilling such requirements in order to avoid any tax contingency with the Mexican tax authorities and to make sure that the deduction could take place by Mexican companies or subsidiaries.

Exchange of information agreements

On the 21 June 2012 the Federal Official Gazette published the decree that contains the agreement between the United Mexican States and the Republic of Costa Rica for the exchange of information on tax matters.

The main objective of the agreement is to provide assistance through the exchange of information that is seen as relevant to the administration and enforcement of the domestic laws of such States, in regard with the comprised taxes or tributes, for the determination, settlement, enforcement, recovery or collection of such taxes or tributes, as well as for the investigation or prosecution on tax matters.

Also published on 2 March 2012 were two decrees in regards to the exchange of information agreements on tax matters:

1. The agreement between the Isle of Man and the United Mexican States governments, for the exchange of information on tax matters, which has been in force since 4 March 2012.
2. The agreement between the Cook Islands and the United Mexican States governments, for the exchange of information on tax matters, which has been in force since 3 March 2012.

Bahrain treaty

Double taxation treaties with middle-eastern countries are rare and Mexico has successfully established such a treaty with Bahrain.

On 27 April 2012 the Federal Official Gazette published the convention between the United Mexican States and the Kingdom of Bahrain governments, to avoid the double taxation and prevent tax evasion on income tax, signed in Washington D.C. on October 10, 2010. The convention will be in force from 22 February 2012.

In general terms, the convention will be applicable in accordance with the following:

- the convention comprises the Mexican income and flat tax and the Bahrain income tax payable under the Amir Decree No. 22/1979, as well as other taxes with the same nature or substantially similar. The corresponding authorities should give notice about any substantial modification that has been made in their respective tax law
- the PE comprises, beside the figure and/or the concepts established in most of the conventions on double taxation, a refinery, a point of sale of goods clearance and a warehouse in regard to a person who provides such facilities for storage goods
- the convention does not include any provision for the treatment of income received from independent services
- both countries will show mutual assistance, inside the limitations of their tax structures, for the purpose of notifying and recovering the taxes comprised in the convention, as well as the surcharges, additions, late payment compensations, costs and fines that are not criminal nature.
- for source withheld tax, the convention will apply on the amounts paid or credited since 1 January 2013, and regarding other taxes generated on any tax year beginning 1 January 2013.

US featured article

Globalisation of the not-for-profit industry

The world in which not-for-profit organisations operate has drastically transformed within the past decade largely due to tighter regulations, widespread globalisation of the economy and increased demand worldwide for programme services. These transformations have created opportunities for not-for-profit organisations to expand their global reach by addressing critical needs across borders, soliciting financial support outside the organisation's country of incorporation, and investing in foreign financial markets and activities. However along with these opportunities, global reach may bring about complex multinational tax implications.

Each country has its own rules and regulations regarding taxation, registration and regulation of not-for-profit organisations. Under US tax law, organisations exempt from US is generally include charitable, religious, educational, scientific and literary organisations, business and civic leagues and fraternal clubs. The single largest category of tax exempt organisations in the US are 'IRC section 501(c)(3) organisations' which are organised and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, to foster national or international amateur sports competition, to promote the arts or for the prevention of cruelty to children or animals. According to the Internal Revenue Service (IRS), the revenue service for the US federal government, there are currently more than one million 'IRC section 501(c)(3) organisations' that in total hold assets valued at roughly $3.2 trillion and have annual revenue of nearly $1.5 trillion. Although an organisation is recognised as tax exempt for US federal tax purposes, the organisation may be subject to US federal and state tax in certain circumstances based upon the organisation's activities or investments.

Given the increased globalisation and the size of the not-for-profit industry, the IRS has outlined in its 2011 and 2012 'Exempt organisation work plans' that international tax enforcement is an on-going priority. In 2011 the IRS legitimised its international priority when it formalised partnerships with outside entities and worked with the Joint International Tax Shelter Information Centre (JITSIC) to gather international data and information. The JITSIC was created by the IRS and tax agencies from Australia, Canada and the United Kingdom to supplement the on-going work of tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements and schemes. In recent years China, Japan and the Republic of Korea have also joined the JITSIC.

The 2012 exempt organisation work plan is primarily concerned about whether charitable assets of tax-exempt organisations are being diverted internationally for non-charitable purposes. In addition, the IRS continues to focus on:

- organisations that make or have reportable investments in foreign entities
- organisations that report ownership of foreign bank accounts
- foreign entities receiving IRS recognition of exemption from US tax
- information referred from the JITSIC
- charities reporting foreign addresses on Forms 990

- charities that participate in 'gifts-in-kind' programmes, where valuation issues surface when charities send non-cash items to foreign organisations
- large private foundations with international operations or international transactions.

The emphasis on reporting foreign activity is evidenced by the persistent reform and clarification of Form 990, one of a series of tax returns that not-for-profit organisations must file annually, calling for increased transparency into an organisation's financial, governance and compliance practices. In addition to Form 990, US tax exempt organisations have reporting requirements related to foreign activities which include:

- transfers of cash or property to foreign corporations, partnerships or trusts
- ownership or control of foreign corporations or partnerships
- operations in or related to countries determined by the IRS to be 'boycott' countries
- transfers to/distributions from or the creation of a foreign trust
- gifts or bequests from foreign individuals, estates, corporations or partnerships
- ownership of foreign bank accounts.

It is crucial for organisations to gather information from foreign parties to accurately complete these forms in order to avoid monetary, civil and criminal penalties depending on the circumstances. Forms 990 filed by US not-for-profit organisations can be found on www.guidestar.org.

In addition to tax considerations in an organisation's country of incorporation, organisations need to pay special attention to procedures directed by the legal and tax frameworks operating in the applicable countries. Examples include, but certainly are not limited to:

- an organisation's tax-exempt status in the applicable countries
- local country registration requirements
- direct and indirect tax reporting requirements
- employment tax considerations
- rules related to the repatriation of cash
- gathering an understanding of permitted activities within the respective country.

Globalisation has created opportunities for not-for-profit organisations to expand their reach, but increased focus on tax enforcement requires not-for-profit organisations to be diligent in understanding and properly reporting activities, investments, and transactions taking place outside their country of incorporation.

EMEA news

Austria

In 2009 the European Commission (EC) brought action against Austria regarding the Austrian tax legislation on the deductibility of donations in the area of science and research. The EC claimed that the Austrian rules were contrary to the provisions on the free movement of capital under the EC treaty and the European Economic area (EEA) agreement. As Austria had refused to amend its legislation, the matter was referred to the European Court of Justice (ECJ). Under the Austrian legislation, donations to certain institutions established in Austria, e.g. universities, art colleges or the academy of science, were treated as tax-deductible expenses by the donors. In contrast, donations to comparable institutions established in other countries were non-deductible.

The issue was whether or not the tax benefit in question, which could be obtained only in respect of donations made to research and teaching institutions established in Austria, was compatible with the free movement of capital. In case number 10/10 it was held that national legislation under which donations made to domestic research and teaching institutions are treated as tax deductible, (whilst donations made to similar institutions established in other member states or in the EEA countries are treated as non-deductible) is incompatible with the free movement of capital.

Belgium

Until 2011, the thin capitalisation rule only applied to the payment of interest to a beneficial owner established in a tax haven. Thin capitalisation restricts interest expense deductibility. A company is deemed to be established in a tax haven if it is not subject to income tax or if it is subject to a substantially more favourable tax regime than the Belgian regime (a tax rate under 15%).

In 2012, Belgium has strengthened its thin capitalisation rule (5:1 debt:equity ratio) and extended it to interest paid to group companies. Companies are deemed to belong to the same group if one company has decisive influence over another company or if both companies belong to a consortium. If a loan is guaranteed or financed by a third party, that party will be deemed to be the beneficial owner if the main purpose of that guarantee or financing is tax avoidance. The deduction of interest paid on debt will be disallowed if, and to the extent of the excess, the total amount of this debt exceeds five times the company's equity. The term 'debt' includes all loans, with the exclusion of bonds, other borrowing instruments that have been issued by public offering and loans granted by financial institutions.

Bulgaria

The EC formally asked Bulgaria to end certain duty and tax relief provisions that are included in an agreement between Bulgaria and the United States on technical assistance. According to the EC, the duty and tax relief applied by Bulgaria under the agreement with the United States does not comply with EU law.

Prior to its accession to the EU, Bulgaria concluded a bilateral agreement with the United States, which provides for duty and tax-free importation of goods financed by the United States and for goods and services purchased on the Bulgarian market with the funds of the technical assistance programme.

The EC request takes the form of a 'reasoned opinion' (the second stage of an infringement procedure). If the legislation is not brought into compliance within two months, the EC may refer the matter to the ECJ.

Czech Republic

The supreme administrative court held that unrealised foreign exchange gains do not constitute taxable income for corporate income tax purposes.

From 2004 to 2006, the taxpayer, a Czech-listed company, obtained long-term loans to finance real estate projects. The taxpayer had unrealised foreign exchange gains in respect of these loans, which, in line with the relevant accounting provisions, were reflected in its profit and loss statement. The taxpayer claimed that unrealised foreign exchange gains could not be deemed as 'income' for corporate income tax purposes. Accordingly, the taxpayer did not include these gains in its corporate tax return.

The tax authorities maintained that unrealised foreign exchange gains were taxable. The tax authorities' position was upheld by the lower court, and the taxpayer brought the case before the supreme administrative court.

The supreme administrative court ruled in favour of the taxpayer. In its decision, the court highlighted that only a real (and not merely fictitious) benefit may be subject to corporate income tax. With respect to foreign exchange gains (and losses), the court held that such real income (or loss) could only arise upon realisation of the gain (or loss).

Denmark

The Danish parliament on 13 June 2012 enacted a bill (No. L 192) that allows new machinery and equipment to be depreciated in an amount equal to 115% of the purchase price. The law is the first of the tax reform measures announced by the government on 29 May 2012. The measure is designed to encourage new investment, thereby creating new jobs and boosting the Danish economy. The 'super-depreciation' will apply only to newly manufactured (unused) machinery and equipment acquired on or after 30 May 2012, and up to 31 December 2013. It will not apply to cars, ships, and certain leasing equipment or to machinery and equipment with a very long useful life, such as aircraft, oil rigs, power stations, and railway facilities.

Qualifying equipment is added to the depreciation base with an increased value (i.e. 115% of the purchase price) and depreciated by an annual rate of 25%. Investments may only be added to the depreciation base with an increased value provided that:

- the equipment is only used for business purposes
- the equipment is newly manufactured
- the provision on accelerated depreciation does not apply, e.g. software.

Estonia

Currently, foreign common funds (funds established as pools of assets) generally are treated as transparent bodies, meaning that their Estonian-source income is subject to taxation in the hands of the shareholders or members of the fund in proportion to their holdings.

If the members or shareholders of the fund are unknown, the income is attributed to the person who administers the assets of the fund or who concludes transactions in the name of the fund. Because foreign funds are usually administered by non-resident management companies, the income is often attributed to the management companies and taxed as if it were received by a non-resident. Real estate income received by foreign funds is therefore taxed at a rate of 21%, regardless of whether the members or shareholders of the fund are residents or non-residents.

In comparison, any income received by a domestic common fund is assumed to be received by a resident (regardless of whether the members or shareholders of the fund are residents or non-residents) and is not subject to any tax in Estonia. The income is to be taxed at the level of the members and shareholders under the tax laws applicable in their home countries.

In an infringement procedure, the EC indicated that the above-mentioned tax regime treats domestic investment funds more favourably than comparable investment funds established in other EU member states or in countries of the EEA. EU law provides for equal treatment between comparable resident and non-resident investment funds. The commission therefore found that Estonia is in violation of EU rules.

The ministry of finance presented draft amendments to the income tax law, which are mainly aimed at eliminating the discriminatory tax rules for non-resident investment funds.

Finland

By way of background, Finnish company A Oy (FIN Oy, receiving company), asked for an advance ruling from the central tax board as it was planning to merge with its fully-owned Swedish subsidiary B Ab (SWE Ab, absorbed company). SWE Ab was loss-making and its activities in Sweden were shut down. After the merger, no PE would be left in Sweden. FIN Oy wanted to deduct the losses of SWE Ab from FIN Oy's taxable profits after the merger. Under Finnish law, the receiving company may deduct the losses of the acquired company from its own taxable profits when the merger is done between two Finnish companies. The law does not, however, stipulate how the losses are treated when the acquired company is resident abroad and the receiving company is a Finnish resident. Based on the case law of the supreme administrative court an additional requirement is that the main purpose of

the merger has not been for the receiving company to benefit from the losses of the acquired company. The EU merger directive does not include provisions on how the losses arising from tax years prior to the merger of an acquired company should be treated in the state of residence of the receiving company.

The advocate general of the ECJ emphasised that the directive provides for an accumulated loss of the transferring company to be taken into account only in its own member state and not in the member state of the receiving company. Consequently, the loss from the transferring Swedish company can only be used in the framework of Swedish taxation. In the case at hand, the right to use the losses in Sweden would, however, be of no use for the receiving Finnish company as it would not have a PE in Sweden after the merger. The AG concluded that neither the directive nor the freedom of establishment preclude the Finnish legislation in question.

France

A recent court decision raises the question whether the restructuring of an entity that resulted in a French company expecting to derive less income in France than before the restructuring could be regarded as an indirect transfer of profits. What makes the decision interesting and important is that it dealt with related companies engaged in common group transactions dealing with cash pooling whereby the cash surpluses and cash deficits.

The case, Sociétè Nestlé Finance International, involved a French company (Société Nestlé Finance France) that transferred its cash pooling activity to a related Swiss entity (Nestlé Treasury Centre Europe). The cash pooling function had been purely administrative, carried out exclusively for the benefit of parties related to the French company. The French company did not receive any compensation for the transfer of the cash pooling activity. The administrative court concluded that the transfer of an internal administrative function to a foreign entity – even if the function only involved other affiliated companies required the payment of arm's length compensation.

