Global tax newsletter

Welcome to the eighth edition of the Global tax newsletter.

Many local businesses are under increased pressure to remain competitive, profitable and, at worst, remain in business. Locally this pressure is as result of labour issues, such as strikes and the lack of skilled workers, a weak currency, the prevalence of corruption and a host of other issues. There are also threats from foreign competitors, seeking to find new revenue in developing markets, such as our own, due to the economic pressures in more developed countries and the attractive exchange rate.

To remain competitive despite these pressures, companies have no choice but to be globally minded in all aspects of their business. Taking a global view on tax is no exception, and those who remain current on tax developments around the world and manage their global tax risks will be likely to thrive in a world of constant change.

As usual, this edition of the Global Tax Newsletter provides up to date information about global tax developments that impact on business. The pace of global tax developments is staggering, and this is evident in the feature article on page 3 about the OECD (Organisation for Economic Co-operation and Development) and Base Erosion and Profit Shifting (BEPS) report. Companies that do business in Africa should take note of significant tax developments in Angola, Kenya, Congo, Cameroon and Ghana.

While on the topic of change, we are delighted to announce that our Johannesburg tax team has more than doubled in size, following the recent merger of Grant Thornton and PKF. This expanded capability means that in addition to excellent general tax advice and service, our specialised team will have increased capacity to provide in-depth guidance on more complicated tax issues such as Indirect Tax (VAT and Customs) and Transfer Pricing advisory services.

Our contact details and specialisations are detailed on the Who's who page 53.

Go to page...

3 OECD featured article

4 Isle of Man featured article

7 EMEA news

20 APAC news

27 Americas news

32 Transfer pricing news

37 Indirect taxes news

42 Treaty news

49 Tax policy

53 Who's who

I would also like to add my welcome to our eighth edition of the Global tax newsletter.

First of all I would like to personally thank Ian Evans for all of the contributions he has made to the GTIL global tax community during his tenure as Global leader - tax services. Ian was the first to hold that position and he has built the role to where it is today. Ian has set the bar high and will be a tough act to follow.

Under Ian's leadership, he established a GTIL tax infrastructure on behalf of all of the tax practices in our member firms which includes many initiatives that have become part of our tax landscape. I look forward to continuing to work with Ian as he assumes new roles and responsibilities within GTIL.

For those of you I haven't met yet, I joined Grant Thornton UK LLP as a direct entry partner in 2006 after 15 years of tax experience. I was a past Chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales and a former Council member of the Chartered Institute of Taxation. I have had the good fortune to sit on a number of Her Majesty's Revenue and Customs' committees and was one of the tax practitioners invited to join the Coalition's Tax Professionals' Forum. For the past several years, I was the UK's head of tax and worked with Ian on the GTIL Tax Advisory Committee.

I am currently active on a number of tax policy committees and therefore find this publication of particular interest. Today we see governments requesting more transparency from taxpayers as well as being more transparent in sharing ideas amongst themselves. These trends have turned what was once a government by government, issue by issue, discussion into a multi government discussion with common issues being raised across the borders.

When you factor in some of the OECD reports, such as the BEPS paper, together with the transfer pricing guidelines, hybrid mismatch arrangements, tackling aggressive tax planning and many more, it is no wonder that tax policy is becoming more unified and the multinational is finding it more difficult to manage the global effective tax rate.

But as suggested, with all of this increased focus on cross border taxation, there will be opportunities, such as thinking outside the tax practitioner's home country and continuing to perform the taxpayer advocacy role. This is the role of this newsletter…to inform you of global tax trends and tax policies.

In this issue we continue to investigate cross border tax issues regionally as well as for transfer pricing, indirect taxation and developments in tax treaties. We are also increasing our African tax focus within the EMEA tab. An analysis by The Economist finds that over the ten years to 2010, no fewer than six of the world's ten fastest-growing economies were in sub-Saharan Africa so it is an important area to keep aware of.

Francesca Lagerberg
Global leader – tax services (Incoming)
Grant Thornton International Ltd

OECD featured article

Since our last edition, one of the more significant developments is a report on BEPS.

BEPS is the ability of a multi-national to shift profits from high tax to low tax jurisdictions. The most publicised BEPS strategy was the double Irish manoeuvre where a multinational, routes profits through its European headquarters in Ireland, whose laws then allow the company to shift profits to zero-tax jurisdictions, such as Bermuda or the Caymans.

The OECD issued a report which addresses 'Base Erosion' and 'Profit Shifting' and presents studies and data regarding the existence and magnitude of BEPS. The report contains an overview of global developments that have an impact on corporate tax matters and identifies the key principles that underlie the taxation of cross-border activities, as well as the BEPS opportunities these principles may create.

The report highlights many of the reasons multinationals are able to achieve BEPS, including; differences in jurisdictional taxing rights; transfer pricing; hybridisation of entities, financing transactions, and leasing arrangements; use of conduit companies; and derivative instruments.

> Base erosion and profit shifting (BEPS) is the ability of a multi-national to shift profits from high tax to low tax jurisdictions.

The tax authorities' armament to combat aggressive tax planning includes: transfer pricing; general anti-avoidance rules or doctrines; CFC rules; thin capitalisation; and anti-hybrid rules.

The OECD notes in its report that there is no magic recipe to address the BEPS issues. Although the OECD is ideally positioned to support countries' efforts to ensure effectiveness and fairness as is noted in the report, no doubt differences in the interpretation and implementation of OECD guidelines will most likely create a new set of challenges and opportunities for adjusting prior tax strategies to comply with future cross border tax opportunities.

OECD: Addressing Base Erosion and Profit Shifting (BEPS)

Base erosion constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for many countries. While there are many ways in which domestic tax bases can be eroded, a significant source of base erosion is profit shifting. The BEPS report presents the studies and data available regarding the existence and magnitude of BEPS, and contains an overview of global developments that have an impact on corporate tax matters and identifies the key principles that underlie the taxation of cross-border activities, as well as the BEPS opportunities these principles may create. The report concludes that current rules provide opportunities to associate more profits with legal constructs and intangible rights and obligations, and to legally shift risk intra-group, with the result of reducing the share of profits associated with substantive operations. Finally, the report recommends the development of an action plan to address BEPS issues in a comprehensive manner.

The outline of the report indicates the comprehensive coverage of BEPS by the OECD.

How big a problem is BEPS? An overview of the available data
- Data on corporate income tax revenues
- Data on Foreign Direct Investments
- A review of recent studies relating to BEPS.

Global business models, competitiveness, corporate governance and taxation
- Global business models and taxation
- Competitiveness and taxation
- Corporate governance and taxation.

Key tax principles and opportunities for base erosion and profit shifting
- Key principles for the taxation of cross-border activities
- Key principles and BEPS opportunities.

Addressing concerns related to base erosion and profit shifting
- Key pressure areas
- Next steps
- Developing a global action plan to address BEPS
- Immediate action from our tax administrations is also needed.

Data on corporate tax revenue as a percentage of GDP

A review of recent studies relating to BEPS
- Studies of effective tax rates of MNEs
- Studies using data from taxpayer returns
- Other analyses of profit shifting
- Bibliography

Examples of MNEs' tax planning structures
- E-commerce structure using a two-tiered structure and transfer of intangibles under a cost-contribution arrangement
- Transfer of manufacturing operations together with a transfer of supporting intangibles under a cost-contribution arrangement
- Leveraged acquisition with debt-push down and use of intermediate holding companies.

Current and past OECD work related to base erosion and profit shifting
- Tax transparency
- Tax treaties
- Transfer pricing
- Aggressive tax planning
- Harmful tax practices
- Tax policy analyses and statistics
- Tax administration
- Tax and development cost-contribution arrangement
- Leveraged acquisition with debt-push down and use of intermediate holding companies.

Isle of Man featured article

> The Isle of Man's taxation policy has been a significant contributor to its economic success.

The Isle of Man taxation system and its use in international trade

The Isle of Man has been, and continues to be, a significant economic success story that has now enjoyed over 29 years of continuous economic growth. The Isle of Man economy is well diversified and counts aviation, clean tech, e-business, e-gaming, financial services, manufacturing, maritime, space, agriculture and tourism amongst its successful industries.

The Isle of Man, located in the Irish Sea between the UK and Ireland is an internally self-governing dependency of the British Crown and is not part of the United Kingdom (it is however, part of the British Isles). Tynwald, the Island's 1,000 year old Parliament, makes its own laws and oversees all internal administration, fiscal and social policies. The population of the Isle of Man is around 85,000 all contained within an area of 221 square miles (572 square kilometres). The Isle of Man is not a full member of the European Union but it falls within the EU common customs area.

The Isle of Man's taxation policy has been a significant contributor to its economic success. The standard rate of tax for individuals is 10% with a higher rate of 20% applicable for all income above £10,500 after generous personal allowances and reliefs have been taken account of. The Isle of Man also operates a cap on the maximum amount of tax payable of £120,000 for a single individual. There is no capital gains tax, wealth tax, stamp duty, death duty or inheritance tax.

The standard rate of corporate income tax in the Isle of Man is 0%. A 10% rate of tax applies to income received by a company from banking business, land and property in the Isle of Man (including property development, residential and commercial rental or property letting and mining & quarrying) and, from 6 April 2013, on companies who carry on retail business in the Isle of Man and have taxable income of more than £500,000.