Germany

A recent decision illustrated the compatibility of the German foreign tax credit with EU law. The issue of the case was whether or not deductions relating to personal and family circumstances must be allocated equally on all income from foreign and domestic sources or must be instead allocated fully to income derived from domestic sources.

The taxpayers were German resident spouses subject to unlimited tax liability. They derived the major part of their income from German domestic sources. However, they also derived portfolio dividends from other EU member states as well as from third-party countries. On this foreign income, the plaintiffs paid withholding tax of more than EUR 2,850. Based on the application of the ordinary credit method under domestic law, the tax authorities credited EUR 1,282 for the foreign taxes paid.

Under German domestic law, the maximum amount of credit is calculated in a way that the German income tax on the general taxable income is apportioned in the same proportion that the foreign income bears to the taxpayer's total (gross) income, without taking into account special expenditures or costs relating to the taxpayer's personal lifestyle and family circumstances. If, however, a different fraction would be applied, where the denominator would be the taxable income taking into account special expenditures or personal costs, instead of the gross taxable income, the maximum of credit would be EUR 1,650.

The taxpayers appealed against the assessed tax credit and argued that the expenditures and costs relating to the taxpayer's personal lifestyle and family circumstances must be taken into account fully in relation to their domestic income and thus the different fraction for calculating the foreign tax credit should be applied.

The advocate general noted that the case at issue must be examined in the light of the free movement of capital, as the participations held by the taxpayers concerned only portfolio dividends. According to settled case law, the provisions on the freedom of establishment are only applicable to the extent that the participation in question gives its owner definite influence over that company's decisions and allows him to determine its activities.

The advocate general noted that the application of the ordinary credit method is generally compatible with EU law. However, the AG opined that the concrete way of applying the ordinary credit method under German domestic law constitutes a restriction on the free movement of capital, as taxpayers deriving parts of their income abroad, are only granted deductions for personal and family circumstances in proportion to their domestic income. Thus, resident taxpayers who derive parts of their income abroad are treated less favourably than resident taxpayers who derive only domestic income.

Hungary

The ECJ delivered an important judgment concerning a cross border corporate migration.

The taxpayer was established and registered under Italian law as two Italian individuals. It filed a request with the Rome chamber of commerce to be removed from the Italian company register. It terminated all its activities in Italy, as well as its legal existence under Italian law.

On the forms submitted to the Rome chamber of commerce the taxpayer indicated its actions as a 'transfer of seat' to Budapest. The Rome chamber of commerce accepted the requests and claims of the company without any further questions.

The former managing director together with another individual established a Hungarian company. The representative registered the company with the court of registration in Budapest, identifying the Italian company as the legal predecessor of the Hungarian company. The Hungarian court of registration rejected the Hungarian company registration as a legal successor (of the Italian corporation) because cross-border legal succession is not permitted under Hungarian law.

The Hungarian company appealed the decision of the court of registration and the case reached the Hungarian supreme court which suspended the proceedings in Hungary and referred the case to the ECJ.

According to the ECJ's judgment, a cross-border intra-EU conversion should be treated the same way as a purely domestic conversion. The judgment was based on the EU principle of freedom of establishment, which provides that 'restrictions on the freedom of establishment of nationals of a member state in the territory of another member state shall be prohibited'. The ECJ found that the freedom of establishment should be 'interpreted as precluding national legislation which enables companies established under national law to convert, but does not allow, in a general manner, companies governed by the law of another member state to convert to companies governed by national law by incorporating such a company'.

Ireland

Ireland recently introduced two interesting provisions concerning the mobility of workers:

- Special Assignee Relief Program (SARP)
- Foreign Earnings Deduction (FED)

The new SARP is only available where the assignment commences in 2012, 2013 or 2014 and replaces the limited remittance basis available to non-Irish domiciled individuals on employment income which applied up to 31 December 2011. Unlike the old remittance basis, it is not a condition of the relief that income is not brought into Ireland. The SARP operates by granting an exemption from income tax on 0% of employment income between €75,000 and €500,000, equating to a maximum annual deduction of €127,500. For a marginal rate (41%) taxpayer, the net value of the relief would be €52,275. The relief can be claimed for the duration of the assignment up to a maximum of five years. The SARP does not reduce liability for the universal social charge or PRSI (social insurance contributions).

The Revenue has updated the tax and duty manuals in order to include guidelines for the new SARP.

The FED, which is an incentive for companies expanding into emerging markets in Brazil, Russia, India, China, and South Africa (the BRICS countries) through assigning Irish based employees to those markets. The relief provides for a reduction in the Irish income tax liability of the individual. The relief will operate for three tax years commencing 1 January 2012 and end on 31 December 2014. The relief operates by way of a deduction against employment income for employees who spend at least 60 qualifying days in a year in a BRICS country. To count as a qualifying day it must be a day which is one of at least 10 consecutive days throughout which the individual is working in the BRICS countries.

Israel

Back office work by senior executives often work in a virtual environment in a different jurisdiction than their company and its customers. A frequently asked question that is arising more and more with technological developments is whether or not such activities can create a PE and thus a taxable nexus.

The Israeli tax authority published a ruling that says that the home office of an Israeli resident investment portfolio manager working for a US company creates a PE in Israel.

The US company provides financial services outside Israel. All the clients of the US company are located outside Israel, and the company does not market its services to Israeli clients. The Israeli employee works from home and provides the following services to the US company: developing and applying the investment team's strategy, examining the level of risk in the clients' portfolio, performing credit analysis to identify undervalued securities, and tracking portfolios that are at risk of depreciation.

The Israeli employee is subordinate to the head of the team and performs no marketing or sales services. She does not perform any negotiations in the name of the US company, and the trading strategy must be approved by the head of the team. The foreign company bears all the risk vis-à-vis its clients, and it provides the Israeli employee with the tools needed to perform her work, such as technology and information on the markets.

Italy

Recent Italian tax changes will impact executives working in Italy and subject to the Italian personal income tax. Foreign companies with executives on an Italian assignment should factor this additional cost into their executives' compensation package.

The Italian government approved a surcharge to be applied on income earned by all Italian residents for the period 2011-2013. This surcharge will amount to (i) 5% on any income exceeding Euro 90,000, up to Euro 150,000, and (ii) 10% over Euro 150,000, and would be deductible from the gross income as of 2012. In addition, if its application results in a marginal tax rate of more than 48% on the last personal income tax bracket (i.e. any income in excess of Euro 75,000), taxpayers could opt to apply such 48% tax rate instead of the solidarity tax.

The Italian government approved the solidarity tax as part of a piece of legislation that is intended to ease the European Central Bank and market concerns about Italy's economics and as indicated above, should apply only for the tax periods 2011-2013.

Malta

Prior to recent amendments, Malta exempted royalties and similar income including any amounts paid for the grant of a license to exercise rights derived from registered patents for qualifying inventions, whether registered in Malta or elsewhere. Parliament has approved amendments to the income tax law that extend the scope of the royalty exemption for patents to cover income from some copyrights, thereby enhancing Malta's position as an EU domicile of choice for intellectual property planning. The amendments apply retroactively from 1 January. The amendments broaden the regime by exempting royalties derived from qualifying copyrights.

Netherlands

The court of appeals gave its decision concerning the avoidance of double taxation for a sportsman who derived foreign employment income from playing test matches in Spain and Thailand.

The taxpayer was a Dutch resident who played as a sportsman for a Dutch club. In 2002, he played test matches with his club in Spain and Thailand. He claimed avoidance of double taxation for the part of his employment income attributable to the days spent in Spain and Thailand, based on the Netherlands-Spain income and capital tax treaty (1971) and article 23 of the Netherlands-Thailand income and capital tax treaty (1975) (the treaties). The tax inspector refused to grant avoidance of double taxation for those days arguing that the test matches did not constitute a public performance.

Contrary to the lower court, the court of appeals decided that avoidance of double taxation must also be granted with respect to the foreign employment income attributable to test matches played in Spain and Thailand. The court held decisive that the test matches were open for the public, which meant that the sportsman was carrying out personal activities. Therefore, the court decided that the sportsman was entitled to avoidance of double taxation for the days spent in Spain and Thailand.

Norway

The government presented to parliament amendments to the National Budget for 2012 (the budget).

The following changes concerning exit taxation (for corporate migration across borders) are made as a consequence to the recent developments in the EU/EEA, especially in the decision of the ECJ in national grid industries:

- an interest charge is introduced on the exit tax that has been deferred and is charged until the date of realisation of the asset. The interest is set annually on 1 January of the relevant year (the rate for 2012 is 2.75%)
- a taxpayer has to provide a guarantee for the deferred exit tax, even though there is a tax treaty providing for exchange of information and assistance in the collection of taxes in force between Norway and the country to which the taxpayer moves
- exit tax liability lasts indefinitely (currently, the exit tax liability is extinguished if the assets are not alienated within five years)
- the deferral is restricted to apply only when the taxpayer moves to another EEA country
- the exit tax is not reduced even though the value of the asset decreases (currently, the tax liability may be reduced provided that the value of the assets decreases after the exit taxation is calculated)
- no tax credit can be claimed for any tax paid in the other state against the exit tax liability in Norway
- losses can be claimed in the year of exit (currently, only at the date of exit from Norway).

Poland

Various government funding opportunities with respect to research and development (R&D)/innovation-related activities will be available for eligible companies in coming months.

For example, funding will be made available to eligible companies having the status of an R&D centre, research consortium or other appropriate entity. Under the programme, certain activities will be co-financed up to 65% to 80% of eligible investment costs (depending on company size). The areas of support include:

- research leading to gains of new knowledge having specific practical use
- industrial research
- technical feasibility studies for the purposes of experimental development
- industrial research
- experimental development
- work connected with preparation for implementation of R&D results.

Portugal

Portugal, as in many jurisdictions, has exit taxation dealing with taxation on corporate migration across borders.

The advocate general of the ECJ gave his opinion in a case concerning Portuguese exit taxation. In this case, the advocate general concluded that the ECJ should declare that the Portuguese Republic has failed to fulfil its obligations by adopting and keeping in force the provisions which establish that:

- in the case of the transfer by a Portuguese company of its head office and its effective management to another member state
- in the case of cessation of the activities of a PE of a non-resident company in Portugal
- in the case of the transfer of the assets of a PE of a non-resident company in Portugal to another member state.

The unrealised gains related to the assets of such entities at the time of its departure from the Portuguese territory will be subject to immediate taxation, irrespective of the nature and extent of the assets of the companies and permanent establishments in question.

Russia

Key tax policy trends adopted by the Russian government for 2013-2015 were published. These measures represent the basis for drafting amendments to the tax legislation. Significant proposals are:

- to introduce controlled foreign companies rules
- to develop special tax regimes for small enterprises
- to define the tax residence for companies based on criteria used in tax treaties concluded by Russia
- to develop the mutual agreement procedures
- to amend individual income taxation
- to improve taxation of depositary notes and Eurobonds of Russian issuers
- to increase the mineral resources extraction tax on extraction of natural gas.

The Russian government approved criteria for the establishment of four special economic zones. The four types of zones are:

- industrial and production
- technological and innovative
- tourist-recreational
- port operations.

South Africa

On the 5 July 2012, the South African treasury published 'the taxation laws amendment bill' to further help the government's goal of making South Africa the gateway to Africa for international investment. The bill seeks to address double taxation and offset aspects of the country's strong anti-avoidance legislation. A key provision of the bill offers relief from South Africa's effective management regime, which has served as a disincentive for firms wanting to use South Africa as their launching board.

Because much of Africa lacks economic infrastructure, overseas firms are forced to set up a significant portion of their overall African operation in the relatively more developed South Africa. In some cases, political instability and the lack of qualified personnel add to the difficulty, requiring companies to carry out most of their management in South Africa.

However, under South African tax laws, extensive guidance issued from South Africa to a related party in another African country crosses the effective management threshold. The company is deemed to be South African and is then treated as a resident for tax purposes. With taxes also due in the target African country, double taxation arises.

In order to promote South Africa as an ideal destination for international capital dedicated to African regional investment, an exception from the effective management test for foreign investment funds has been created. The purpose of the exception is to remove the potential to subject the fund to South African worldwide taxation if the fund is managed by a South African manager.

To qualify for this exception from the effective management test, the foreign fund must meet the following criteria:

- the fund must be incorporated, formed or established in a foreign country
- the fund must operate in a comparable fashion to a collective investment scheme
- the sole assets of the fund must consist of cash or listed financial instruments (or financial instruments determined with reference to listed financial instruments, such as derivatives)
- the fund must have no employees and no full-time directors
- South African residents may not directly or indirectly own more than 10% of the value of the shares, units or participatory interest in the fund.

The management fees and performance fees earned by the South African investment manager will still be subject to tax in South Africa.

This change will be effective for years of assessment commencing on or after 1 January 2013.

Spain

Spain has introduced corporate tax measures to guarantee a balanced budget in view of the European financial crisis. The measures introduced relevant amendments to the corporate income tax.

- carry-forward of losses: Previous amendments established a limitation on the amount of losses to be carried forward for large companies in tax years 2011 through 2013. The revisions increase the limitation for taxable years 2012 and 2013 as follows:
  - companies whose turnover is between EUR 20 million and less than EUR 60 million will only be able to compensate to 50% (previously 75%) of the losses of the previous years
  - companies whose turnover equals or exceeds EUR 60 million will only be able to compensate 25% (previously 50%) of the losses of the previous years.

Limitation on the deduction of financial expenses: The changes abolished the Spanish thin-capitalisation rules and introduced a limitation on net financial expenses. Under such limitation, companies can only deduct their net financial expenses up to 30% of their operating profit, with a minimum deduction of EUR 1 million

- depreciation of intangible assets with indeterminate useful life: The annual depreciation rate is reduced to 2% (from 10%).
- optional special tax on dividends and capital gains derived from abroad: A new tax of 10%, applicable on dividends and capital gains that do not qualify for the participation exemption is introduced. To be eligible for the new 10% special tax, the 'subject to tax test' in the foreign jurisdiction does not need to be met, and just the condition that at least a 5% participation has been held for at least one year prior to the date on which the distribution of the profit was declared. The special tax of 10% will only apply for income liable for taxation between 15 July and 30 November 2012. The special tax would be non-deductible from the ordinary corporate income tax.

Sweden

The Swedish government submitted to the council on legislation an exposure draft of further restrictions on the deduction of interest on intragroup debt.

The exposure draft can be summarised as follows:

- currently, the restriction on the deduction of interest applies only to interest expense on intragroup loans related to an intragroup acquisition of shares. The exposure draft would broaden the scope of the restriction to include all intragroup debt, regardless of the purpose or origin of the loan
- under the existing rules, an interest deduction is allowed if the corresponding interest income is taxed at a rate of at least 10% in the hands of the beneficial owner. According to the exposure draft, even if the 10% threshold is met, a deduction would be disallowed if, from a group perspective, the loan structure is mainly tax driven. The burden would be on the taxpayer to demonstrate otherwise
- under current rules, an interest deduction is allowed even if the 10% threshold is not met if the intragroup acquisition and the debt are based on predominantly sound business objectives. The exposure draft suggests that this exception be broadened to apply to all intragroup debt.

Switzerland

As in many other jurisdictions, the US and Switzerland have issued a statement about Swiss cooperation concerning the recently passed US Foreign Account tax Compliance Act (FATCA). The US enacted provisions introducing reporting requirements for foreign financial institutions (FFIs) with respect to certain accounts. Because of certain legal or contractual restrictions in Switzerland, however, financial institutions in Switzerland may not be able to comply directly with all the reporting, withholding and account closure requirements of FATCA.

Intergovernmental cooperation to facilitate FATCA implementation would address these legal or contractual impediments to compliance, simplify practical implementation, and reduce FFI costs. Further to the policy objectives of FATCA, the US is open to adopting with interested countries, either an intergovernmental approach to implement FATCA (which would involve reporting by FFIs to their own governments followed by the automatic exchange of this information with the United States), or a framework for intergovernmental cooperation to facilitate FATCA implementation (which would provide for reporting directly between the FFIs and the US according to the FATCA rules, supplemented by exchange of information on request).

In the expectation of contributing to a solid basis for an enhanced co-operation in tax matters with the United States, Switzerland is supportive of negotiating a bilateral framework agreement to facilitate the implementation of FATCA. In light of these considerations, Switzerland and the US declared their intent to negotiate an agreement providing a framework for cooperation to ensure the effective, efficient, and proper implementation of FATCA by financial institutions located in Switzerland.

Turkey

A bill that would amend the tax laws for Turkey was sent to parliament. Among the proposals are measures that would:

- impose a limitation on interest deductions, effective in 2013
- impose interest on tax refunds and on underpayments of tax
- provide tax incentives for venture capital investment funds
- provide new rules for PEs for non-resident investment funds
- revise the withholding tax treatment of income derived by asset management companies
- provide tax incentives for services provided to foreign entities
- allow a corporate tax credit of up to 80% of certain investments made in specific regions
- allow for value added tax relief on certain investments.

Ukraine

Tax incentives have been approved for information technology (IT) companies. The operations recognised as IT activities include the supply of software, adaptation and modification of software, programming services (including web design), IT consulting, IT systems planning and development, data processing and database creation.

For 10 years, starting on 1 January 2013, eligible IT companies will be allowed to apply a 5% corporate income tax rate, as opposed to the current rate of 21% (which will gradually be lowered to 16% by 1 January 2014).

A company qualifies for the IT tax incentives if it meets the following requirements:

- at least 70% of the company's operational income is derived from its IT operations
- the initial value of the company's capital assets is more than 50 minimal salaries (approximately UAH 50,000
- the company has no outstanding tax debts.

United Kingdom

HMRC has recently issued guidance on the new UK patent box regime. The patent box enables companies to apply a lower rate of corporation tax to profits earned after 1 April 2013 from its patented inventions and certain other innovations. The relief will be phased in from 1 April 2013 and the lower rate of corporation tax to be applied will be 10%.

Who can benefit from the patent box?

Benefit from the patent box is available if the company is liable to corporation tax and makes a profit from exploiting patented inventions. The company must also own or exclusively license-in the patents and must have undertaken qualifying development on them. If the company is a member of a group, it may qualify if another company in the group has undertaken the qualifying development.

Which patents are eligible and what must be done with them?

Patents granted by the following are eligible:

- UK intellectual property office
- European patent office
- the following countries in the EEA: Austria, Bulgaria, Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Poland, Portugal, Romania, Slovakia, and Sweden.

The company or another group company must also have undertaken qualifying development for the patent by making a significant contribution to either:

- the creation or development of the patented invention
- a product incorporating the patented invention.

Exclusively licensing-in patents

Patent holders may wish to license their inventions for others to develop. If the company holds licenses to use others' technology it may still be able to benefit from the patent box. But to do so it must meet all of the following conditions:

- rights to develop, exploit and defend rights in the patented invention
- one or more rights to the exclusion of all other persons (including the licensor)
- exclusivity throughout at least an entire national territory – rights to manufacture or sell within part of a country, for example, would not qualify as exclusive.

Also, the licensee must either be able to bring infringement proceedings to defend its rights or be entitled to most of the damages awarded in successful proceedings relating to its rights. The exclusive licensing conditions are relaxed for groups of companies. This recognises that one company in the group may own a portfolio of patents while another exploits them.

Income earned from exploiting patented inventions

Not all profits may come from exploiting patented inventions. To be relevant IP (intellectual property) income, it must come from at least one of the following:

- selling patented products – that is sales of the patented product or products incorporating the patented invention or bespoke spare parts
- licensing out patent rights
- selling patented rights
- infringement income
- damages, insurance or other compensation related to patent rights.

The company can also benefit from the patent box if it uses a manufacturing process that is patented or provides a service using a patented tool. In these circumstances, the company will need to calculate a notional royalty.

How and when to claim

The company needs to make an election to benefit from the reduced rate of corporation tax that applies to the patent box. This is accomplished in the computations accompanying the company tax return or separately in writing. There is no special form of words for this election. The election must be made within two years after the end of the accounting period in which the relevant profits and income arose.

The full benefit of the regime will be phased in from 1 April 2013. The appropriate percentages for each financial year are:

- 1 April 2013 to 31 March 2014: 60%
- 1 April 2014 to 31 March 2015: 70%
- 1 April 2015 to 31 March 2016: 80%
- 1 April 2016 to 31 March 2017: 90%
- from 1 April 2017: 100%

The reduced rate of 10% is applied by subtracting an additional trading deduction from the corporation tax profits.

APAC news

Australia

Australian media conglomerate News Limited, owned by billionaire Rupert Murdoch, won a tax battle with the Australian Tax Office (ATO) when the federal court of Australia ruled that the ATO improperly disallowed deductions in excess of AUD 1 billion.

The case involved a News Limited subsidiary, News Publishers Holdings Pty Ltd., and the 1989 global restructuring of News Limited, when 18 subsidiaries underwent refinancing because of severe debt and losses.

The group was restructured again in 1991, and using loans from offshore subsidiaries brought total borrowing by News Limited to AUD 3 billion, an increase of 500%, causing what Murdoch called a 'severe liquidity crisis'.

Because the transactions were conducted using Australian dollars, US dollars, and British pounds, the company claimed deductions for losses arising from the relative decline in value of the Australian dollar against the other currencies at the time the foreign currency loans were repaid in 2001 and 2002.

The ATO argued that the transactions didn't result in losses from relative foreign currency values and that News Limited was not entitled to any related tax deductions. But the federal court of Australia (Sydney) disagreed, finding that foreign currency losses generated a legitimate tax deduction.

China

Beneficial ownership

The State Administration of Taxation (SAT) issued an announcement providing rules on determination of beneficial owner under tax treaties.

Whether or not a resident of a contracting state is the 'beneficial owner' may not be decided merely on certain adverse factors or the absence of the intention of tax evasion or reduction and shifting or accumulation of profits. It must be determined on the basis of an analysis of these:

- article of association
- financial statements
- statement of cash-flow
- minutes of the board of directors
- allocation of human resources and assets
- related expenditures
- function and risk analysis
- loan contracts
- agreements on use or transfer of intellectual properties
- certificate of the patent registration
- certificate of the ownership of author's right
- contract on agency or designated nominee.

If the requesting taxpayer of the tax treaty benefit for the dividends derived from China is a listed company of the contracting state, the applicant automatically meets the definition of the beneficial owner. The same applies to 100% subsidiaries directly or indirectly owned by the listed company of the contracting state (the intermediate indirect shareholding in a third country is excluded) provided that the dividends stemmed from the shareholding of the listed company.

Software Incentives

The ministry of finance and SAT issued a notice to renew the business income tax incentives for software businesses. The main renewed and extended incentives are summarised below.

In the period from 1 January 2011 to 31 December 2017 the exemption from enterprise income tax (EIT) for the first two years (starting from the first profit-making year) and the reduction of the EIT rate from 25% to 12.5% for the three following years apply to:

- the certified enterprises engaged in manufacturing integrated circuits (IC) with a line width of less than 0.8 microns (inclusive 0.8 microns)
- the certified enterprises which are engaged in manufacturing IC with a line width of less than 0.25 microns (inclusive 0.25 microns) or have invested more than CNY 8 billion in IC industry if the operation of such an enterprise lasts more than 10 years. The certified enterprises operating less than 10 years are subject to EIT at a reduced of 15%
- the software and IC enterprises which are newly established in China and certified by the relevant government bodies.

The 10% EIT rate is available to certified key software enterprises (i.e. those being recognised within the state's plan).

A certified enterprise engaged in software may claim a refund of the part of VAT which exceeds 3% of the total VAT paid (the normal rate of VAT paid is 17%). The refunded VAT is not subject to EIT if the refund is reinvested in R&D activities or expansion of the enterprise.

Employee training expenses incurred by the enterprise are not subject to restriction of deduction and are fully deductible for EIT purposes.

Accelerated amortisation or depreciation is introduced for purchased software which is considered as fixed asset or intangible and for machines used for IC production. The purchased software is allowed to be amortised or depreciated within two years and IC machines may be depreciated within three years.

To be eligible for the incentives, the enterprise must meet various requirements in respect of sale revenue, the education level of the personnel, the number of personnel engaged in R&D activities, the possession of the core technology or intellectual properties, quality management system and the premises and machineries suitable for the development of software and the production of technological products.

Hong Kong

A recent judicial decision dealt with unrealised gains on investments.

The taxpayer is a private company incorporated in Hong Kong on 8 September 1999 and its principal activity was investment trading. In its profit and loss accounts for the years 1999/2000 to 2005/2006 the taxpayer recorded an item of net realised and unrealised gains or losses on trading investments/securities. The realised gain/loss is based on the disposal of trading investment/securities. The unrealised gain/loss is based on changes in fair value (i.e. quoted market price) of the unsold trading investments/securities held by the taxpayer during the relevant period. In computing the adjusted losses or assessable profits, the taxpayer excluded from assessment the unrealised gains for the years 2003/2004

($456,060,896), 2004/2005 ($722,510,089) and 2005/2006 ($1,433,575,398) but claimed deduction of the unrealised losses (described in the profit and loss accounts as provision for diminution in value of listed investments held at year end) for 1999/2000, 2000/2001 ($352,858,935), 2001/2002 ($316,151,590) and 2002/2003 ($393,240,817).

The commissioner was of the view that the unrealised gains and losses arising from revaluing the unsold trading investment/securities held at the year-end should be included in the profits tax assessment for the year of assessment in which the unrealised gains were credited and unrealised losses were debited in the taxpayer's accounts. Accordingly, the assessor issued computations of loss for the years of assessment 1999/2000 to 2002/03 and profits tax assessments for the years of assessment 2003/04 to 2005/06. The difference between the profits tax thus assessed over the years and that calculated by the taxpayer without taking into account the unrealised gains was very substantial, being in the region of $250 million.

The judge held that the unrealised gains are not chargeable to profits tax on the following basis.

- profits under the inland revenue ordinance mean real profits arising in or derived from actual buying and selling of commodities in commercial transactions between the taxpayer and his trading partners, or supply of professional or other services by the taxpayer to another person and do not include notional or unrealised profits arising out of revaluation of the taxpayers stock of trade.
- the taxpayer has done nothing to attract liability to profits tax. It made no trading transactions from which the unrealised profits arose and it could not trade with itself. On the facts, not only was there no trading between the taxpayer and a third party, there was no exchange, not even simple transfer by the taxpayer of the listed securities from itself in one capacity to itself in another or to its shareholders, directors or employees, or selling them at undervalue. There was a total lack of commercial activity.

India

A company doing business in India for a related Singapore company qualifies as a PE, and the Singapore Company is subject to tax on the income attributable to the Indian PE, according to India's Authority for Advance Rulings (AAR). The facts of the ruling were:

- the applicant (A-Singapore) is part of Group, an international shipping and transportation conglomerate. A-Singapore entered into an agreement with an Indian company (AIPL) that also belongs to the Group
- under the agreement, AIPL picks up outbound shipments from consignors in India and arranges for their delivery to destination ports outside India. When those shipments reach the foreign ports, A-Singapore arranges for customs clearance and delivers the consignments to the ultimate recipients

- in the case of inbound consignments, A-Singapore picks up the shipments from consignors in various foreign countries, either by it or through other affiliates, and transfers the consignments to international airlines or on-board couriers for transportation to India. Once the consignments reach India, AIPL takes the necessary steps to deliver them to the recipients there
- A-Singapore claimed that AIPL is an independent, nonexclusive service company providing service on a principal-to-principal and arm's-length basis. AIPL is free to use other service providers outside the Group at the request of an Indian customer. AIPL also has no authority to act on behalf of A-Singapore or to legally bind it in any manner. AIPL independently provides consignment shipping services to clients in India, for which the offshore network of the Group and A-Singapore are not required.