The island has long been committed to international standards of tax transparency and helped develop the OECD template for tax information exchange agreements (TIEA). Since then, the Isle of Man has remained at the forefront of efforts to put in place tax co-operation agreements, signing 27 TIEAs and 11 double taxation agreements thus far. Such agreements have been signed with Argentina, Australia, Bahrain, Belgium, Canada, China, Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France, Germany, Greenland, Guernsey, Iceland, India, Indonesia, Ireland, Japan, Jersey, Luxembourg, Malta, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Qatar, Seychelles, Singapore, Slovenia, Sweden, Turkey, UK and USA. Further agreements with Italy, the Netherlands and Spain are currently being negotiated.

This commitment to openness was recognised by the G20, with the Isle of Man earning a place on the OECD 'white list' of countries. Responding to evolving world standards, the island moved to the automatic exchange of tax information on savings, under the EU savings Directive, in 2011.

In further recognition of its wish to cooperate on the international stage, the Isle of Man Chief Minister announced that they would be moving to a closer form of tax cooperation with the UK, based on the same principles as the FATCA agreement which the Isle of Man was negotiating with the USA. The new arrangements with the UK will also

be put in place shortly. The Isle of Man Treasury Minister said that after three months of intensive negotiation he anticipated a package of measures with the UK that would include:

- a bespoke Isle of Man disclosure facility, based on the Liechtenstein model, for UK taxpayers wishing to regularise their tax affairs. This will give those taxpayers a number of important assurances about what to expect after they first contact HMRC. The Isle of Man Government will assist the UK authorities in ensuring that the facility is a success
- the extension of the double taxation agreement between the Isle of Man and the UK to include the automatic exchange of tax information between the two countries
- a new agreement between the Isle of Man and the UK, closely modelled on a US FATCA agreement that will result in Manx financial institutions providing a broad range of information on the investments of UK resident taxpayers, which will then be shared automatically with the UK by the Isle of Man tax authorities. Both governments will work together to minimise the burden on those businesses affected by the new system. In addition, in recognition of their different status under UK tax law, people who are resident but non-domiciled in the UK will be subject to an alternative reporting regime under this agreement.

In respect of international trade matters, the Isle of Man, by virtue of its unique Customs and Excise Agreement with the United Kingdom and European Law, is treated as part of the UK and EU for customs, excise and Value Added Tax (VAT) purposes.

Non-EU companies which supply goods to the EU can often face complexities and costs when importing into the EU, but using the Isle of Man can significantly reduce these issues and provide a very effective route to the EU market. The Isle of Man has its own electronic Entry Processing Unit (EPU) which is housed within the UK's import/export computer system. This provides importers, exporters and their agents with the ability to electronically declare goods imported to or exported from the UK/Isle of Man. Accordingly Isle of Man importers, exporters and their agents are able to obtain fast electronic system generated customs clearance without the need for the goods to physically travel to the Isle of Man.

Advantages of using an Isle of Man company in this way are that Isle of Man companies are taxed at 0% for this type of business, a permanent establishment in the UK is avoided, the Isle of Man is treated as part of the EU for VAT and customs purposes, goods do not need to physically travel to the Isle of Man and an electronic single point of entry is provided for all customs and excise imports, no matter where in the EU the goods arrive. In summary, one of the primary benefits for businesses from, for instance, the USA, China, India or Canada, will be their ability to use the Isle of Man as a base to operate in the EU.

For any further information regarding the Isle of Man, please contact:

Richard Ratcliffe
Partner
T +44 (0)1624 639481
E richard.ratcliffe@im.gt.com

EMEA news

Austria

Cross border pension payment taxation continues to be an EU issue given the proximity of borders and worker mobility.

A change to German tax law will require individuals currently in receipt of a German pension to pay taxes on their income, with retroactive effect from 2005. In 2010 a 2005 amendment to the German Income Tax Act entered into force. Individuals who are not resident in Germany are subject to income tax in Germany if they receive a German pension. Almost three years after this change – and just before the statutory period of limitations for 2005 expired on 31 December 2012 – the German tax authorities began sending notices to hundreds of thousands of the 1.6 million recipients of German pensions who reside outside Germany.

The German tax authorities will send out demands for Austrian pensioners to submit a tax declaration dating back to 2005. The move follows the decision to modify German legislation. The new legislation provides that German pensions paid out to foreign taxpayers will be subject to taxation in Germany. The Austrian Finance Ministry intends to challenge the decision to seek hefty back payments and to find a sustainable solution to protect low-income pensioners in particular.

Algeria

Algeria recently introduced an advance tax ruling regime. The regime, which had immediate effect, is designed to provide greater certainty for taxpayers and enhanced monitoring capabilities for the tax administration. Administered by the Directorate of Large Enterprises (DGE), it allows a taxpayer to request a ruling that sets out the formal position of the tax administration on the taxpayer's particular situation. A taxpayer requesting a ruling must act in good faith, and must state the particulars of its situation clearly so that the tax administration can make a fully informed decision on the request. The ruling can be applied only to the specific situation for which the ruling was requested and is binding on the tax administration only in relation to the specific case and the corresponding provisions of the tax law (this is not binding for other taxpayers).

Angola

Angola's National Assembly recently enacted several corporate tax amendments which include:

- new rules for companies involved in mergers – providing for an exemption from taxation of those operations if the transferred assets are registered in the account of the acquirer at the same value they had in the merged company, and are amortised the same way
- establishment of a withholding tax rate of 6.5% on the Angola-source income of companies that do not have their head office or place of effective management or permanent establishment in Angola
- non-allowable expenses to include interest on loans from shareholders.

African Tax Administration Forum (ATAF)

The ATAF is a platform to promote and facilitate mutual co-operation among African tax administrations (and other relevant and interested stakeholders) with the aim of improving the efficacy of their tax legislation and administrations.

The ATAF brings together heads of African tax administrations and their representatives to discuss the progress made, challenges faced and possible new direction for African tax policy and administration in the 21st century. ATAF works towards state building, governance, political economy and revenue mobilisation.

The work and programme priorities of the Forum will be driven and managed by African countries, with the support of donor agencies, other tax administrations and international organisations to reflect African needs and strategies.

The OECD and ATAF have signed a 'Memorandum of Co-operation', agreeing to work together to improve tax systems in Africa.

This memorandum was signed at the Global Forum on Transparency and Exchange of Information in Cape Town, South Africa. The forum brings together 116 members, including 15 from Africa.

Joint activities planned for 2013 – 2015 include technical events for African tax officials to share knowledge and develop good practices. Co-operation efforts will include working on tax incentives for investment, transfer pricing, exchange of information, taxpayer education, and collection of African revenue statistics and support for the proposed Tax Inspectors without Borders (TIWB) initiative.

Belgium

A Dutch national, had been working in the Netherlands for a government-subsidised foundation. Upon retiring, he took up Belgian residence in 1992. Part of his pension relates to his work for the foundation in the Netherlands and the pension was taxed in Belgium for tax years 2004 and 2005.

The taxpayer appealed, arguing that under the Belgium-Netherlands tax treaty, his pension should be taxable in the Netherlands because it was derived from government service. The taxpayer argued that a pension derived from employment with a foundation should not be treated differently from a pension derived from government service that is taxable in the Netherlands since both pensions were funded (at least partially) by the Dutch government. Taxing his pension in Belgium is, therefore, discriminatory according to the taxpayer.

The Antwerp court and appeal court ruled for the government and held that the pension was derived from private employment. Under the treaty, pensions and other similar remuneration paid to a resident of a contracting state in consideration of past employment – as well as annuities and benefits, whether or not periodic, arising from pension savings, pension funds, and group insurance funds – that are paid to a resident of a contracting state will be taxable only in that state.

At the request of the taxpayer, the court of appeal submitted a request for a preliminary ruling from the constitutional court.

The constitutional court held that the treaty's treatment of pensions derived from a government service in the source state is in accordance with the rules of international courtesy and mutual respect between sovereign states and that the right to tax government pensions is reserved for the state that financed the pension build-up.

The constitutional court referred the case back to the referring court, which must determine whether the build-up of pension rights occurred from private employment or from government service and to what extent the state was in charge of financing the build-up of those pension rights.

Bulgaria

Advance or estimated tax payments are merely a prepayment of the current year's tax liabilities. From a tax authority viewpoint, such payments feed the treasury sooner rather than later when the final tax payment is made. The basis upon which the advance payment is calculated can also influence the fat or lean situation of taxpayer revenue in the treasury.

Corporate income tax advance payments will be calculated, commencing 1 January 2013, on the basis of forecasted tax profit instead of being calculated on taxable profits of previous years. Taxpayers will pay instalments on either a monthly or quarterly basis depending on their level of net income from sales. Monthly advance instalments are due the 15th day of the current month and for quarterly depositors the 15th day following the quarter.

Cameroon

The African region is offering more incentives than usual to spur economic growth in the region.

Cameroon introduced several tax incentives to boost private investment in the country. The following incentives are granted to companies during the setup phase, which should not exceed five years:

- exemption from registration duties on deeds related to setting up the company or increasing its share capital
- exemption from VAT on purchases of services provided by non-residents that relate to establishing the activity
- exemption from VAT, other taxes and customs duties, levied on the import of equipment indicated in the investment programme.

During the operating phase, and for a maximum of ten years, entities will be granted a total or partial exemption (depending on the investment's size and efficiency) from the following taxes:

- corporate income tax and other taxes on profits and incomes
- stamp duties
- registration duties
- taxes and other levies due on the purchase of equipment required for the operating activities.

During the operating phase, losses incurred may be carried forward for the five subsequent years (as opposed to four years under the standard treatment of losses).