The AAR held that AIPL does constitute a PE of A-Singapore in India and that subject to transfer pricing, the profits attributable to the PE are taxable in India. The AAR held that without AIPL, A-Singapore could not manage and ship the consignments to and from India. AIPL's independent legal character does not alter the fact that it is carrying out A-Singapore's business in India and not simply its own business. The AAR ruled that AIPL is a fixed-place PE of A-Singapore under the terms of article five of the India-Singapore income tax treaty on the basis that A-Singapore effectively has access to the offices of AIPL in India. In addition, the AAR found that AIPL is a dependent-agent PE because it secures orders from Indian clients that are partly for A-Singapore.

Indonesia

A new regulation concerning the export of raw materials is effective from the issuance date on 7 May 2012. The Minister of energy and mineral resources disclosed that the export tax, which could be around 20%, applies mainly to the export of various raw minerals, as follows:

- copper
- gold
- silver
- tin
- lead (metal) and zinc
- chromium
- molybdenum
- platinum
- bauxite
- iron ore
- iron sand
- nickel and/or cobalt
- manganese.

Japan

The US recently enacted the withholding tax regime FATCA on US taxpayers with deposits in foreign institutions. The US allows an exemption on the withholding tax if the foreign institution adopts extensive account identification, verification and reporting procedures. To expedite such adoption many countries are implementing a FATCA model agreement with the US.

Japan and the US announced a joint declaration on the implementation of the FATCA legislation. The details are to be negotiated in the following months. This joint declaration should increase legal certainty for affected financial institutions and reduce implementation costs.

The following facilitation measures are sought under the joint declaration:

- Foreign Financial Institutions (FFIs) in Japan should be registered with and annually report directly to the IRS:
  - the information on US accounts for which consent is obtained from the US account holders
  - the aggregate number and value of accounts held by recalcitrant account holders
- obligation should be eliminated for each FFI in Japan to enter into a separate comprehensive FFI agreement directly with the IRS, provided that each FFI is registered with the IRS
- FFIs are not obliged to report the names of recalcitrant US clients, make a tax deduction or close the client's account. The US can request administrative assistance concerning such recalcitrant clients by means of group requests
- certain financial institutions such as pension funds should be treated as deemed compliant with FATCA (so-called deemed-compliant FFIs) or exempt from FATCA (so-called exempt FFIs) due to presenting a low risk of tax evasion
- other measures should be provided to reduce burdens and simplify the implementation of FATCA.

Malaysia

The Inland Revenue Board of Malaysia (IRBM) has recently issued the following Public Rulings (PR) dealing with foreign nationals working in Malaysia. The PR provides clarification as to the claiming of tax treaty relief for foreign nationals working seconded to Malaysia for a short period of time by non-resident employers. The PR looks at the three conditions set out in article 15 concerning Dependent Personal Services (DPS) of tax treaties and how they are applied in Malaysia.

The following is an explanation of the conditions in the DPS Article that are to be satisfied to be eligible for tax exemption in the country of source.

Condition one – not exceeding the 183 days period. The foreign national is present in Malaysia for a period or periods not exceeding 183 days in aggregate in the fiscal/calendar year concerned; or the foreign national is present in Malaysia for a period or periods not exceeding 183 days in aggregate in any 12 month period commencing or ending in the fiscal year concerned. When considering the 183 days period, the word 'day' includes any day or part of a day of the calendar/fiscal year on which the person was physically present in Malaysia, regardless of the number of hours present, including holidays and weekends. The interpretation of this condition depends on the manner in which the provision is drafted. Satisfaction of this condition depends on individual circumstances.

Condition two – the remuneration of the foreign national working in Malaysia is paid by or on behalf of an employer who is not a resident of Malaysia. The second condition is that the employer paying the remuneration must not be a resident of the country where the employment is exercised. This includes a situation where a foreign national seconded by his non-resident employer to its subsidiary in Malaysia or a company resident in Malaysia (deemed employer) is paid by the non-resident employer on behalf of a deemed employer in Malaysia.

Condition three – remuneration is not borne by a resident or PE in Malaysia. This condition will not be satisfied if the remuneration is deducted as an allowable expense in calculating the taxable income of a non-resident employer who has a PE or fixed base in Malaysia. In determining whether the non-resident employer has a PE in Malaysia, substantiating facts and evidence would be required.

New Zealand

An issues paper for public comment 'Taxation of foreign superannuation', deals with the rules for taxing foreign retirement savings of New Zealand residents.

Foreign retirement savings may have been accumulated by people migrating to New Zealand, or by New Zealanders who have previously worked overseas. The current law for taxing foreign retirement savings is complex and can produce inconsistent outcomes. The issues paper proposes a single set of rules, which are designed to achieve fairness and simplicity from a compliance perspective.

The issues paper proposes the following:

- pensions would be taxed at an individual's marginal tax rate when received
- lump-sum payments would be partially taxed depending on the length of time between when the individual arrives in New Zealand and the date that they transfer or withdraw their superannuation funds. At the time the funds are withdrawn or transferred from the foreign superannuation scheme, the individual would apply an 'inclusion rate'
- the individual's marginal tax rate would be applied to the result calculated by multiplying the amount of superannuation funds withdrawn by the inclusion rate
- transitional residents would continue to be temporarily exempt from most New Zealand tax, including tax on foreign superannuation.

Lump sums arising from a retirement benefit scheme in Australia are not taxable in New Zealand under the Australia-New Zealand income tax treaty (2009). Also, superannuation falling under the new arrangement with Australia regarding the portability of retirement savings would not be affected.

Philippines

The house of representatives have approved a Bill seeking to rationalise the taxes on international air carriers which lawmakers said would boost tourism in the Philippines and enable the country to recognise the tax treaties that have not been honoured.

Bill 6022 titled 'Rationalising the taxes on international air carriers operating in the Philippines' provides that international air carriers doing business in the country will not be liable to pay a tax of 2.5% on its gross Philippine billings pursuant to the principle of reciprocity. The grant of reciprocal exemptions to international air carriers shall enter into force 30 days from the exchange of diplomatic notes between the Philippines and the foreign jurisdiction.

As defined in the bill, gross Philippine billings refers to the amount of gross revenue derived from carriage of persons, excess baggage, cargo and mail originating from the country in a continuous and uninterrupted flight, irrespective of the place of sale or issue and the place of payment of the ticket or passage document.

The measure also provides that the transport of passengers and cargo by domestic and international air or sea carriers from the Philippines to a foreign country shall be subject to 0% value added tax rate.

It also exempts international air carriers doing business in the country from payment of the 3% tax of their quarterly gross receipts.

The tourism and travel sectors have earlier expressed support for the measure as it would boost tourism in the Philippines through enhanced international air transport connectivity.

Singapore

The Inland Revenue Authority of Singapore (IRAS) has, pursuant to its most recent budget, released guidance that provides for the existing M&A scheme to be enhanced as follows:

- the requirement that a wholly-owned acquiring subsidiary must be directly owned by the acquiring company is removed. The acquiring subsidiary may now be directly or indirectly wholly owned by the acquiring company. Where the wholly-owned acquiring subsidiary is indirectly owned by an acquiring company through any intermediate company, each intermediate company must:
  - not carry on a trade or business in Singapore or elsewhere on the date of the share acquisition
  - be wholly owned by the acquiring company on that date
  - not claim any deduction provided under the M&A scheme
- the requirement that the conditions to be met by the target company can only be met by a wholly and directly-owned operating subsidiary of a target company is removed. With this, the conditions can be satisfied by an operating subsidiary, whether directly or indirectly, wholly owned by the target company.

The Budget 2012 also introduced a double tax deduction (DTD) scheme for qualifying transaction costs incurred on qualifying share acquisitions made during the period 17 February 2012 to 31 March 2015. Transaction costs include legal fees, accounting or tax advisor's fees, valuation fees and such other professional fees that are necessarily incurred for a qualifying share acquisition but do not cover professional and incidental fees in respect of a loan arrangement.

Taiwan

Capital gains taxation

The Executive Yuan passed draft amendments to the income tax act (ITA) and income basic tax act (i.e. alternative minimum tax act (AMT)) on 26 April 2012 to impose income tax on capital gains derived from a disposal of Taiwanese securities and futures, which are currently exempt under the regular income tax system. For corporate shareholders under the new rules, taxpayers are still subject to basic income tax on their capital gains from the sale of shares, but the tax rate is to be increased from 10% to 12% and the tax free threshold on income is to be reduced from TWD 2 billion to TWD 500,000. However, capital losses can be carried forward for up to five years to offset future capital gains, and only 50% of capital gains are taxed if the shares are held for more than three years.

Foreign Tax Credits

The Taipei National Tax Administration (TNTA) issued a statement that overpaid foreign tax cannot be claimed as a credit against tax payable in Taiwan if there is a failure to apply for tax treaty benefits on such income.

Under the ITA, a taxpayer is allowed to claim a credit for foreign tax paid on income derived outside Taiwan, upon the submission of supporting documentation when filing the final tax return. However, where the tax on income derived from a treaty partner is exempted or reduced in that jurisdiction in accordance with the provisions of a tax treaty, but no application has been made for the exemption or reduction in that jurisdiction, the overpaid foreign tax on such income may not be claimed as a credit against the tax payable in Taiwan.

Thailand

Although Singapore and Hong Kong are often used as tax favourable locations for Asian Pacific operations, Thailand can also offer some advantages for regional operations. A qualified International Procurement Centre (IPC) will be subject to corporate income tax (CIT) on its net profit from qualified income at the rate of 15% for five consecutive accounting periods. IPC refers to a company established under Thai law carrying on the business of procuring and selling goods, raw materials and parts to affiliated companies. Qualified income includes:

- income from procuring and selling goods outside Thailand to affiliated companies situated abroad and the goods must not be brought into Thailand
- income from procuring parts and raw materials either in Thailand or abroad for sale to affiliated companies situated abroad for manufacturing goods outside Thailand by the affiliates.

The five conditions to become a qualified IPC are:

1. Paid-up capital must be at least THB 10 million at the end of each accounting period.
2. The following expenditure must be maintained in each accounting period:
    - not less than THB 15 million operating expenses payable to recipients in Thailand, excluding depreciation, cost of goods, raw materials, royalties, parts and packing materials
    - not less than THB 30 million capital expenditure payable to recipients in Thailand, excluding investments in securities.
3. The counter party affiliated companies must carry on an active business and have their own management and employees.
4. Skilled staff who graduated at least secondary school or primary vocational institute or equivalent must be employed.
5. From the third accounting period onwards, the IPC must:
    - have qualified income of not less than THB 1 billion in each accounting period
    - pay compensation of not less than THB 2.5 million per person per annum to at least three employees.

If the conditions cannot be met in any year, the corporate and expatriate tax benefits will be withdrawn with effect from the first year. The IPC and expatriate staff will also be subject to penalties and surcharges.

Americas news

Argentina

Argentina's National Supreme Court of Appeals (NSCA) confirmed that the determination of the 'probable' depreciable life of a capital asset is a matter to be determined by the reasonable interpretation of the taxpayers because neither the CIT law nor its implementing decree define this concept. The CIT law allows taxpayers to make depreciation deductions based on the wear and depletion of capital.

The taxpayers in the case, Telecom Argentina S.A. and Telefónica Argentina S.A. considered the depreciable life of marine fibre optic cables (MFOC) to be determined by the obsolescence derived from technological advances. So they fixed it at 15 years for tax deduction purposes.

The NTA held that the CIT law only allows the deduction of depreciation based on the 'wear and depletion' of capital assets, not obsolescence. In the NTA's view, the obsolescence factor determines the 'lack of use' of a certain asset, which has a specific and different treatment in the CIT law. So the NTA fixed the useful life of MFOC at 20 years.

The NSCA confirmed the taxpayers' criterion, holding that the determination of a capital asset's probable depreciable life is up to the taxpayer, but also held that the concept of depreciable life refers to the 'economically useful life', meaning the length of time that a capital asset can be used in an economically profitable manner. In the telecommunications industry, and that obsolescence causes an asset depreciation derived from technological innovations.

Brazil

A recent ruling created a new filing obligation with information concerning transactions involving non-resident persons regarding services, intangibles and any other operation with an impact on the equity of resident persons.

The responsible parties to provide this information are those individuals and/or legal entities resident in Brazil who:

- render or contract services
- dispose or acquire intangibles, including intellectual property rights, by any legal means
- represent unincorporated bodies that carry out transactions which may change their equity value.

Agencies, departments of public administrations as well as resident individuals and legal entities carrying out these types of transactions by means of a related foreign presence (e.g. a branch) are also subject to these filing procedures.

The following transactions are not subject to the filing procedure:

- those involving the purchase and sale of goods, even if involving services and intangibles embedded in them, provided that they are duly registered with the Integrated Foreign Trade System (SISCOMEX)
- those carried out by:
  - legal entities subject to the unified system for the payment of taxes and contributions by small businesses
  - the individual micro entrepreneur
  - individuals who do not carry out, on a regular and professional basis, any economic for profit activity in his/her own names related to the sale of goods and services, provided the transaction value during the month does not exceed USD 20,000.

Failing to comply with the required information is subject to:

- a penalty of BRL 5,000 on each month of delay
- a 5% penalty over the value of the transaction in cases where the information is not provided, inaccurate or incomplete.

The effective date of normative ruling varies from 1 August 2012 to 1 October 2013, according to the nature of the transaction involved.

Canada

The government has requested comments regarding the impact that contingency fees may have on the Scientific Research and Experimental Development (SR&ED) tax incentive programme.

This follows on from the government's commitment in economic action plan 2012 to study contingency fees charged by tax preparers for SR&ED claims.

"The SR&ED tax incentive programme is the single largest federal programme supporting business research and development in Canada, providing more than $3.6 billion in tax assistance in 2011," said Minister Flaherty. "The feedback from this consultation will be important in ensuring that the programme continues to benefit Canadian businesses and the economy."

The Canada revenue agency, which administers the SR&ED tax incentive programme, will work closely with the department of finance throughout this consultation process. The government seeks input from taxpayers to better understand:

- why firms hire third-party tax preparers on a contingency-fee basis
- why these tax preparers charge contingency fees
- the prevalence of this practice
- the amounts charged
- the impacts of this practice on the effectiveness of the SR&ED tax incentive programme.

Canadian corporations that owe debt to certain non-residents need to review the modifications to Canada's thin capitalisation in the 2012 federal budget. These modifications include a reduction in the debt-to-equity ratio, an extension of the regime to partnership debt, and the introduction of a new deemed dividend rule for excess interest expense. Although the reduction of the debt-to-equity level to 1:5 (from 2:1) will generally not apply until 2013, important changes are already in effect.

Chile

The Chilean President Sebastián Piñera submitted a tax bill containing measures to finance a major reform of the education system, provide economic relief to the middle class, stimulate economic growth, and improve the tax system by eliminating unjustified exemptions and closing loopholes. Certain provisions of the bill contain provisions of interest to multi-national corporates with Chilean investments.

The concept of Chilean-source income would be broadened to include an indirect sale made by a seller resident abroad of shares or quotas in a Chilean entity when the interest acquired is 10% or more of the ownership, control, profits, or income of the Chilean entity, regardless of whether the purchaser is domestic or foreign.

The scope of taxation of a Chilean PE of a non-resident company would be extended to include (in addition to Chilean-source income) any foreign-source income attributable to the PE. Furthermore, the PE would be treated as a separate and independent entity from its head office, and all transactions between the PE and its head office would have to be on arm's-length terms.

For loans from related parties, the 3:1 debt-to-equity threshold would be calculated monthly for foreign debt eligible for the 4% withholding tax rate.

The transfer pricing rules would be replaced by rules that conform to the OECD transfer pricing guidelines and enhance the Chilean tax authorities' ability to adjust prices in related-party transactions.

Colombia

The newly signed agreement between the EU, Colombia and Peru will open up markets on both sides and increase the stability of the trade relationship that was worth €21.1 billion in bilateral trading of goods in 2011. The agreement includes far reaching measures on the protection of human rights and the rule of law, as well as commitments to effectively implement international conventions on labour rights and environmental protection. The agreement will provisionally take effect once the European parliament has given its consent and ratification procedures are concluded in Peru and Colombia. Full entry into force will be pending ratification by the 27 EU member states.

Some of the key elements of this agreement are:

- over the course of its implementation, the agreement will fully relieve EU exporters of industrial and fisheries products to Peru and Colombia from paying customs duties. At the latest 10 years after its entry into force, EU exporters of these products will be saving at least €250 million annually in tariffs to these two countries. After a gradual liberalisation over a slightly longer period (up to 17 years) an additional €22 million will be saved annually on exports of agricultural and processed agricultural products, bringing the total benefit for the EU export sector at the end of the transition period to more than 270 million a year

- systemically, the parties will cooperate on market surveillance and will improve transparency by enhancing communication and cooperation in the area of technical regulations, standards and conformity assessment
- Colombia and Peru have committed to full access to the procurement of local municipalities in addition to that of central authorities above the pre¬determined thresholds. This will leave ample room for EU bidders to participate in any significant market. EU operators will in addition benefit from improved conditions in Colombia regarding service concessions and airports as well as the purchase of engineering and printing services.

Ecuador

Ecuador's tax administration has identified the following countries' tax systems as providing 'preferential tax regimes':

- Estonia – with respect to a corporate income tax imposed on distributed profits only
- Bulgaria – with respect to the corporate income tax rate (10%)
- Macedonia – with respect to the corporate income tax rate (10%)
- Ireland – with respect to the corporate income tax rate (12.5%)
- US – with respect to limited liability companies (LLCs) whose owners are not US residents and neither the LLC nor its owners are subject to federal income tax; also, for taxpayers located in Delaware, Nevada, Wyoming, and Florida who are not subject to state income tax
- Montenegro – with respect to the corporate income tax rate (9%)
- Serbia – with respect to the corporate income tax rate (10%).

Among other things, this determination means that any transaction that is entered into with taxpayers located in any of these 'low tax' countries or territories will be considered a related-party transaction.

El Salvador

El Salvador's ministry of finance published transfer pricing guidelines that are in line with the OECD guidelines. The initial transfer pricing regulation was introduced in 2009. According to the new regulation an independent tax auditor appointed by the taxpayer must disclose in the company's annual tax report the overall tax status of the taxpayer, including a specific section on the level of compliance with the transfer pricing rules.

The scope of the new guidelines covers related-party transactions and parties domiciled in tax havens or jurisdictions with preferential tax regimes. The new regulation specifies all the required documentation supporting covered transactions that covered persons should prepare.

Taxpayers involved in related-party transactions that individually or collectively amount to or exceed $571,000 dollars must file an informative return providing details of such operations including:

- general information about the related party
- the transaction type
- the amount of the transaction
- comparability factors used
- adjustments made
- the method applied.

The deadline to submit this return is the end of the first three months following the expiration of the tax year.

Also, taxpayers should document the pricing method and policies used for transactions with related parties or with parties domiciled in tax havens by 31 May of each tax year. Taxpayers are not required to file this documentation but it must be available upon request by the relevant authorities.

The new guidelines include the transfer pricing methods as defined by the OECD guidelines:

- comparable uncontrolled price method
- resale price method
- cost-plus method
- transactional net margin method
- profit-split method.

In the case of a lack of compliance with the transfer pricing regulation, the tax authorities will assess the value of transactions with related parties using the fair value for similar products or services between third parties.

Also, if a taxpayer does not present the required documentation in time or the documentation is not duly prepared, the tax authorities are entitled to charge a fine of 0.5% levied on the equity value shown on the taxpayer's balance sheet.

Mexico

On the 1 June 2012, the organisation for economic cooperation and development announced that the 'multilateral pact on administrative cooperation in tax matters' that it co-founded in 1988 is now open to all countries to join. When the convention on 'mutual administrative assistance in tax matters' originally took effect in 1995, it was limited to 54 countries—members of the Paris-based OECD, which now number 34 and include the world's advanced economies, as well as the 47 members of the Council of Europe (CoE), which is based in Strasbourg, France and is independent from the EU. Several countries are members of both the OECD and CoE.

By 2010 only 17 countries had signed or ratified the original pact, limiting its effectiveness. By that time the 'G20 countries' had begun their big push against tax evasion, in particular by naming and shaming uncooperative tax havens and improving tax information exchange and transparency among tax administrations worldwide.

In April 2010, urged by the G20, the OECD and CoE updated the accord to make it a more powerful instrument in the international fight against tax evasion and open it to more jurisdictions, including developing countries. Mexico signed the convention on 25 January 1988 and the protocol on 27 May 2010. The convention provides for the mutual exchange of tax information and assistance in the recovery of taxes and the service of documents. The protocol updates the 1988 convention in accordance with OECD standards for exchange of information. The OECD council of Europe convention on mutual administrative assistance in tax matters, as amended by a 2010 protocol, will enter into force on 1 October for Mexico.

Puerto Rico

Due to the complexity in maintaining plans qualified under both the US tax code and under the Puerto Rico tax code, sponsors are considering transferring the assets of the plan benefiting Puerto Rico employees to a plan that is intended to satisfy only the Puerto Rico tax code. The benefit of transferring the assets to a Puerto Rico only plan has been called into question with the issuance of a revenue ruling which provides that such transfers should be treated as distributions from a plan qualified under the US tax code. However, the ruling provides a transition period, which has since been extended generally to 31 December 2012. Additionally, for US qualified plans participating in a group trust on 10 January 2011, the deadline is further extended until future guidance is issued. This transition relief is important because the US tax code limits when distributions can be made from US qualified plans.

Following the release of the ruling, questions were raised as to whether Puerto Rico only plans could participate in group trusts. Although a notice provides relief to group trusts with respect to investment of Puerto Rico only plans that are transferees of assets from US qualified plans, or Puerto Rico only plans that were participating in a group trust as of 10 January 2011, it is unclear whether a group trust will be able to hold assets of Puerto Rico only plans in the future.

The IRS has solicited comments regarding the tax treatment of nonqualified entities participating in group trusts.

United States

A UK publicly held multi-utility company (UKPLC) that owned 100% of a Nevada general partnership (NAGP) that elected to be treated as a corporation for US tax purposes. UKPLC made a loan to NAGP in connection with NAGP's acquisition of Target. The issue was whether the loan constituted debt or whether it should have been treated as equity for US tax purposes. The deductibility of interest payments was at issue. The court held that the loans constituted debt for US tax purposes.

UKPLC and Target completed the proposed merger under which Target became a direct subsidiary of NAGP and an indirect subsidiary of UKPLC. Target's shareholders received shares in UKPLC in the transaction. NAGP also issued notes to UKPLC equal to 75% of the share value given to the public shareholders of Target. It did so in exchange for UKPLC's transferring UKPLC shares to Target shareholders in the acquisition. It did this on behalf of NAGP. The loan notes consisted of $4 billion of fixed-rate loans and nearly $1 billion of floating-rate notes. Shortly after closing, Target sold a large Australian subsidiary for approximately $700 million.

Under the loan notes, interest was payable quarterly in arrears. The loan notes were unsecured and ranked equally and rated with other debt obligations of NAGP. UKPLC, as the note holder, could require NAGP to repay all or a portion of the loan notes at any time with proper notice. NAGP had the right to redeem the loan notes without penalty at an agreed market rate. UKPLC could require repayment of all of the loan notes at a market rate if any principal or interest was not paid within 30 days of the due date. The loan notes were transferable.

UKPLC and NAGP both reflected the loan notes as debt on their books. They also represented to the US SEC that the loan notes were debt.

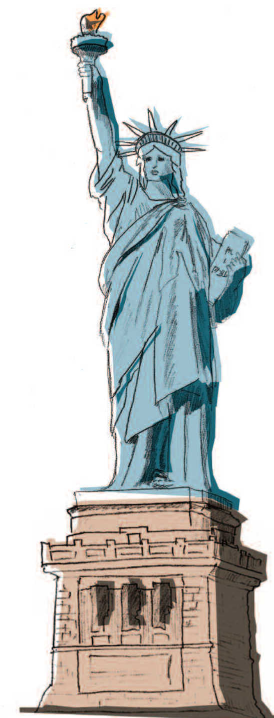
NAGP borrowed $200 million on a short-term basis from UKPLC to fund the first two interest payments. NAGP also entered into a $360 million credit facility with Royal Bank of Scotland (RBS). The RBS credit facility matured after just a few months. UKPLC's right to repayment of the loan notes was subordinated to the amount that NAGP owed to RBS.

NAGP borrowed under the RBS credit facility to repay the short-term loan from UKPLC and to fund additional interest payments to UKPLC. NAGP repaid the RBS loans with proceeds from Target's sale of its Australian business.

The court commenced its analysis by stating that a transaction's substance, not its form, controls its effect for US tax purposes. The court also stated that tax consequences are a significant consideration in many commercial transactions, and planning a legitimate transaction to take advantage of tax benefits does not invalidate the transaction.

In considering distinguishing debt from equity, these factors were considered:

- the name given to the documents
- the presence of a fixed maturity date
- the source of payments
- the right to enforce payments of principal and interest
- participation in management
- a status equal to or inferior to that of regular corporate creditors
- the intent of the parties
- thin or adequate capitalisation
- the identity of interests between creditor and shareholder
- payment of interest out of only 'dividend' money
- the corporation's ability to obtain loans from outside lending institutions.



Transfer pricing news

OECD transfer pricing simplification

The OECD will attempt to tackle five areas of transfer pricing simplification, according to the 2012 version of OECD's current tax agenda. The five areas are:

- revision of the current guidance on safe-harbour provisions
- creation of a sample memoranda of understanding for use by country competent authorities in developing bilateral safe harbours and resolving groups of common transfer pricing cases
- simplification of documentation rules
- development of clearer guidance on low value-adding services
- simplification of the advance pricing agreement process.

The OECD explained that the creation of safe harbours could reduce taxpayer compliance costs and free tax administration resources, particularly when adopted in low-risk matters and on a bilateral or multilateral basis. The OECD stated that the creation of sample competent authority agreements for use by countries in negotiating bilateral safe harbours could allow routine cases to be taken out of the transfer pricing dispute resolution system, allowing taxpayers and tax administrations to focus their resources on the right matters.

The document states that problems regarding charging group members for head office and regional administrative expenses consume time and resources when very little is usually at stake. More standard approaches among countries, possibly leading to a multilateral safe harbour provision for some classes of expenses, would greatly simplify compliance and free resources.

The OECD have said that they will also work on accelerating the advance pricing agreement (APA) process, focusing primarily on more routine APA cases giving taxpayers the opportunity to achieve the certainty offered by a well-functioning APA without the need for years of negotiations. The initial focus will be on identifying areas in which bilateral memoranda of understanding can be used to accelerate specified cases.