Congo

The Congolese Government has introduced a new tax regime for holding companies under the following conditions:

- the company holds shares in other companies (domestic or foreign) that are classified as companies limited by shares and the share value represents more than two-thirds of the fixed assets of the holding company
- the company holds the above-mentioned shares for at least five years
- activities should consist only of the management of share portfolios, management services rendered to affiliate companies, research and development activities performed for the sole benefit of a group of companies, and management of the group's assets.

Czech Republic

The Ministry of Finance has published information on the means to demonstrate the income recipient's residence for the purpose of application of withholding tax. Tax residence of the recipient of income, is a determinant for both the application of the correct domestic withholding tax rate (i.e. 35% or 15%), and the withholding tax rate under a tax treaty.

The residence of individuals who claim to be resident in the Czech Republic shall be demonstrated by the relevant identification document. The residence of companies incorporated in the Czech Republic shall be demonstrated by an excerpt from the relevant public register (e.g. company register). Alternatively, a sworn statement can be used as evidence of residence.

To demonstrate the non-resident's income recipient's eligibility for the lower 15% domestic withholding tax rate, a valid identity card or a sworn statement can be used. Where the recipient of income claims the benefits of a tax treaty, the withholding agent may apply the reduced tax treaty rates where:

- the recipient of income has furnished a valid tax residency certificate confirming that the recipient is resident in the other contracting state
- the recipient of income has made a sworn statement that the recipient is the beneficial owner of the income
- all other conditions for applying the relevant treaty have been met.

Where the recipient's eligibility for the lower 15% domestic withholding tax rate or for tax treaty benefits cannot be demonstrated, the 35% domestic withholding tax rate shall be applied.

Denmark

The Danish parliament passed two bills (Bill no. 10 and Bill no. 49) that expand the scope of dividend withholding taxes.

Bill no. 10 prevents non-resident taxpayers from circumventing dividend withholding tax by internal reorganisations. Denmark does not levy tax on capital gains on shares in Danish companies derived by non-residents unless the shares are attributable to a permanent establishment in Denmark. By contrast, non-residents are subject to a 27%, or lower, treaty rate of withholding tax on dividends from Danish companies. Non-residents that intend to repatriate cash from a Danish subsidiary may thus be better off by adopting a transaction that receives capital gains treatment rather than dividend treatment. The bill negates planning structures that attempt to circumvent the dividend/capital gain distinction with a result that makes it less attractive to use Denmark as an international holding company location.

Bill no. 49 prevents resident minority corporate shareholders from transforming taxable dividends into tax-exempt capital gains through liquidations, share redemptions, and repurchase strategies. The basic issue is the same issue of the taxation of dividends and capital gains.

Finland

Two cases concerning cross border tax issues are of interest, the first deals with portfolio dividends and the second with cross border loss portability.

A company resident in Finland (FIN Oy), received portfolio dividends from a group's parent company resident in the UK (UK Co) during which time Finland applied an imputation credit system. The assets of UK Co consisted of dividends it received from its subsidiaries running the business of the group.

The issues were whether Finland, when calculating the imputation credit, should take into account:

- the statutory income tax rate instead of the tax actually paid
- the corporate income tax paid by the subsidiaries of UK Co.

The Finnish supreme court did not find any grounds to apply the statutory income tax rate of the UK instead of the tax actually paid when calculating the imputation credit granted to FIN Oy.

In another case, the European Court of Justice (ECJ) held that Finland's rules denying the transfer of tax losses incurred by a non-resident subsidiary to its Finnish parent company in a cross-border merger do not violate the freedom of establishment unless the parent is not allowed to show that the non-resident subsidiary has exhausted the possibilities of taking those losses into account.

The second case, involved a Finnish parent company, A Oy, that had a wholly owned subsidiary in Sweden. Following trading losses, the Swedish subsidiary ceased trading in Sweden, though it would remain bound by two long-term leases. It was decided that the subsidiary would be merged into its parent in Finland; the parent would no longer have a subsidiary or permanent establishment in Sweden as a result of the merger.

The Finnish parent asked the Finnish tax authority if it could deduct the Swedish subsidiary's tax losses once the merger was carried out. The Finnish tax authority denied the request on the grounds that the Finnish tax rules do not allow the use of losses, if the losses are from a business activity in another member state that is not subject to Finnish tax.

A Oy contended that the Finnish tax rules constitute a violation of the freedom of establishment because they permit a Finnish parent company to use a subsidiary's losses in a merger only if the subsidiary is located in Finland (provided the merger was not carried out solely to obtain a tax advantage).

The ECJ held that the rules do constitute an obstacle to the freedom of establishment because the inability of a resident parent company to use a non-resident subsidiary's tax losses when it merges with that subsidiary, is liable to make establishment in the non-resident state less attractive and to deter the parent from setting up subsidiaries there.

France

As part of an effort to raise more tax revenues from large Internet companies, the French government is studying the feasibility of measures proposed in a new report on the taxation of the digital economy, including a levy on the collection of personal data.

The Colin-Collin report had been commissioned by the government to evaluate the rise of the digital economy and find ways to effectively tax multinational companies that pay little to no corporation tax in France despite their business activities there.

On 19 January 2013, the expert commission submitted their official report that states, the current tax legislation is not able to effectively tax this type of activity. The report gives proposals to remedy this problem as summarised below:

A new tax on database collection

The report proposes the creation of a new tax on the use of data that has been collected from the systematic monitoring of web usage on the French territory.

Adaptation of the research and development (R&D) credit to the digital economy

According to the report, the current R&D credit is not adapted to the digital economy. The report proposes to merge the R&D credit and the start-ups or innovative companies credit.

Promoting the role of the market in financing the digital economy

The availability of capital is a critical factor for the development of the digital sector. To stimulate the contribution of this capital, the report contains four proposals to encourage the equity financing of companies.

A new definition of permanent establishment for the digital economy

In order to more effectively attribute profits to a permanent establishment, the report proposes a number of measures. These measures are as follows:

- applying (in some form) the concept of 'free work' of web users which, in providing their data, must be regarded as a source of revenue for digital companies (i.e. the permanent establishment in France)
- the implementation of a virtual permanent establishment for companies that provide services based on personal data collected from the systematic monitoring of web usage on French territory.

Germany

Currently, there is a 100% exemption on dividend and capital gains income received from a corporation by another corporation regardless of its nature, foreign or domestic, and regardless of any holding period or amount of shareholding.

In 2011, the ECJ decided in an infringement proceeding that the non-refunding of German withholding tax on dividend payments generated by portfolio holdings of foreign corporate investors is contrary to the Treaty on the Functioning of the European Union (TFEU) and the European Economic area (EEA) agreement. Since Germany taxes dividends paid to foreign companies more heavily in economic terms than dividends paid to domestic companies, it restricts the free movement of capital provided for in article 63 of the TFEU and article 40 of the EEA agreement.

The upper house of Germany's parliament and the lower house decided to insert a 10% minimum shareholding requirement in the participation exemption rule. The minimum 10% requirement is fulfilled if at least 10% of the shares are held directly from the beginning of the calendar year.

After the legislative modifications entered into force, nothing changes for those shareholders with a participation of more than 10% and those with income from capital gains. However, those owning less (portfolio shares) must tax 100% of their dividend income at a corporate tax rate of 15% and an average trade tax rate of another 15%.

Ghana

The Budget for 2013 was presented to parliament by the Minister for finance and economic planning. The minister announced the following tax administration measures:

- to undertake a comprehensive review of the tax exemption regime with the view to reducing the grant of such incentives
- to make changes to the income tax and anti-money laundering laws in accordance with recommendations of the OECD
- to initiate steps to expand the network of tax information exchange agreements
- to establish a special unit that will undertake tax audits with the view to detecting and reducing transfer pricing abuses
- to make improvements to the tax administration in order to facilitate compliance by taxpayers
- to improve the system of VAT refunds and duty drawbacks.

Hungary

The government has published a list of the Free Business Zones (FBZ). Different tax, social security and vocational training contribution credits and allowance are available for businesses operating in the designated zones from 2013.

The decree lists 903 business zones in towns and villages located in the least developed parts of Hungary. A designation is valid for five years but can be prolonged by the government. The available FBZ benefits are:

- a corporate tax credit for the promotion of development for investments in FBZ
- a social contribution tax credit for employment in FBZ
- a vocational training contribution allowance.

Iceland

The Icelandic parliament approved a bill to change the withholding tax law applicable on fixed income securities. The change will abolish withholding tax on interest and capital gains from Icelandic fixed income securities, for both foreign and resident investors that are issued by Icelandic financial institutions or Icelandic energy corporations.

Exemption will be granted at issuer and instrument level. In order to qualify for the exemption, issuers must meet a set of specific requirements. The issuance of the bonds must be done in their own name and issuers must qualify as financial institution by meeting the requirements set forth in the Act or, if the issuer is an energy company, it will be subject to a different set of rules under an Act on the taxation of energy companies.

Ireland

Ireland has long been user friendly for establishing soft tech industries through tax incentives. The Irish Ministry of Finance has opened a consultation with interested parties on provisions that would increase research tax incentives for small and medium-size enterprises.

Ireland has a tax credit scheme for R&D, the key features of the scheme include:

- a tax credit of 25% on incremental R&D expenditure – in addition to the normal 12.5% trading deduction
- the scheme is based on incremental spend and provides for expenditure on R&D that is in excess of that company's R&D expenditure in the base year of 2003 to qualify for the credit
- the base year has been permanently set at 2003, making it effectively volume based for new entrants
- the first €100,000 spend on R&D can qualify for the credit on a full volume basis: any spend above €100,000 must be more than the 2003 base year spend
- the exemption from the base year restriction would be increased to the first €200,000 of R&D expenditure. There is no ceiling to the level of eligible expenditure over the 2003 base year level
- unused tax credits can be carried back and set-off against a company's prior year corporation tax liabilities thus generating a tax refund
- where there is insufficient current or prior year corporate tax liabilities, the company can claim unused tax credits in cash over three years (in three instalments over 33 months from the end of the accounting period in which the expenditure is incurred)
- expenditure includes direct and indirect costs in addition to capital expenditure on related plant and machinery
- a company's credit may be assigned to key employees
- a scheme also exists in respect of capital expenditure for R&D purposes

Israel

Many countries with worldwide taxation, that allow the profits of a foreign subsidiary to be deferred from taxation until repatriated, are finding locally based multi-nationals hoarding profits in offshore subsidiaries. Israel has adopted new legislation which, if copied elsewhere, would be a good approach to encourage both local investment and homeward repatriation. A combination of host country withholding taxes and home country foreign tax credit erosion discourage homeward repatriations of offshore profits.

Israel's legislators passed a law that will reduce the amount of tax payable by multinational companies seeking to distribute dividends or invest profits abroad, in return for these companies investing at least 50% of their profits in the country.

Under prior law, a qualifying industrial companies profits were not taxable until distributed as dividends. However, this led to large scale profit retention by these companies. The government has therefore proposed a one year lowering of the tax rate on profit distributions made by such multinationals.

The 'trapped profits' law will lower the amount payable by multinationals by 40% to 60%, depending on how much the company is willing to invest in Israel. However, the tax rate of a company benefiting from the trapped profits law cannot fall below 6%.

The law specifies that the company must invest in 'industrial enterprise, in assets used by the enterprise, in R&D or in the salaries of new employees' and that tax benefits will only be available if the company commits to reinvest at least half of the freed profits in Israel. The proposals will also change the tax treatment of dividend distributions from such profits in the hands of the recipient.

Italy

The European Commission (EC) called for the development of innovative financing solutions, making the creation of an efficient European venture capital market a reality. Italy has now implemented an attractive tax incentive to stimulate investments in venture capital initiatives in line with the principles expressed by the commission.

Italian investment funds are subject to corporate income tax and thus entitled to tax treaty benefits. However, under domestic legislation income in the hands of Italian investment funds is exempt from corporate income tax, provided that either the fund or the fund manager is subject to oversight. Italian investment funds are exempt from the business regional tax on productive activities. Therefore, no income taxation applies at the fund level (except for a possible final withholding tax). In particular, dividends and capital gains are not subject to income taxes in the hands of investment funds.

Foreign investors are only taxed on the distribution of profits from the investment fund. These untaxed profits are subject to a final 20% withholding tax. No further Italian taxation applies.

Foreign investors are fully exempt from withholding tax on the funds' profit distributions, if they are:

- resident in a country or territory included in Italy's 'white list'
- entities or international bodies established in accordance with international treaties implemented in Italy
- institutional investors established in a 'white list' country, even if they are not subject to tax
- central banks or bodies that manage a country's official reserves.

Kenya

Despite the tax authorities victorious attacks on taxpayers, tax authorities must play by the rules when enforcing collection in what it perceives to be delinquent taxes. The Kenyan High Court gave its decision against the tax authorities on this issue.

The taxpayer (GDC) entered into a contract with another company (GWDC Ltd.) to provide drilling services for ten geothermal wells.

Kenya Revenue carried out an audit of the transaction and issued a tax demand to GDC. The letter of demand set out the amount due and requested GDC to pay to avoid additional interest. The letter did not draw GDC's attention to the fact that it was an assessment and the subsequent consequences of failure to comply. Kenya Revenue sought to enforce the tax due through an agency notice.

GDC filed a petition seeking to have the agency notice removed on the basis that the letter did not meet the requirements of a proper notice.

The court ruled that a notice to enforce collection of taxes must clearly state the amount claimed, the legal provision under which it is made and draw the taxpayers attention to the consequences of failure to comply with the law. It must also state the opportunity provided by law to contest the finding.

The court held that the letter failed to meet the requirements of a proper notice as it failed to draw attention to the consequences of non-compliance and notify GDC of the available channels to review and appeal.

Netherlands

Tax transparency reporting and increased taxpayer reporting although sometimes burdensome, can come to the taxpayer's benefit particularly in terms of determining beneficial ownership for tax treaty benefits.

The Dutch Supreme Court (Advocate General (AG)) gave an opinion on the refund of dividend withholding tax to an exempt pension fund.

The taxpayer (X), a Swiss resident pension fund received portfolio dividends from listed companies, resident in the Netherlands on which dividend withholding tax (DWT) was withheld. X was exempt from a tax on profits in Switzerland.

X requested, and received a refund of dividend withholding tax on the basis of the Netherlands – Switzerland income and capital tax treaty (1951). This treaty entitled X to a refund of the tax as the withholding rate exceeded 15%.

X also requested a refund for the rest of the withheld DWT. X argued that the domestic law provisions, which grant a full refund of DWT to resident, tax exempt entities, read in conjunction with freedom of establishment laid down in the EC treaty.

The tax inspector disagreed, and denied the request as did the he District Court. The appeal court, however, sided with X and decided a refund should be granted. The case was appealed to the Dutch Supreme Court.

The DWT law provides that a Dutch resident entity, not subject to corporate income tax, may request a refund of any withheld DWT if that entity is the beneficial owner. The beneficial ownership criterion also applies to non-resident situations. In the specific treaty, there was no mutual assistance provision under which the Dutch tax inspector may request information from the Swiss tax authorities about the beneficial ownership of the recipient (X).

Regarding the Netherlands – Switzerland income tax treaty, the AG noted that neither the treaty, nor the protocol, requires the Swiss authorities to exchange information regarding the beneficial ownership (in this case, the dividends).

The AG acknowledging that the agreement did not cover portfolio dividends, and noted that the exchange of information requirements of the agreement could only be activated in the case of '...tax fraud or the like'. The term 'the like' refers to acts that have the same degree of severity as that of tax fraud. As the case at hand concerned portfolio dividends, it falls outside the scope of the agreement.

This led the AG to propose that X's situation resulted in no refund of DWT as the beneficial owner cannot be officially verified.

Norway

On 11 April, Norway's Ministry of Finance released a consultation paper on a plan to limit the deduction of interest on related-party debt. The main purpose of the proposal is to restrict earnings stripping, via intercompany debt financing.

Details of the bill are summarised as follows:

- parties are considered related if one party directly or indirectly owns or controls the other party by at least 50% of the capital or voting power. Related parties may be resident in Norway or abroad. Hence, the limitation also applies to the deductibility of interest expenses between two Norwegian companies
- qualifying interest expenses in excess of 25% of the taxable income of an entity, subject to certain adjustments, are not deductible for tax purposes
- irrespective of whether or not the interest has been deductible for the payer, the recipient of the interest income is taxed according to the normal rules
- the limitation is calculated separately for each entity in a group situation
- disallowed interest deductions may be carried forward for five years
- the limitation applies to limited liability companies and other companies and entities that are non-transparent for tax purposes. In addition, it covers partnerships and CFC companies, as well as foreign entities that have a taxable presence in Norway (e.g. a permanent establishment). Financial institutions are excluded from its scope
- the new rules are proposed to be effective from 2014 but would also apply for interest expenses on loan agreements concluded before 2014

Sweden

The deductibility of certain interest payments was abolished in 2009 to prevent certain types of tax planning using interest deductions on debts to group companies provided the loan funded an intra-group stock purchase. Loans that funded external acquisition of shares were not covered by the rules and the scope of the rules was extended as from 1 January 2013 to cover all intra-group interest payments irrespective of whether intra group or third party stock purchases are made.

The EC stated that it had received several complaints regarding the Swedish interest deduction limitation rules. The EC considers it unlikely that domestic intra-group loans can ever be considered to have arisen in order to obtain a significant tax benefit because of exceptions for deductibility together with the low rates of Swedish income taxation.

The commission believes the interest deduction limitation rules only affect interest payments to companies that are not resident in Sweden. It believes that similar problems may arise when interest is paid to a pension fund that is not domiciled in Sweden.

The EC considers that the rules constitute indirect discrimination for companies and pension funds that are not resident in Sweden and, accordingly, the Swedish interest deduction limitation rules violate the freedom of establishment.

Sweden's Ministry of Finance issued a reply to the EC inquiry and essentially stated that Sweden considers that the interest deduction limitation rules do not restrict the freedom of establishment because the rules apply regardless of where the lender is domiciled and regardless of whether the borrower has limited or unlimited liability to tax.

Switzerland

The Swiss Federal Supreme Court denied treatment as a permanent establishment to a foreign finance branch that a Swiss corporation operated in the Cayman Islands. The Swiss group financing performed with part-time employees was not deemed to be a sufficient enough business activity to justify treatment as a foreign permanent establishment, which would have been exempt from taxation in Switzerland.

The taxpayer involved a Swiss group that had outsourced its group financing to a Cayman branch of a Swiss affiliate. The Cayman branch had hired four people who each worked one day per week and were paid annual salaries.

The group claimed that the financing activities constituted a foreign permanent establishment of the Swiss company and that therefore the profit resulting from the financial activities should be exempt from Swiss taxation.