OECD intangibles discussion draft

The OECD released the report 'Discussion draft – revision of the special considerations for intangibles in Chapter VI of the OECD transfer pricing guidelines and related provisions'. The document contains:

- a proposed revision of the provisions of chapter VI of the OECD transfer pricing guidelines for multinational enterprises and tax administrations
- a proposed revision of the annex to chapter VI containing examples illustrating the application of the provisions of the revised text of chapter VI.

In 2010, the OECD announced the commencement of a project on the transfer pricing aspects of intangibles. In the interim three public consultations have been held with interested commentators. In November 2011, representatives of the business community suggested that it would be helpful if the OECD were to release interim drafts of its work as it progresses, for further detailed public comment.

As the report is an interim draft it should be recognised that it is not necessarily a consensus document and that the committee on fiscal affairs has not yet considered the draft. One or more countries may not be in full agreement with one or more of its provisions. Nevertheless, OECD working party six believes that it will be extremely helpful to its on-going work on the intangibles project to have detailed business input with regard to the various provisions of this draft.

It should also be recognised that the discussion draft does not represent a complete draft of all of the provisions ultimately expected to form a part of the output for this project. In particular, the working party still intends to address at least the following topics not currently addressed in this draft:

- any necessary modifications to chapter VIII of the OECD transfer pricing guidelines related to cost contribution arrangements that may be necessitated as a result of the modification of chapter VI;
- the transfer pricing consequences of various items treated in this draft as comparability factors rather than intangibles, including market specific advantages, location-based advantages, corporate synergies and workforce issues.

Denmark

Swiss Re Copenhagen Holding ApS, was wholly owned by the US company ERC Life Reinsurance Corporation. In the spring of 1999, the group considered transferring the German subsidiary, ERC Frankona Reinsurance Holding GmbH, from the US parent company to the Danish company on 1 July 1999. The value of the German company was determined to be DKK 7.8 billion. The purchase price was to be settled by the Danish company issuing shares with a market value of DKK 4.2 billion and debt with a market value of DKK 3.6 billion.

On 27 May 1999, the parent company and the Danish company agreed to analyse whether the debt could be structured as a subordinated, zero-coupon note. Compensation for the loan would be structured as a built-in capital gain in order to defer recognition of the compensation for the period 1 July 1999 to 30 June 2000 until income year 2000. Hence, the Danish company would be unable to use a deduction in income year 1999. A built-in capital gain would be recognised in 2000 where payment of the first instalment would be made. If compensation were structured as interest payments, the compensation should be recognised on an accrual basis whereby half of the deduction for the initial 12-month period would be recognised in 1999.

On 17 June 1999, a bank provided the Danish company with information about market terms for a zero-coupon loan.

On 21 June 1999, an extraordinary shareholders meeting of the Danish company approved the acquisition of the German company with effect from 1 July 1999. The minutes stated that the debt should be settled by issuing an instrument of debt from the company to ERC Life Reinsurance Corporation at terms to be specified in more detail.

On 14 September 1999, the parent company informed the Danish company that approval had been obtained for the issuance of the zero-coupon note and that it should state that the loan was made on 30 June 1999.

On 15 October 1999, the parties signed the loan agreement. The principal of the loan was fixed at DKK 4.9 billion corresponding to a market value of DKK 3.6 billion. The effective interest on the loan was 6.1 % per annum. The capital loss associated with the first instalment on 30 June 2000 was DKK 222 million, which was claimed by the Danish company as a deduction in its tax return for 2000.

The issue before the courts was whether tax authority adjustments to interest, capital gains/losses were timed barred under the income tax provisions, or if the adjustments could be made as the result of a violation of the arm's length principle.

The tribunal thus ruled in favour of the taxpayer, concluding that the income years 1999 and 2000 were time barred.

The high court held that the adjustments were covered by the extended deadline for controlled transactions.

The supreme court held that the loan agreement infringed on the arm's length and that the adjustment by the tax authorities was warranted.

France

France's parliament adopted legislation that shifts the burden of proof to French taxpayers in transfer pricing audits when they transfer profits to subsidiaries located outside the EU.

Under the draft bill, the burden of proof would have shifted to French taxpayers when they transferred profits to subsidiaries located in tax havens. The profits of subsidiaries controlled by French companies and located in low-tax jurisdictions may be taxed in France.

For companies located outside the EU, the article makes a further distinction as to whether the foreign undertaking is located in a 'non-cooperative jurisdiction'. For subsidiaries located outside the EU, the new finance act eliminates the distinction based on the location of the foreign undertaking and shifts the burden of proof to taxpayers when profits are moved outside the EU, whether the non-EU location is considered a tax haven or not.

The new finance act would automatically apply unless the taxpayer can prove that the main purpose and effect of the controlled subsidiary's operations are other than placing profits in a state or territory where the undertaking is subject to favourable tax treatment.

The taxpayer would satisfy its burden of proof if the undertaking is engaged in an actual industrial or commercial business in the state where its establishment or head office is located.

EU joint transfer pricing forum report

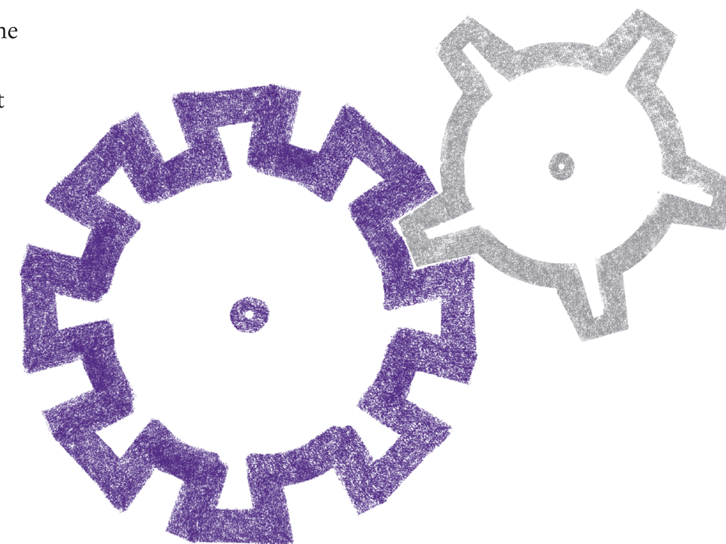
A recent EU joint transfer pricing forum report on cost contribution arrangements (CCAs) involving services, which do not create intellectual property (IP), emphasises that each participant to such an arrangement should have a reasonable expectation of benefit.

The report on CCAs covers services including information technology, logistics, purchasing, real estate, finance, tax, human resources, accounting, payroll, and billing. The report said a CCA on services not creating IP has the following features:

- the arrangement makes business sense
- the economic substance is consistent with the terms of the CCA
- the terms of a CCA generally are agreed prior to the beginning of the activity
- the terms of a CCA are at arm's length taking into account the circumstances known, or reasonably foreseeable, at the time of entry into the arrangement
- each participant has a reasonable expectation of benefit
- the participant's share of the costs is consistent with its share of the expected benefits
- reasonable expected benefits can be assessed in terms of efficiency, or effectiveness, in quantitative or qualitative terms
- contributions by a participant can be in cash or in kind
- when a service subject to a CCA is also provided to, or received from, nonparticipants in the CCA, it is valued at arm's length
- if participants join or leave the CCA, shares are adjusted in accordance with the arm's length principle.

The report states:

- a participant's contribution must be consistent with the expected benefits it will derive from participating in the CCA and benefit means an increase in economic or commercial value such as savings in expenses, or an increase in income or profits
- the key used for allocating costs should reflect the benefit expected by the participant and how the participant takes advantage of the outcome of the CCA in a way consistent with the arrangement
- the expected benefit also may be evaluated directly by estimating the additional income to be generated or costs to be saved, or indirectly by using indirect indicators of the expected benefit, such as turnover, number of employees, or gross profits.



Indirect taxes news

Chile digital books

Cross border e-commerce continues to trouble many countries where transactions cross borders. A recent Chilean administrative ruling addressed the cross border sale of digital books.

The company engaged in the distribution of digital books intended to conclude a redistribution contract with a distributor of digital books based in Spain. The Spanish distributor operated a digital platform through which it enabled its customers to download books from various publishers. Under the contract, the Spanish distributor would provide the Chilean redistributor with a connection to its digital platform, enabling the redistributor to sell digital books to final customers resident in Chile only.

For every purchase made from Chile through the redis¬tributor's website, the system automatically generated an order to the Spanish distributor, who then sent an encrypted link to the redistributor who, in turn, forwarded the link to the customer enabling him to down¬load the purchased book. The transactions had the effect that the Spanish distributor sent an invoice to the Chilean redistributor, and the redistributor sent an invoice to the final customer in Chile.

According to the tax authorities, both transactions are in principle subject to VAT in Chile. However, the trans¬action between the Spanish distributor and the Chilean redistributor will be subject to income tax under the with¬holding system applicable to non-resident entities and, consequently, exempt from VAT.

With respect to the tax treaty between Chile and Spain, income derived from the transactions between the Spanish distributor and the Chilean redistributor may be exempt from income tax in Chile, provided that the Spanish distributor does not have a PE in Chile. If related income is exempt from income tax in Chile, the services of the Spanish distributor are subject to VAT in Chile.

India taxation of services

A new comprehensive system of taxation of services became effective on 1 July 2012. From that date, all ser¬vices will be subject to a service tax, unless they are included in the negative list or are specifically exempt. The new system of taxation of services replaces the system under which only specified categories of services which were subject to service tax. Since 1 April 2012, the rate of service tax is 12%. The 'deemed sales of goods' are excluded from the concept of services. Under the constitution, 'deemed sales of goods' are transactions involving the transfer of ownership of goods, where the transactions are by nature composite transac¬tions, involving a supply of goods and also a supply of services.

Brazil technology industry

The Brazilian government published various tax measures aimed at stimulating economic development. For indirect taxes, the plan contains the following measures:

- exemption from import duty, federal consumption taxes (PIS, COFINS and IPI) for the supply and importation of raw materials and intermediate products used for the production of computers or software to be supplied to the government
- exemption from federal consumption taxes (PIS, COFINS and IPI) for the supply of machinery or equipment to be used for the modernisation of the telecommunications network, especially the broadband network
- with effect from 2013, deduction of IPI (tax on industrialised products) due on expenses incurred in relation to technological innovation and the acquisition of essential raw materials.

USA technology transactions and state sales and use taxes

Despite the fact that the USA does not have a VAT/GST, it does have a retail level sales tax or use tax. A sales tax is imposed on the retail sale with no successive levels of taxation with input credits. A use tax is similar to a reverse charge VAT.

The Missouri department of revenue has issued two letter rulings on the application of sales and use tax to software, software licenses, maintenance contracts and related transactions.

Standard and customised computer software downloaded electronically (in intangible format) over the internet is not subject to sales or use tax because the customer never takes possession of any goods. Delivery of software in intangible format includes the provision of access to non-downloadable software housed on the vendor's website and installation, by the vendor, of software on a physical carrier onto the customer's computer or website if, after installation is complete, the vendor does not leave the carrier with the customer. Standard and customised computer software that is delivered in tangible format (on a physical carrier) is subject to sales or use tax. Services relating to software, such as the granting of licenses enabling more persons to use the software, and maintenance and support services are subject to the same regime as the original supply of the software.

The South Carolina department of revenue has issued a sales and use tax ruling clarifying that the sale of software delivered electronically via the internet is not subject to sales and use tax, provided that no part of the software, such as back-up tapes, diskettes or flash drives, is delivered in a tangible form. Electronically delivered software does not fall within the definitions of goods or telecommunications services. However, the provision of access to software stored on the vendor's website is taxable. Where a programmer brings a laptop to the customer's location, establishes a connection between the laptop and the customer's computer and does not download software but, instead, makes changes to the source code of the customer's software, the transaction is not taxable because the programmer has provided a service and did not sell software delivered by tangible or electronic means.

China

The Ministry of Finance and the State Administration of Taxation issued a circular on 31 July 2012 for the implementation of the decision to extend VAT beyond the pilot location of Shanghai. There are eight municipalities or provinces to which the pilot programme has now been extended. From 1 August 2012, Beijing, Tianjin, Jiangsu, Anhui, Zhejiang (including Ningbo), Fujian (including Xiamen), Hubei, Guangdong (including Shenzhen) may start preparatory work such as training of the tax officials and providing information to taxpayers.

The commencement dates of the programme for the different provinces/municipalities are as follows:

Province/municipality	Commencement date
Beijing	1 September 2012
Jiangsu and Anhui	1 October 2012
Fujian and Guangdong	1 November 2012
Tianjin, Zhejiang and Hubei	1 December 2012

European Commission

The European Commission published the draft council directive on the introduction of a Quick Reaction Mechanism (QRM) to combat VAT fraud. Details of the directive proposal are summarised below. The draft council directive is a result of the communication on the future of VAT in which it was announced that measures would be proposed for a quicker response to VAT fraud.

Currently, VAT fraud can only be combated by an amendment of the EU VAT directive or by individual derogations granted to member states on the basis of the EU VAT directive. The latter requires a proposal from the European Commission, a process which can take up to eight months. Afterwards, the proposal must be adopted unanimously by the European Council which causes further delay. Therefore, the Commission proposes to introduce a QRM, which allows a more speedy reaction to VAT fraud. The QRM is not intended to replace the current derogation system. Therefore, its scope is limited to massive and sudden fraud mechanisms in specific economic sectors in a particular member state.

The draft council directive lists the following forms of a QRM:

- reverse charge mechanism under which the recipient has to remit VAT
- any other measures determined by the council acting unanimously on the basis of a commission proposal.

QRM measures will be granted by the Commission itself in an examination procedure which allows the Commission to immediately adopt applicable acts on the basis of duly justified grounds or urgency. Once the requesting member state has submitted the required data, the Commission will take a decision within one month.

A QRM authorisation will be granted for one year to allow in the meantime the member state concerned, if necessary, to request an authorisation to derogate from the EU VAT directive.

The directive proposal should be implemented by the member states by 1 January 2013.

Australia

The administrative appeals tribunal handed down a denial of the availability of GST input tax credits in respect of carrying on an enterprise.

The taxpayer claimed input tax credits on a number of acquisitions between 1 August 2008 and 30 June 2010 on the basis that they carried on a business, which was established in 2008 with a friend with a view to develop a software package that would help mining and resource firms manage all of their human resource functions. While the friend was busy developing the software at taxpayer's home, taxpayer was engaged in marketing activities and market research. The business was funded by a wealthy individual who was a mentor of the taxpayer. During that period, it appears that the business did not make any supplies and therefore all input tax credits claimed by taxpayer would have been refunded by the Australian tax office (ATO).

The taxpayer's home was burgled of all equipment used in the business and all business records. As no backups of the software were made, the developed software was lost together with the computer equipment.

When the ATO queried the taxpayer about the business, they could not provide any documentation whatsoever confirming the business's existence, as unfortunately all documentation was stolen in the burglary. Further, it was claimed that since the burglary, the person developing the software left the business and her whereabouts were unknown. As the business was funded by the mentor by way of the mentor's credit card, taxpayer did not have any funding or other records either, as she was not able to contact the mentor, who had severed all contact with taxpayer.

The ATO decided that there was no genuine business, disallowed the credits and imposed a 50% penalty for recklessness. The taxpayer appealed to the tribunal.

The taxpayer provided no evidence of the business to the tribunal and thus the input credits were denied and penalties imposed.

Slovak Republic

Difficulties in VAT registration process

The VAT act stipulates that domestic tax payers are obliged to register for VAT purposes upon reaching a turnover of 49.790 EUR in 12 consequent calendar months. The turnover is represented by the sum of all revenues (income) before tax from goods and services delivered inland. On the contrary from the turnover are excluded revenues (income) from occasional sale of tangible and intangible assets. The VAT act however enables the taxpayers to register for VAT purposes on a voluntary bases before reaching the turnover of 49.790 EUR. A voluntary VAT registration before the reaching of an obligatory turnover is a standard request of tax payers who naturally want to deduct the input VAT, e.g. on acquired services. Without the VAT registration the VAT paid on services acquired will be lost forever.

Voluntary registration as a condition for deduction of input VAT

Until about April 2011 entities did not encounter any problems when registering voluntarily for VAT purposes and the tax authorities regularly accepted requests for voluntary registration without further complications. Upon revealing several tax frauds related to VAT the tax authorities in the Slovak Republic applied stricter rules for voluntary VAT registration in first half of 2011. Beside additional information required in a form of a questionnaire the tax authorities established a committee that reviews every request for voluntary registration and decides based on its opinion.

Difficulties in voluntary VAT registration process

In case of voluntary VAT registration the tax authorities look to a provision of the VAT act that stipulates who is a taxable person, meaning a person who carries out an economic activity. The tax authorities require the following documents as a proof of intention to constitute taxable transactions:

- business plan (with detailed description of activities, SWOT analysis, financial plan)
- contracts (optionally business pre-agreements)
- invoices and other documents confirming constituting of economic activity.

Presenting economic activity

The contracts and optionally issued invoices are the key documents for tax authorities as these are the documents that prove the taxpayer is carrying out an economic activity. Newly established companies that have not yet issued invoices or have not concluded any contracts with customers will find it very difficult to present any economic activity, so a request for voluntary VAT registration could fail.

Are Slovak financial authorities violating EU law?

Slovak VAT professionals point to the binding interpretation of the European Court of Justice (C-268/83) that the mere preparation for future taxable transactions should be considered in terms of a common VAT system applied in the EU as constituting an economic activity.

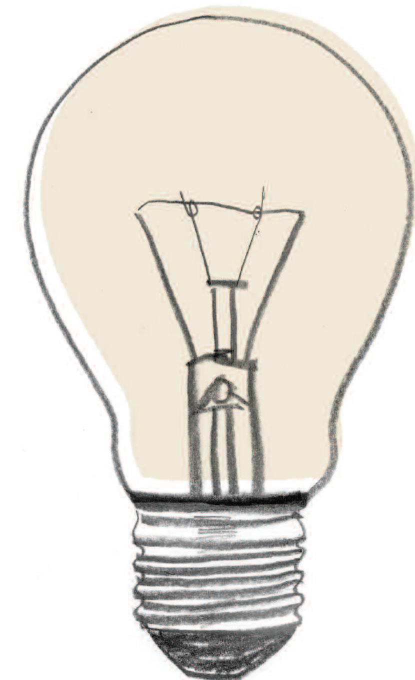
The Slovak VAT professionals believe that the tax authority is obliged to register the taxpayer for VAT purposes in the context of start-up operations. Also, according to the opinion of the tax directorate of the Slovak Republic in cases of newly established companies that do not have any documents supporting their economic activity, the tax authorities should approve their VAT registration. However, as mentioned the final decision on voluntary VAT registration is up to the respective tax authority and up to the committee established for this purpose.

Comparison of practice in Slovakia and Austria

This situation should be contrasted with what happens to an Austrian start-up:

A newly established company received an invoice from their legal advisor for legal services connected with establishment of the company amounting to 3,000 EUR + VAT 600 EUR and an invoice for tax advisory services in amount of 1,000 EUR + VAT 200 EUR. The company then filed a request for voluntary VAT registration.

The Austrian company is allowed to deduct VAT provided they filed a request for voluntary VAT registration immediately after being established, however the Slovakian company is not permitted to deduct VAT from these invoices as the company was not a VAT payer and the amount of VAT 800 EUR is inevitably a cost for the company. In the case of the Slovakian company, as they do not possess any concluded agreements or issued invoices, there is a risk that the voluntary VAT registration will not be successful and the entity loses the possibility of deducting VAT on all received services up until the day of a later registration.



Treaty news

Germany-Turkey

The taxpayer was a German resident who worked for an Irish airline company as a pilot. Under the Irish pay-as-you-earn (PAYE) rules, the employer withheld the income tax on salary and paid it to the Irish tax authorities. On request the tax was refunded on the grounds that the taxpayer was not an Irish resident and that the aircrafts, directed by him, did not land in Irish airports. This was a situation when Germany might refuse to grant the tax exemption in the Germany-Ireland tax treaty. Under the treaty, salaries, wages and other similar remunerations are exempt from German income tax if, under the Germany-Ireland tax treaty, Ireland has the right to tax the salaries. However, Ireland chose not to tax the income. Therefore overriding the exemption provision, the finance office assessed the pilot in order to avoid double non taxation. The finance office applied domestic tax law under which the exemption is not granted if the taxpayer is not taxed in the other country because he is not a resident of that country and because the income is deemed not to be derived from sources of that country. The pilot appealed to the finance tribunal which rejected the appeal. The taxpayer then appealed to the federal finance court (BFH).

The BFH agreed that under the treaty Germany, as the residence country, had to exempt the pilot's salary from income tax and that according to German domestic tax law, the exemption would be excluded. However, the BFH held that this provision was overridden by another provision (unmentioned by the finance tribunal) — the special subject-to-tax clause of German domestic tax law. The purpose of this provision is also to avoid double non-taxation under specific conditions. This clause provides that an income tax exemption of salaries, provided for in a tax treaty, will be granted only if the taxpayer proves that the country that is entitled to tax the salary under the treaty explicitly abstained from taxing the salary or that the salary was effectively taxed in that country. It was evident that Ireland had the full knowledge of the pilot's income and that it explicitly refrained from taxing that income. This was evident because Ireland reimbursed the tax, which had been withheld and paid under the Irish PAYE provisions by the Irish airline company.

Brazil-Canada

The court ruled that the payments made in favour of a Canadian resident entity in consideration for services rendered to a legal entity resident in Brazil do not trigger withholding tax, as a result of the application of the provisions of article seven of the tax treaty signed by Brazil and Canada.

The Brazilian tax authorities argued that article seven of the OECD Model (2010) does not apply to payments made by a resident of Brazil to a resident of a treaty partner country when they do not entail the transfer of technology. In this case, the tax authorities take the position that article 21 of the relevant tax treaties should apply. Article 21 would result in a higher Brazilian tax.

The court ruled that the remuneration of services rendered by a non-resident legal entity to a Brazilian legal entity is encompassed by article seven of the treaties signed by Brazil with Canada, according to which business profits of a legal entity are taxable only in its state of residence, unless a PE of such legal entity exists in the other contracting state.

Based on such a provision, the court took the view that the payments made by the Brazilian taxpayer in favour of the entities domiciled in Canada were business profits of such entities, which are subject to taxation only in the state of residence. Therefore, Brazil would not have taxing rights over such income.

China

China issued a State Administration of Taxation (SAT) supplementary circular (announcement 30) on recognition of beneficial ownership under tax treaties. The SAT formally introduced the beneficial ownership concept in 2009.

One of the most significant aspects of announcement 30 is that it provides a safe harbour on treaty qualification for public companies. It states that for dividend income, if the treaty benefit applicant is a public company, or it is 100% directly or indirectly owned by a public company that is a tax resident of the contracting country, the beneficial ownership status of the applicant can be confirmed automatically without further verification by the tax authorities.

The other significant development provided by announcement 30 is that it allows another party (other than the original income recipient) to qualify as the beneficial owner. As long as the original income recipient is acting as a collection agent and claims that it is not the beneficial owner of the income, the applicant could apply for beneficial owner status.

Announcement 30 allows for retroactive enforcement on non-qualified applicants by the tax authorities. If benefits were originally granted but the tax authority later discovers, through a tax treaty or information exchange, that the agent is in fact the beneficial owner, the tax authority may alter its previous decision and impose applicable taxes and a late payment surcharge on the former beneficial owner.

Announcement 30 also introduces a unique mechanism for allocating power among the tax authorities. According to announcement 30, local tax authorities can only deny an applicant tax treaty benefits after obtaining consent from provincial-level tax authorities. However, it does not require approval from provincial-level tax authorities for the granting of benefits. Also, provincial-level tax authorities should report denied applications to the SAT.

US-UK

Recent guidance has been issued in the US/UK rollovers for pension schemes.

Issues

- Whether a UK resident individual may make a tax-deferred rollover distribution from a US pension scheme to a UK pension scheme that is not an 'eligible retirement plan' within the meaning of the internal revenue code (the code)
- Whether a lump-sum transfer from a US pension scheme to a UK pension scheme that is not an eligible retirement plan is taxable as a distribution in the United States pursuant to the treaty.

Conclusions

- No, the UK pension scheme is not an 'eligible retirement plan' within the meaning of the code, and nothing in the treaty overrides the requirement that a tax-deferred rollover distribution can be made only to an eligible retirement plan
- Yes, a lump-sum transfer from a US pension scheme to a UK pension scheme that is not an eligible retirement plan is taxable in the US as a distribution pursuant to the treaty.

Facts

For the tax year at the time of issue, the taxpayer was a resident of the UK and a non-resident alien for US income tax purposes. The taxpayer is a university professor and has worked for most of their career at various universities located in the UK. The taxpayer has contributed to a UK plan, a qualified pension scheme under UK law. In year one, the taxpayer accepted a position at a US university where they worked from date one through date three. After date three, he returned permanently to the UK.

During the period the taxpayer worked at the US university, he was a member of a US plan that invested in a custodial account operated by a US investment company. When the taxpayer returned permanently to the UK, he sought professional advice regarding the ability to roll over his balance in the US plan to a UK pension scheme. HMRC advised in a letter, dated date two, that the details of the receiving scheme should be given to the administrators of the US scheme so they might consider the request and advise whether or not the proposed transfer would be permitted under the scheme rules.

On date three, the US plan issued a lump-sum check for a $ amount payable to the UK plan. The taxpayer received a year two Form 1099-R (distributions from pensions, annuities, retirement or profit-sharing plans, IRAs, insurance contracts, etc.) issued by US investment company reporting a gross distribution of the $ amount.

The taxpayer has not filed a US income tax return and has not paid any US income tax.

Belgium-Netherlands

The Belgian supreme court rendered a decision concerning the compatibility of the denial of certain personal deductions to a Belgian resident, who earned employment income only in the Netherlands, with the non-discrimination article of the Belgium – Netherlands income and capital tax treaty (2001) (the treaty). The court confirmed the decision of a lower court that it agrees with the non-discrimination provision of the treaty, the Belgian constitution and the EU treaty freedoms.

The taxpayer derived employment income from Belgium, and his spouse derived employment income from the Netherlands. The taxpayers opted for joint taxation. In their Belgian tax return, they claimed a deduction for childcare and for services paid with service vouchers. The Belgian tax administration allocated the deductions pro-rata to the Belgian and Dutch income.

The Belgian income tax code provides for a deduction for childcare and provides for a deduction for service vouchers used to pay housemaids or employees carrying out household activities.

The treaty provides that Belgium applies the exemption with the progression method to avoid double taxation with respect to foreign employment income. The treaty regulates that individuals who are residents of a contracting state and who derive income or gains from the other state for which the right to tax has been allocated to that other state, are entitled, insofar as these gains or income are included in their worldwide income, to the same personal allowances, reliefs and reductions on account of civil marital status or family responsibilities as are residents of that other state, insofar as they are in the same circumstances as the residents of that state.

The issue was whether the pro-rata allocation of the deductions is compatible with the non-discrimination provision of the treaty, the Belgian constitution, and the EU free movement of persons.

The lower court held that that a pro-rata deduction for childcare could not be claimed in the Netherlands because in the Netherlands different requirements apply for this deduction and did not result in an incompatibility with the free movement of persons, or a discrimination but was the result of the disparity between Belgian and Dutch law. The same applies for the deduction for vouchers which does not exist in the Netherlands.