The cantonal tax authorities had granted an advance tax ruling confirming that the Cayman finance branch constituted a foreign permanent establishment. Accordingly, the relevant financial assets (loans) and income (interest) was allocated from Switzerland to the foreign permanent establishment, and based on Swiss domestic law, exempted it from Swiss taxation.

The Swiss federal tax administration did not accept this assessment and requested a decision that for federal tax purposes the branch's income be taxed in Switzerland.

The court confirmed the tax authority's view. It held that the overseas financing activities did not reach the level of business substance required for a foreign permanent establishment to be recognised. The company's lean structure in the Cayman Islands and the economic value created in the Cayman Islands were contrasted with the considerable financial assets and the related income involved.

The Cayman branch's main purpose was the financing of the Swiss group companies that were eligible to claim full tax deduction for interest paid.

As a result of collapsing the Cayman permanent establishment, the entire profit resulting from the financing activities was subject to Swiss corporate income taxes.

Turkey

The Ministry of Economics has published a new Decree, which provides an opportunity for regional management centres to operate in Turkey under a liaison office structure. A regional management centre may perform the coordination and management services for business units in other countries for the following areas:

- establishment of investment and management strategies
- planning
- promotion
- sales
- after sales services
- brand management
- financial management
- technical support
- research and development
- procurement
- testing of new products (including laboratory activities)
- research and analysis
- employee training.

The liaison offices are granted the license to operate in Turkey for a period of three years. However, based on the new decree, if a liaison office operates as a regional management centre after the initial period of three years, an extension of an additional ten years can be granted.

Liaison offices cannot have any commercial operations, thus they are exempted from the major taxes in Turkey. Accordingly, based on the new decree, a regional management centre operating under a liaison office will be exempted from the following Turkish taxes:

- corporate income tax
- value-added tax
- income tax on salaries of
- the liaison office employees
- stamp tax.

United Kingdom

HMRC has issued a report in conjunction with the release of the 2013 budget that describes its strategy to address offshore tax evasion. The report defines offshore evasion as using a non-UK jurisdiction with the objective of evading UK tax. This includes moving UK gains, income or assets offshore to conceal them from HMRC; not declaring taxable income or gains from overseas sources or taxable assets kept overseas; and using complex offshore structures to hide the beneficial ownership of assets, income or gains.

The report states that HMRC is building a new offshore evasion strategy, expressing a renewed commitment to clamping down on those who conceal income, assets and gains overseas to evade tax. The objectives of this new strategy are to ensure that:

- there are no jurisdictions where UK taxpayers feel safe to hide their income and assets
- would-be offshore evaders realise that the balance of risk is against them
- offshore evaders voluntarily pay the tax due
- those who do not come forward are detected and face vigorously enforced sanctions
- there will be no place for facilitators of offshore evasion.

The report states that the way that HMRC will achieve these objectives is by:

- reducing the opportunities to evade offshore through initiatives to ensure compliance, international agreements and multilateral action
- increasing the likelihood of evaders, and those who make offshore evasion possible, being caught, by investing in the skills of specialist staff, using the data generated by international agreements, and investing in improved tools, technology and customer understanding to identify, understand and profile high risk customers
- strengthening the severity of the punishments for those who are caught, with tough penalties, the possibility of criminal investigation and publishing the names of the most serious evaders.

APAC news

Australia

The globalisation of business has led to dealing in multiple currencies due to supply contracts and customer contracts. This has resulted in the management of foreign currencies and resulting hedging contracts, the taxation of which is not often a well settled issue.

The Australian tax Office (ATO) recently ruled favourably for a taxpayer with foreign currency hedging losses (FX losses), arising from transactions entered into to hedge exposure to foreign currency movements. The ATO held that the FX losses were 'reasonably related' to foreign currency hedging gains (FX gains) in relation to the same investments.

The Australian resident taxpayer held a diverse asset portfolio with particular classes of assets, including international equity investments that were held in foreign currencies but were recorded in Australian dollars in the taxpayer's financial statements. The taxpayer adopted a mark to market accounting system.

In relation to the international equity investments only, the taxpayer entered into foreign currency hedging transactions to hedge its exposure to currency risk in respect of the underlying capital value of these investments through an actively managed currency strategy applicable to those investments. The taxpayer realised assessable FX gains and incured FX losses arising from these foreign currency hedging transactions. No foreign income tax was paid on the FX gains. The FX gains and FX losses are from a foreign source.

The taxpayer's FX gains and FX losses arise from currency transactions that are entered into as part of its strategy to hedge its exposure to foreign currency fluctuations affecting the underlying value of its international equity investments. A currency hedging transaction by its nature will result in FX gains and FX losses. These are a function of the direction in which the foreign currency moves against the Australian dollar.

The FX losses are reasonably related to the FX gains in this instance by being part of the hedging strategy implemented by the taxpayer in relation to its international equity investments to limit its exposure to FX risks.

China

China's State Administration of Taxation (SAT) issued a new bulletin on capital gains provisions in China's tax treaties. Such articles usually deal with the sale of shares but often contain exceptions to treaty benefits for capital gains where the underlying assets of the company in which the shares were sold meet certain specified requirements.

Under most of China's tax treaties, capital gains arising from the sale of shares of a company resident in a treaty country can be exempted from tax provided that the following two tests can be satisfied:

- the target company is not a 'land-rich' company in which 50% or more of the share value consists (directly or indirectly) of immovable property (the 50% test)

- the transferor company must hold, directly or indirectly, less than 25% of the shares of the target company (the 25% shareholding test).

The bulletin provides that the scope of immovable property includes operational and non-operational housing properties, land use rights, and attached fixtures. The bulletin also further describes the meaning of the three-year look back period for determining the proper date, or dates that should be used to apply the 50% test defining it as the 36 consecutive calendar months before the month of the share transfer.

The bulletin introduces a look-through concept for the 25% shareholding test. If a Singapore resident indirectly owns the equity interest of a Peoples Republic of China (PRC) company through a nominee, but exclusively enjoys the participation interest of the equity and substantially bears the equity investment risks of the PRC. company, the Singapore resident can be treated as if it holds the equity interest of the PRC company directly for purposes of the 25% shareholding test. The nominee can be an individual, company, or other entity.

Hong Kong

Hong Kong is used for several purposes with respect to a multi-national's Asian based operations. One taxpayer, a well-known athletic shoe company used Hong Kong as a location in which procurement services were performed. Despite the efficiency of the Hong Kong operation, the taxpayer ran into tax difficulties for services performed with respect to services provided to a related party in India.

The taxpayer was a Hong Kong resident and it functioned as a 'buyer' for the entities within the group of companies including a related company in India. The services provided by the taxpayer to India included, amongst others:

- sourcing new manufacturers and maintaining relationships with existing manufacturers
- procuring samples and relaying of the manufacturers terms and conditions
- coordination activities, including negotiating and placing purchaser orders, between India and the manufacturers
- payment of the manufacturers on behalf of the athletic shoe company India. The invoices were issued in the taxpayer's name as the agent of India.

However, the taxpayer did not have the authority to accept or reject prices or terms established between India and the manufacturers. In return for the above services, the taxpayer received an arm's length agency service fee. The taxpayer contended in its Indian tax return that the fees did not qualify as fees for technical services and in the absence of a permanent establishment in India, the income was not taxable in India.

The tax authorities disagreed and held that the fees did qualify as fees for technical services and thus, were taxable in India. The issue before the tribunal was whether the fees were in the nature of fees for technical services and thus, taxable in India.

The tribunal held that the fees were not for managerial, technical or consultancy services and as such did not constitute fees for technical services. Fees for technical services had to involve some type of applied and industrial sciences and in this case, the taxpayer provided no such technical services.

India

India is well known as a favourable location from which to conduct outsourcing activities. In a recent ruling, the use of an outsourcing operation together with a tax advantaged company was addressed.

The taxpayer Z, a provider of back office support services (excluding telecommunication services), was established in a designated software park and was eligible for a tax holiday for the profits attributable to its exported services.

Z supplied its services exclusively to a related party in the United States (S). In terms of the business model, clients contracted with S to provide back office services, and S subcontracted with Z for the non-telecommunication portion of those services. S assumed the marketing, contractual, and credit risks whereas Z assumed the operating risks associated with the delivery of its services.

In its transfer pricing analysis, Z chose the comparable uncontrolled price (CUP) method to establish the arm's-length price of its transaction with S. The US company paid 85% of the amount it received from its external clients to Z as an arm's-length fee under the CUP method, based on the functions performed and risks assumed by each party.

As a backup analysis, Z also adopted the transactional net margin method (TNMM) and selected a few comparables from the public domain. The average operating margin of the comparables was around 8%. Z's operating margin was 1.5 times its operating cost and was much higher than the average operating margin of the comparables. Z therefore determined that its transaction with S was at arm's length. As Z was eligible for the tax holiday, it claimed that its profits from the transaction with S were exempt from tax under the domestic income tax act (ITA).

In the transfer pricing audit, the transfer pricing officer examined Z's documentation and agreed that its transaction with S was at arm's length. The transfer pricing officer issued an order to that effect and advised the tax assessing officer (TAO).

The TAO challenged the amount of Z's profits that were eligible for the tax holiday under the ITA. The TAO denied the tax holiday for profits in excess of 8% of Z operating costs, and assessed tax on that amount.

The tribunal ruled that profits from the supply of business outsourcing services to a related party by an Indian company qualifying for a tax holiday are fully tax exempt, even if the profit margins are excessive because of operating efficiencies, provided that the supply is at an arm's-length price.

The tribunal sided with Z and overruled the tax assessment. It held that once the transfer pricing officer agreed with the taxpayer and accepted the arm's-length nature of the transaction with S the TAO had to have new evidence to invoke his powers under the ITA.

Further, the TAO provided no independent evidence to support his conclusion that Z had generated more than ordinary profits by virtue of the arrangement of its dealings with its related party.

The tribunal also found that Z had significant operating efficiencies and low-cost advantages over some of the comparables.

The tribunal therefore held that the TAO could not adjust Z's profits for purposes of the tax holiday and erred in assessing tax on a part of the profits.

Indonesia

Indonesia's Finance Ministry has been looking into the granting of tax incentives to encourage the production of environmentally-friendly 'green' vehicles. The proposals have recently received parliamentary backing.

The proposals would allow tax incentives for the manufacturing of low-cost low-emission cars in Indonesia, that could, not only reduce fuel consumption, but also make the country into an Asian production base for such vehicles.

The incentives for low-cost green car production form part of the Ministry of Industry's plans for Indonesia to become a regional production base, in competition with Thailand and Malaysia, while increasing employment.

The Indonesian government has also announced that companies involved in the exploration of oil, gas and geothermal resources are able to get tax incentives.

Japan

Two recent international developments are of interest, the bad news, earnings stripping, the good news, a taxpayer victory concerning residence.

Earnings stripping

Japan adopted earnings stripping provisions under which a corporation's deduction for net interest expense paid to a related party will be limited to 50% of adjusted income, effective for tax years beginning on or after 1 April 2013. A related party is defined to be any:

i) person with whom the corporation has a 50% of more equity relationship
ii) person with whom the corporation has a de facto controlling or controlled relationship
iii) third party lender which is financially guaranteed by one of the above.

Residence taxpayer victory

A victory in a Japanese gift tax case of the elder heir of the recently bankrupt Japanese consumer finance company has been widely publicised. One aspect of the case that drew particular media attention was the loss to the Japanese state through the payment of around JPY40Bn (USD450m) of interest and penalties to the taxpayer in addition to the taxes repaid of around JPY133Bn (USD1.6Bn).

In the case the taxpayer had received a gift of the company's shares during a period when he was living in Hong Kong, where he spent approximately two thirds of his time while spending just over a quarter of his time visiting Japan and the remainder elsewhere.

The tax authorities had asserted that the taxpayer was resident in Japan during the period concerned, despite his relatively short period of residence in Japan.

The authorities asserted that he had an 'address' in Japan and hence the gift of shares to him was a taxable transaction by virtue of such residence.

Under changes to the law in Japan in 2000, where either the recipient or transferor of gifted assets has been resident in Japan for five years tax can apply to such assets even when they are not located in Japan.

In the instant case, the taxpayer's lifestyle was 25% or less in Japan for more than the five year period.

The court ruling in the case indicated a warning from the Japanese courts against abusive interpretation of the tax law by the tax authorities. In particular the ruling noted the words of the Japanese constitution, that '…taxes should be assessed according to the law…'.

Korea

Previously, tax residents in South Korea were required to file a foreign financial accounts report form with the National Tax Service (NTS) between 1 June and 30 June of the following year if the aggregate value of cash and listed stocks held in foreign financial accounts exceed KRW 1 billion on any day during the tax year. Under the revised law, the reportable criterion is extended to include all financial assets including bonds, derivatives, etc. In addition, the KRW 1 billion value measurement date has changed from 'on any day during the year' to the 'end of each month' for the convenience of taxpayers in determining the reportable financial accounts value.

Additionally, new penalty provisions have been introduced to enhance effective enforcement of the law, these are as follows:

- name of the individual who fails to comply will be disclosed to the public effective from reporting year 2012 (filing due 30 June 2013)
- if the total amount not reported or under-reported exceeds KRW 5 billion, criminal law penalties will apply with a maximum of two years imprisonment or a fine up to 10% of the non-reported or under-reported amount.

Malaysia

The Labuan Financial Services Authority (LFSA) has issued guidelines applicable to all Labuan international trading companies (LITCs) licensed to conduct international commodity trading business in the Labuan International Business and Financial Centre (LIBFC) under the Global Incentives for Trading (GIFT) programme.

The guidelines that were effective from 1 January 2013, cover a Labuan international commodity trading business involved in the trading of physical and related derivative instruments of petroleum and petroleum-related products including liquefied natural gas (LNG), agriculture products, refined raw materials, chemicals and base minerals. An LITC can only deal with non-residents in any currency other than Malaysian ringgit.

Under the GIFT program, a general LITC is subject to a corporate tax rate of 3%, but an LITC set up purely as an LNG trading company is entitled to a 100% income tax exemption on chargeable profit for the first three years of its operation, provided the company is licensed before 31 December 2014.

Other tax incentives applicable for an LITC include:

- a 100% exemption on fees paid to non-Malaysian directors of the LITC
- a 50% exemption on gross employment income of non-Malaysian professional and managerial staff, including traders with the LITC
- an exemption on dividends received by or from the LITC
- an exemption on royalties received from the LITC
- an exemption on interest received by residents or non-residents from the LITC
- a stamp duty exemption on all instruments for Labuan business activities and the transfer of shares.

New Zealand

Although miles from Europe, New Zealand is just as plugged into attacking tax avoidance schemes as other jurisdictions many times its size.

The appeal court has recently issued a judgment concerning a finance structure which was held to be a tax avoidance scheme. The case involved taxpayer (NZCo) funding its NZD 78 million acquisition of two New Zealand companies by issuing non-interest bearing, ten-year optional convertible notes (OCNs) to its Australian parent company (AUSCo). At maturity the OCNs could be redeemed in cash or converted into NZCo shares at the rate of one share for one note.

Under international accounting standards (which required that the OCNs be split into their debt and equity components, and interest recognised on the debt element), and a determination issued by the Inland Revenue, NZCo treated the difference between the present value of the debt component of the OCNs (NZD 38 million) and the cash redemption value (NZD 78 million), i.e. NZD 40 million, as deductible interest expenditure. It then amortised over the term of the OCNs. Australia treated OCNs as equity and did not assess the amortised amounts.

NZCo's resultant tax loss was offset against the taxable incomes of its New Zealand group companies.

The High Court found that the arrangement was a tax avoidance arrangement and therefore void. NZCo appealed the High Court's decision. The appeal court upheld the High Court decision in favour of the commissioner.

Taiwan

A proposed plan has been announced to introduce six pilot economic free zones in northern, central and southern Taiwan. The zones will offer foreign investors tax incentives including:

- a reduced corporate income tax rate of 10% (previously 17%) for multinational companies that set up their regional headquarters in the designated locations
- a 50% income tax exemption for foreign and Chinese workers in the first three years of their employment within the zones
- incentives for profits repatriated from overseas to enterprises established in the zones
- incentives for the acquisition of patented technologies
- incentives for research and development activities
- duty-free import and export of goods and raw materials from and to the zones.

Subsidies for rents and a relaxed work permit policy for qualified foreign workers will also be available.

Thailand

Many countries are raising corporate tax rates but are being criticised by those who say raising tax rates lowers government tax collections and lowering tax rates has the opposite effect. Who is right? Let's look at Thailand.

Thailand's cabinet approved a package of tax measures to provide assistance to small and medium-sized enterprises (SMEs) and lessen the effect of the government's minimum wage policy.

While the government has already lowered corporate tax from 30% to 23% last year, and has adjusted the rate even lower to 20% in 2013, there have been calls for further help to small-medium sized entities (SMEs), with annual revenues of up to THB50m (USD1.65m), to counteract the increased wage costs caused by the introduction of the country's THB300 daily minimum wage on 1 January 2013.

In 2013, the annual income tax exemption for SMEs will be increased from THB150,000 to THB300,000, and there will be a 15% tax rate on their profits between THB300,000 and THB1m. The normal 20% tax rate would apply to incomes above THB1m.

Thailand's tax collections for the first five months of the 2013 fiscal year beginning last October reached 28.06 billion US dollars, which is 13% or 3.21 billion dollars more than targeted, according to the Fiscal Policy Office.

The Fiscal Policy Office reported that the collected taxes from all agencies between October and February were higher than targeted, reflecting an economic expansion, especially regarding domestic demand and household income.

Vietnam

From 1 January 2012, companies were no longer entitled to enjoy incentives based on the export criteria, as a result of Vietnam's world trade organisation commitments. This is somewhat similar to the US Foreign Sales Corporation complaint several years ago.

The Ministry of Finance issued a circular describing the alternative corporate income tax (CIT) incentives available to these affected companies. The circular indicates the length of time that the replacement incentive is to run, as well as, which regulations to apply.

The circular also provides guidance on the conversion of CIT incentives in some special cases and also provides a number of specific examples.

In order to enjoy an alternative incentive, an enterprise must notify the local tax authority of the alternative CIT incentives by the submission deadline for the 2012 final CIT return. Where an enterprise has already declared/notified an alternative CIT incentive which is not in line with circular 199, it is allowed to make an adjustment and submit a revised notification to the local tax authority.

Americas news

Argentina

Cisco Systems Argentina SA (CA) entered into a contract with Cisco Systems Inc (CI) under which CA agreed to promote the sale of Cisco products to distributors and customers located in Argentina and neighbouring countries. This promotion included the use of advertising, technical support and promotional materials.