Consequently, the lower court held that the pro-rata allocation of the deductions is compatible with the non-discrimination provisions of the treaty, the Belgian constitution, and the EU free movement of persons.

The supreme court held that a resident taxpayer, who derives only foreign income, is not entitled to the same deductions and allowances as a resident taxpayer, who derived his entire income in Belgium.

Because the wife's employment income was derived in the Netherlands, this income was taxable in the Netherlands based on the treaty. Therefore, the supreme court held that based on the non-discrimination provision of the treaty, the Netherlands was obliged to take a pro-rata part of the deductions into account. The state of residence (Belgium) is then not obliged to take these deductions into account.

The supreme court confirmed the decision of the court of appeal that the non-deductibility was not incompatible with the non-discrimination principle of the Belgian constitution. The court observed that as a result of the exemption of the foreign employment income, the spouse had no taxable income in Belgium. This means that she would not have any benefit from additional deduction possibilities.

Singapore-Japan

The Income tax board of review gave its decision recently on the availability of unutilised tax losses for offset against the profits of a foreign branch in Singapore. Details of the decision are summarised below.

A Japanese company (X) registered a branch in Singapore (the old branch) to carry on business there. The old branch was de-registered in 2004, at which time it had accumulated unutilised losses amounting to SGD 30 million. X re-registered itself in Singapore and carried on business activities through a newly-registered branch (the new branch).

X sought to deduct the unabsorbed losses of the old branch against the business profits of the new branch. However, the claim was disallowed by the comptroller of income tax, on the basis that pursuant to the Japan – Singapore income tax treaty (1994) (the treaty), a branch is treated as a distinct and separate entity from the enterprise of which it is a part for income tax purposes. As such, the losses incurred by the old branch cannot be utilised against profits earned by the new branch.

X argued that a branch is, from a legal perspective, an extension of the head office, and that the income tax act dealing with unabsorbed losses refers to the amount of loss incurred by a person, which refers to the legal entity, i.e. X corporation and not the Singapore branch.

The issue was whether the unabsorbed tax losses of the de-registered branch could be utilised against the profits earned by the new branch of the same company.

The board held that the unutilised losses of the old branch could be used to offset the profits of the new branch.

The board concluded that the unabsorbed tax losses belonged to X and therefore were available for offset provided that there was no substantial change (more than 50%) in the shareholders and their shareholdings of X.

Germany-Switzerland

The federal financial court ruled on the question of whether foreign extraordinary losses have to be taken into account fully or only partially because of the exemption with progression provision.

The federal financial court held that foreign losses from the sale or closure of a business have to be taken into account fully in view of the exemption with progression provision. The domestic law provision, dealing with 'extraordinary income' is only taken into account subject to a ceiling of one-fifth, does not apply to losses. Positive income is only factored in at one-fifth to avoid undue hardship within the application of the progressive tax rates, but this ratio cannot be applied to negative income. Thus, the federal financial court dismissed the tax authority's appeal against the lower court's decision and ruled in favour of the taxpayer.

The taxpayers set up a medical practice in Switzerland, but closed it in order to re-open a medical practice in Germany. In their German tax assessment, as resident taxpayers, the taxpayers claimed a deduction for the losses regarding the medical practice in Switzerland to be taken into account in their entirety, and not only with one-fifth as the German tax authorities calculated.

The Germany-Switzerland tax treaty generally provides for the exemption with progression method to avoid double taxation. Based on this treaty provision, the domestic implementation of the exemption with progression method in Germany, the income tax act (ITA), is applicable in cases in which the foreign income is exempt from German taxation but is taken into account, due to the progression of the individual income tax rate.

The ITA contains rules for taxpayers with unlimited tax liability that generates income for which an extraordinary tax rate is applicable. This 'extraordinary income' is only taken into account with one-fifth. Regarding domestic 'extraordinary income', the ITA provides for the same rule, i.e that only one-fifth of the income is taken into account.

The financial court ruled in favour of the taxpayers and held that the losses concerning the Swiss medical practice must be taken into account to the full extent for the calculation of the applicable tax rate. The court held that the term 'income' in the ITA cannot be interpreted as including positive and negative income in this context. While the term 'income' might be used as including positive and negative income within the ITA, the interpretation is different for the purpose of progression.

The court held the one-fifth rule does not apply to losses. In fact, positive income is only factored in with one fifth to avoid undue hardship within the progression, but this ratio cannot be applied to negative income. However, the court considered the decision to be of fundamental significance, and granted leave for an appeal.

Malta – Hong Kong

On 18 July 2012, a new double tax treaty between Hong Kong and Malta came into force for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. This treaty will have effect in Hong Kong for any year of assessment beginning on or after 1 April 2013 adding to Malta's extensive tax treaty network with many major countries, including China, enabling tax efficient structures and relief from double taxation on cross-border transactions. The agreement mainly follows the OECD Model Convention with certain deviations. The salient features of the treaty are:

Withholding taxes

- **Dividends and Interest** – dividends and interest are taxable solely in the state in which the recipient is resident. Withholding taxes are not chargeable in line with the two countries' domestic tax provisions.
- **Royalties** – 3% (Malta does not charge any withholding taxes on the payment of royalties to non-residents)

Elimination of double taxation

The treaty provides for the ordinary credit method for the elimination of double taxation. Maltese domestic participation exemption provisions apply on dividends received and capital gains realised on the sale, from/of shares in companies resident in Hong Kong, subject to certain conditions being satisfied. The treaty also provides for the exchange of information and assistance in the collection of taxes.

Deviations from the OECD Model Convention

- **Permanent Establishment (PE)** – a PE includes a building site or a construction, assembly or installation project but only where such site, project or activities continue for a period of more than six months. It also includes the furnishing of services, including consultancy services, by an enterprise or through employees or other personnel engaged for this purpose, but only if such activities for the same or a connected project within a contracting state for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned.
- **shipping and air transport** – profits derived by an enterprise of one of the states from the operation of ships or aircraft in international traffic are taxable solely in that state. No reference is made to boats engaged in inland waterways transport and such profits are therefore taxable in terms of the domestic tax provisions of the two countries.
- **capital gains** – gains on the transfer of shares in a company deriving more than 50% of their value from immovable property situated in one of the states are taxable in that state. However, no tax is chargeable in that state where the shares are listed on either the Malta or Hong Kong stock exchange.
- **pensions** – pension payments made under a scheme which is a public scheme forming part of the social security system of one of the states or a scheme recognised as such by the authorities of the state and in which individuals participate to secure benefits are taxable solely in the state in which the said schemes are operated.

Tax policy

India

The Indian Prime Minister has constituted a committee to review taxation of development centres and the IT sector. The committee will engage in consultations with stakeholders and related government departments to suggest the approach to taxation of development centres. This is in conjunction with the widespread consultation and finalisation of the General Anti-Avoidance Rules (GAAR).

While this committee would address concerns on the GAAR provisions and would reassure investors about the predictability and fairness of the tax regime, it was felt that there is still a need to address some other issues relating to the taxation of the IT sector such as the approach to taxation of development centres, and tax treatment of 'onsite services' of domestic software firms.

Many multi-nationals (MNCs) carry out activities such as product development, analytical work, software development, through captive entities in India. They exist in a wide range of fields including IT software, IT hardware, pharmaceutical R&D, other automobile R&D and scientific R&D. These are often called development centres. Over 750 MNCs have such centres at over 1,100 locations in India. The reason for this large concentration of development centres in India is the worldwide recognition of India as a place for cost competitive, high quality knowledge related work. Such development centres provide high quality jobs to scientists, and indeed make India a global hub for such centres. However, India does not have a monopoly on development centres. This is a highly competitive field with other countries wanting to grab a share of the pie, so there is a need for clarity on their taxation.

European commission

The European commission has issued a consultation paper on tax issues related to cross-border venture capital investment and has asked stakeholders for their comments on the following issues:

1. General

- have you experienced direct tax obstacles in connection with your cross-border venture capital investment? If so, please provide details of: the tax obstacles and the reasons why they occurred
- the countries involved the result for these obstacles (for example: double taxation, tax treatment uncertainties, administrative obstacles and additional costs).

2. Permanent establishment (PE)

If a permanent establishment has been deemed to exist in the country of the target company, please provide details about:

- the reasons for the deemed existence of the PE
- whether the PE is in respect of the income of the venture capital fund manager himself or of the venture capital fund or of the investors
- which member state has deemed the PE to exist
- what percentage/part of total profits have been attributed to that PE
- what method was used for the profit attribution
- whether the profits attributed to the PE have suffered unrelieved double taxation as a result and if so, why double taxation was not relieved
- the amount of the unrelieved double taxation

- whether some member states, despite deeming a PE to exist, nevertheless in practice exempt the profits of that deemed PE and which are these member states.

3. Entitlement under double taxation conventions

Have you suffered unrelieved double taxation due to the fact that the tax classification and tax treatment of venture capital funds varies from one country to another? If so, please specify:

- the exact reasons for the double taxation
- the countries involved
- the amount of unrelieved double taxation
- whether the OECD partnership report and the commentary to the OECD model have provided guidance/assistance in resolving the issue (the partnership report and the commentary to the OECD model suggest that the classification of a partnership as transparent or non-transparent applied by an investor's country of residence should be the decisive one as far as the taxation and double taxation relief of the investor are concerned)
- how often the mutual agreement procedure provided for in double tax conventions based on the OECD model has been applied in practice and whether it was efficient.

4. Avoiding the risk of double taxation

If there was a risk of double taxation of your investment returns, which you managed to avoid in practice, please specify:

- how you managed to avoid the risk and the extra costs and complexities involved
- the EU and non-EU countries involved.

5. Risks of double non-taxation/tax avoidance and evasion

Are you aware of any cases in which mismatches between member states' domestic tax rules might lead to double non-taxation or tax planning? If so please provide:

- details, including the jurisdictions involved
- an estimation of the amounts of lost tax revenue.

6. Tax burden and additional costs for venture capital investors investing across borders

- are your proceeds from cross-border venture capital investment taxed in the country of the target company?
  - If so, please indicate how they are taxed; please specify the type of proceeds (capital gains, dividends, etc.), the tax rate applied and any special tax incentives/tax regimes applicable
  - If not, please specify why not – e.g. because the country where the target company is established does not tax capital gains, etc.
- are your proceeds from cross-border venture capital investment taxed in the country where the fund is established?
  - if so, please indicate how they are taxed; please specify the type of proceeds (e.g. capital gains, dividends) and the tax rate applied, whilst mentioning any special tax incentives/tax regimes applicable
  - if not, please specify why, for example because the fund is a tax exempt entity or transparent for tax purposes, etc.

- are your proceeds from cross-border venture capital investment taxed in your state of residence?
  - if so, please indicate how they are taxed; please specify the type of proceeds (e.g. capital gains, dividends) and the tax rate applied, whilst mentioning any special tax incentives/tax regimes applicable
  - if not, please specify why, for example because your state of residence does not tax capital gains, dividends; because you are a tax exempt entity, etc.
- what is the effective tax burden on your cross-border venture capital investment?
- have you suffered any additional costs due to your cross-border investment in venture capital? If so, what are the annual additional costs related to your cross-border venture capital investment? Please specify per category, e.g. for advisory fees, unrelieved double taxation, foregone tax relief, administrative costs, etc.

7. Possible discrimination of cross-border venture capital investment compared to domestic venture capital investment

- does the country where the target company is established, tax proceeds from venture capital investment differently depending on whether the investors are resident or non-resident? For example, are there specific venture capital benefits, such as exemption, deferral/investment reserves, lower tax rates, relief from economic double taxation available only to domestic fund and investors? Is capital gains tax applicable only on (some or all) sales of shares of non-resident investors? Please provide details about any differences in treatment and the countries in which these occur
- does the country where the fund is established, tax receipts of the venture capital fund differently depending on whether these arise from domestic or foreign sources? Does the country where the fund is established, tax dividends paid to non-resident investors differently to dividends paid to resident investors? Please provide details about any such differences in treatment and the countries in which these occur
- does your country of residence tax the income and gains you receive from a non-resident venture capital fund or non-resident target company differently to income and gains you receive from a domestic venture capital fund or target company? Please provide details about any such differences in treatment and the countries in which these occur.

8. Possible solutions to the tax obstacles encountered when venture capital is invested across borders

- What are your proposals for possible solutions to the tax obstacles you encounter?
- Why do you prefer this solution/these solutions? Please outline the advantages and disadvantages of your suggestion.
- How should your suggested solution(s) be implemented e.g. by EU legislation or by changes in different national laws?
- How would your suggested solution(s) impact on the investors' return of investment and governments' tax revenues?
- How would your suggested solution(s) impact on Member States' tax legislation, their double taxation conventions and existing EU law, e.g. on direct taxation, State Aid, etc.?

- What would the advantages be for Member States in adopting the proposed solution? Would there be winning and losing Member States and if so how could the losing Member States be persuaded to agree to the solution?
- If you are a fund or fund manager and are currently established outside the EU, would your suggested solution make it more attractive for you to move into the EU?
- Can you recommend any best practices in any EU Member States or third countries in the area of taxation of venture capital?
- Are you aware of any statistics or legal or economic studies which could further contribute to the analysis of the costs and benefits of implementing the solution(s) you suggest?

OECD

The OECD issued a press release introducing a new international tax agreement model, designed to improve cross-border tax compliance and boost transparency. The model allows the implementation of the Foreign Account Tax Compliance Act (FATCA) through automatic exchanges between governments, reduces compliance costs for financial institutions and provides for reciprocity. Although the US created the FATCA type tax reporting for financial institutions with respect to their US depositors, other countries are beginning to introduce similar legislation.

The model agreement calls on the OECD to work with interested countries on adapting the terms of the agreement to create a common model for automatic exchange of information, including the development of reporting and due diligence standards for financial institutions.

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