The service fee paid by CI to CA comprised of: (i) an amount equal to the sum of the costs incurred by CA, to comply with the contractual marketing obligations, including employee salaries, professional fees, rents, depreciation, and other expenses; plus (ii) 5% of those costs (cost plus).

The National Tax Administration challenged some of the expenses incurred by CA outside of Argentina (and also locally), arguing that they were unrelated to the activity developed in Argentina and therefore were not deductible from the tax balance. The Argentine National Tax Court held that expenses a company incurred outside of Argentina were tax deductible because they were necessary to comply with contractual obligations and were therefore directly related to the taxable stream of income.

Bolivia

The Bolivian tax authorities issued a resolution which regulates the carrying forward of accumulated losses for financial years 2010 and 2011. The resolution has an immediate effect and establishes the period to set off tax losses as follows:

- a three year period for:
  - accumulated tax losses generated until 2010
  - tax losses generated as from 2011
- a five year period for:
  - the hydrocarbon and mining sector
  - new businesses registered after 9 September 2011 with an investment capital that exceeds USD 150,000.

Brazil

Brazil internet infrastructure

The Brazilian Government has approved new tax breaks to encourage investment in the nation's internet infrastructure. Companies wishing to secure the tax breaks must submit investment plans by 30 June 2013, outlining proposed improvements to their 3G and 4G networks to improve mobile access to the internet. Tax breaks provide for an exemption to PIS/COFINS taxes (social security levies) and to industrial profits tax, known as IPI. The concessions will not only benefit telecoms providers but also those firms providing the equipment and necessary hardware and software infrastructure to facilitate the improvements. In order to be eligible for the tax breaks, companies must complete their proposed projects by the end of 2016, and domestically source at least 50% of the technologies and components they intend to use.

Imports (PIS) and (COFINS)

Brazil's Supreme Court (STF) has ruled on a case of interest to Brazilian importers. The case concerns the tax base determination of two social welfare taxes levied on imports (PIS-imports and COFINS-imports) as unconstitutional. The decision is important because it will reduce the overall tax cost of importing products into the country.

In its lawsuit, the Brazilian importer argued that the PIS-imports and COFINS-imports tax basis was unconstitutionally enlarged and that the two taxes should be levied only on the 'customs value' of the imports, which is legally established and composed of the cost, insurance, freight (CIF) value, the freight tax (AFRMM), the financial transaction tax (IOF) and other customs charges. There was no constitutional basis to include either a grossed-up calculation or the ICMS (state sales tax) in the tax basis for PIS-imports and COFINS-imports, the Brazilian importer had argued.

According to the court, a grossed up calculation of PIS-imports and COFINS-imports and the inclusion of ICMS into the tax base amounted to an unconstitutional extension of the definition of customs value and should be excluded.

The decision is important to foreign exporters, local importers and Brazilian consumers as the overall tax burden on imports will be reduced by as much as 5%, depending on the ICMS tax rate in the state of destination of the goods.

Canada

The Canada Revenue Agency (CRA) considered the withholding obligation arising on remuneration paid by a Canadian employer to a non-resident employee (a nonbinding technical interpretation). In the ruling, the Canadian employer operated a business that had computer servers physically located in Canada. The non-resident employee was a programmer/analyst who performed his duties from his home country by way of an electronic connection to the employer's Canadian computer servers.

Canada's tax system imposes withholding obligations on payments for services rendered or performed in Canada. Employers are required to withhold and remit tax to the CRA for remuneration paid to their employees, subject to exclusion for employees who are neither resident nor employed in Canada and whose remuneration does not reasonably relate to employment duties performed in Canada.

Any person paying a fee, commission, or other amount to a non-resident for services rendered in Canada is required to withhold and remit to the CRA 15% of the payment.

In either case, the CRA may provide a waiver from withholding tax if it can be shown that the non-resident is not subject to Canadian tax on the payment (for example, under a tax treaty).

The CRA ruled that a person performs the duties of his employment in the place where he is physically present. As such, if the employee is physically located outside Canada when performing his employment duties, no Canadian tax should be withheld from the remuneration paid to that employee.

Cayman Islands

The OECD recently released a 'phase 2' peer review report in respect of the Caymans' regime, which stated that the islands have demonstrated that standards for transparency and tax information have been properly implemented, and that the territory exchanges tax information effectively in practice. Among the many positive comments in the report, the OECD states the tax information authority's exchange process is 'very well organised with many internal processes in place for handling exchange of information (EOI) requests as well as the unit being well resourced in personnel, IT and technical expertise. As a result, high quality responses are provided to partner jurisdictions and in 87% of cases the time in which a final response was provided was less than 90 days'.

The Cayman Islands agreed to enter into a 'Model 1 Intergovernmental Agreement (IGA)' under the US Foreign Account Tax Compliance Act (FATCA) with the US due to its desire to rid itself of any association with facilitating the evasion of taxes. The information disclosed under FATCA will be cross-referenced against individuals' tax filings, and as such, if anyone thought a Cayman bank account could be used to hide US taxes, it will most certainly now be very transparent.

The Cayman Islands Monetary Authority has reported that it received 67 applications for new captive insurance licenses in 2012, with 52 licenses granted and the remainder scheduled for approval in 2013. This represents growth in applications of 58% year-on-year, the strongest year in terms of interest in captives since 2004. Although Cayman is widely recognised as a leading healthcare captive domicile, the 52 new formations came from a broad range of sectors including life reinsurance, property and casualty reinsurance, manufacturing and technology, as well as healthcare.

Chile

The Supreme Court held that financial institutions must inform the tax administration (SII) on international transactions carried out on behalf of third parties according to a resolution which was upheld as lawful.

The resolution issued by the SII provides that banks, financial institutions and other resident entities must annually inform the SII on any international transaction carried out on behalf of third parties. These transactions include remittances, foreign payments and capital inflows for an amount equal to or exceeding USD 10,000. For this purpose, an affidavit must be filed electronically by 15 March of each year.

Various banks requested that the resolution be declared void based on general bank law provisions, under which banks and financial institutions are subject to bank secrecy and bank confidentiality. Bank secrecy is applicable with regard to any type of bank deposits. This information may be provided only to the holder of the bank account or its representative. Other bank transactions are subject to bank confidentiality. This information may be provided only to those who have a legitimate interest so long as it does not imply an economic damage for the client. In the case of offshore companies, the income tax law specifically provides that the bank secrecy or reserve is not applicable.

The resolution was successfully challenged before the lower court and the appeals court. However, the Supreme Court reversed the decision and decided that resolution was lawful.

Columbia

Colombia's congress recently approved a comprehensive tax reform that will substantially change the international tax rules for individuals and for companies carrying out business in Colombia.

The tax reform aims to update Colombia's tax rules to align them with the income tax treaties it has concluded thus far, which are mainly based on the OECD model tax treaty. Specifically, the tax reform amended the transfer pricing rules, extended the income tax to foreign capital investment portfolio income, and introduced thin capitalisation rules and provisions to tackle the use of tax havens, among other things.

The main provisions that will affect companies and individuals carrying out business in Colombia include:

- residency
- permanent establishment
- income tax rate and tax base
- capital gains tax
- general and specific anti-abuse rules
- exchange of information
- transfer pricing rules.

Costa Rica

Costa Rica notified the OECD that it has ratified the 'Convention on Mutual Administrative Assistance in Tax Matters', the most comprehensive multilateral agreement available for tax-cooperation and exchange of information.

The convention was developed jointly by the OECD and the Council of Europe, and has been open to all countries since 1 June 2011. It helps counter cross-border tax evasion and ensures compliance with national tax laws, while respecting the rights of taxpayers. G20 leaders strongly encouraged all jurisdictions to sign the convention.

The convention provides a multilateral basis for a wide range of administrative assistance, including information exchange on request, automatic exchange, simultaneous tax examinations and assistance in the collection of tax debts. The convention will enter into force for Costa Rica on 1 August 2013.

Mexico

Mexico, as Chile has done a few years ago, is looking to introduce a new tax on mining companies' profits in a bid to raise the country's tax-to-Gross Domestic Product (GDP) ratio, which remains the lowest among OECD member states.

A lower house parliamentary committee endorsed the new law, which would impose a 5% levy on pre-tax mining profits, up from a 4% rate that had previously been under consideration.

The royalty would apply to net earnings before interest, taxes, depreciation, and amortisation (EBITDA). The definition of EBITDA in the income tax law refers to the company as a whole, without regard to the nature of the income and expenses. The calculation of income and expenses would be based on taxable income and deductible expenses under the income tax law.

The proposed bill also includes increased penalty payments for duties or rights that are currently assessed on concession holders based on the size of the property. These penalties are imposed when a concession is not being developed.

USA

The tax court held that a US bank's Structured Trust Advantaged Repackaged Securities (STARS) transaction with a counterpart in the UK lacked economic substance and, therefore, did not give rise to foreign tax credits, deductible expenses or foreign-source income. Through a complicated system of subsidiaries and special-purpose entities, the US bank contributed assets to a trust, the trust sold its shares to the UK counterpart, and the UK counterpart loaned the US bank money through the trust.

For UK tax purposes, the UK counterpart was treated as the owner of the trust and, thus, was able to claim deductions and credits against its UK taxes. However, for US purposes, the transactions were treated as a secured lending arrangement, so that the US bank was the owner of the trust and could claim foreign tax credits for the UK taxes paid on the trusts income. While the STARS transaction was structured to meet the foreign tax credit requirements, it was actually an elaborate series of pre-arranged steps designed for generating, monetising and transferring the value of the foreign tax credits between the US bank and the UK counterpart.

Uruguay

Uruguay has continued in issuing industry specific tax incentives by providing tax incentives for the biotechnology industry.

The corporate income tax exemption applies to income derived from the qualified activity as follows:

- a 90% exemption for tax years that began or will begin between 1 January 2012 and 31 December 2017
- a 75% exemption for tax years that will begin between 1 January 2018 and 31 December 2018
- a 50% exemption for tax years that will begin between 1 January 2020 and 31 December 2021.

The tax incentive is granted if any one of the conditions below is met:

- the activity implements a 'programme of development for providers (of biotechnology products and services'
- the activity is carried out by a micro, small or medium company
- the taxpayer is a new company created ad hoc to produce qualified biotechnology products and/or services.

The tax incentive does not apply automatically. Taxpayers must file with the Ministry of Industry, Energy and Mining, an affidavit describing the activity. The requested ministry and a special commission have the final decision on whether to grant the tax incentive.

Transfer pricing news

United Kingdom

According to official guidance published by an advisory committee from HMRC on 15 April 2013, a general anti-abuse rule, soon to become law in the UK, will not apply to many of the recent transfer pricing related controversies. However, abusive arrangements which try to exploit particular provisions in a double tax treaty may still fall under the rule, which is included in the 2013 finance bill.

The General Anti-Abuse Rule (GAAR) received support from the Prime Minister following public controversy over alleged tax avoidance amid dwindling revenues and slashed social services — including claims that large multinational companies were using transfer pricing as a way to avoid paying corporate income tax in the UK, despite doing substantial business in the country.

Argentina

Argentina is now requiring all transfer pricing reports to be filed electronically. The Argentine tax authority issued a general resolution which established the new requirements for taxpayers. The resolution states that taxpayers must file a transfer pricing report in a digital format through the tax authority's website, **http://www.afip.gob.ar**. The transfer pricing report must be translated by a public translator if prepared in a different language, and must include the digital signature of the taxpayer, the independent certified public accountant, and the accountant's professional board. The new requirement applies to fiscal years ending 31 December 2012, or later. For years ending 31 December 2012, the deadline for filing a new report is August 2013.

Czech Republic

The Czech Supreme Administrative Court rendered a decision concerning the burden of proof in transfer pricing disputes and the application of transfer pricing methods.

The taxpayer was a company resident in the Czech Republic and they filed an additional tax return in respect of its 2007 tax liability. In that return, the taxpayer declared that its tax liability for 2007 should have been higher than originally declared, because the transfer prices in transactions with its parent company, were not at arm's length. The plaintiff paid the additionally assessed corporate income tax in respect of the 2007 tax year.

Subsequently, the taxpayer filed another additional tax return for the 2007 tax year in which it declared a substantially lower tax liability. The taxpayer claimed that there was no reason for the adjustment of the transfer prices, as claimed in the 2008 additional tax return. The tax authorities disputed the reduction of the tax base and the tax liability in respect of the 2007 tax year, and argued that the taxpayer failed to demonstrate that the transactions with its parent company, resulting in a lower tax liability, were at arm's length. The lower court upheld the tax authorities' position. The taxpayer then brought the case before the Supreme Administrative Court.

The dispute concerned the following types of controlled transactions:

- purchase of raw materials from the parent company – the cost-plus method was used
- sale of finished goods to the parent company – the profit-split method was used.

The court ruled in favour of the tax authorities. The taxpayer must substantiate all information stated in his tax return; thus, the burden of proof is generally on the taxpayer. In an earlier case, the Supreme Administrative Court found that this principle does not apply in transfer pricing disputes. In such disputes the burden of proof shifts to the tax authorities.

In the present case, however, the burden of proof was on the taxpayer, rather than the tax authorities, as it was the taxpayer who claimed that the transfer prices used as a basis for its 2007 tax liability, declared in the 2008 additional tax return, should be revised. Accordingly, the taxpayer was expected to provide evidence of both the price in a controlled transaction and the arm's length price. The court held that the taxpayer did not meet its burden of proof in the present dispute.

The court further held that the transfer pricing methods were not applied correctly. In particular, the court found that the costs taken into consideration for the application of the cost-plus method included the plaintiff's 'share in the losses of the parent company'.

In addition, the court found that the application of the profit-split method resulted in the transfer of 80% of the parent company's losses to the plaintiff. The court found that these arrangements were not at arm's length, and effectively resulted in the transfer.

Russia

The Russian Federal tax service released guidance clarifying when transactions are controlled transactions for Russian transfer pricing purposes when they are executed by an agent in its own name but at the request of and for the account of a principal.

The guidance indicates a transaction is considered to be controlled where:

- transactions involving a sale or services executed with the participation of (or through the agency of) third persons that are not considered related for tax purposes
- foreign trade transactions involving the following commodities traded on global stock exchanges: oil and oil products, fertilisers, ferrous and nonferrous metals, precious metals, and precious stones, if the aggregate annual amount of income resulting from all the transactions between the parties exceeds RUB 60 million (about $1.95 million)
- transactions involving a person that is registered or resides for tax purposes in countries or territories included in the Russian Finance Ministry's list of countries and territories that have a preferential tax regime or do not require the disclosure of information about financial transactions.

The guidance indicates that if (under an agency contract) an agent at the request of the principal and in exchange for a fee, undertakes legal and other acts in the agent's name but for the account of the principal, or in the principal's name and account, a controlled transaction exists.

If an agent executes a transaction with a third party in the agent's name but for the account of the principal, the agent acquires the respective rights and obligations and a controlled transaction exists. If the agent executes a transaction with a third party on behalf of and for the account of the principal, the principal acquires the respective rights and obligations that arise, a controlled transaction exists.

The tax service said, to recognise a transaction executed by the agent and the principal as controlled, it is necessary to total the income the agent received from the principal as an agency fee under an agency contract and the income the principal gained from the transaction executed by the agent with a third party.

To recognise as 'controlled' a transaction executed by the agent and a third party in the agent's name but for the account of the principal, it is necessary to total the income that the agent must transfer to the principal in connection with that transaction under an agency contract. The tax service stated that this transaction is subject to transfer pricing provisions because a third party incurs expenses as a result of the transaction's execution.

The tax service also stated that taxpayers must notify tax authorities of their controlled transactions executed in a calendar year. Therefore, a third party that entered into a transaction with an agent must notify the tax authorities of that transaction if it is recognised as controlled.

Finland

The case dealt with whether the transfer pricing between Finnish A Oyj and its Estonian subsidiary B AS had been in accordance with the arm's-length principle. A Oyj had included in the remuneration paid to B AS a portion of the calculated location savings caused by the lower price level of Estonia compared with Finland.

A Oyj the parent company of the group operated the group's research and development activities and had ownership of the technology and models used in the group's business activities. B AS owned the equipment used in its own manufacturing activities and had bought the equipment from A Oyj in 2004, before which it had rented the equipment from A Oyj. B AS operated as a contract manufacturer for A Oyj and it did not have any other customers. Still, it was the largest manufacturer in Europe in its line of production. A Oyj had the ownership of the products manufactured by B AS throughout the entire manufacturing process.

A Oyj also had an Irish subsidiary to which it sold at least a portion of the products made by B AS that required finishing. The Irish subsidiary finalised and packed the products and resold them to distributors in its own name.

The transfer pricing of the manufacturing services purchased by A Oyj from B AS had been determined using the transactional net margin method. The pricing method by which the remuneration was paid by A Oyj to B AS was based on a transfer pricing analysis carried out by A Oyj. The remuneration included a 'location-neutral' cost-plus margin but also a location savings compensation.

The court held that the location savings principle did not apply in this particular case because the Finnish company, which had transferred its manufacturing operations to Estonia, never had manufacturing activities in Finland that were comparable to the operations of its Estonian subsidiary.

Canada

The Supreme Court of Canada issued its first transfer pricing ruling to GlaxoSmithKline (Glaxo).

Glaxo Canada procured ranitidine, an active pharmaceutical ingredient, from Adechsa S.A. Switzerland, as associated entity, under a supply agreement. The ranitidine was used by Glaxo Canada to manufacture an anti-ulcer drug, which was sold in the Canadian market under the Zantac brand name. This brand name was owned by Glaxo Group Ltd. UK; another associated entity, and was made available for use by Glaxo Canada under a licensing agreement.

Under the licensing agreement, Glaxo Canada was required to pay Glaxo Group a royalty of 6% on sales in Canada, and also to procure ranitidine only from entities nominated by Glaxo Group. In consideration, Glaxo Canada obtained the right to use the Zantac brand name and a clutch of other benefits and support services from Glaxo Group.

Consequently, Glaxo Canada purchased ranitidine at prices fixed by Adechsa (CAD 1,512-1,651 per kg) that were far in excess of the prices paid (CAD 194-304 per kg) to other suppliers of ranitidine by other local drug manufactures that sold the anti-ulcer drug under its generic name. However, Glaxo Canada's Zantac sold at a higher price as compared to the other anti-ulcer drugs that were sold under their generic name of ranitidine.

The Minister of National Revenue reassessed Glaxo Canada for the tax years 1990 to 1993, holding that the excess consideration paid by it to Adechsa for purchase of ranitidine was not an arm's length payment that was to be considered under section 69(2) (subsequently replaced in 1998 with section 247(2)), and that the excess payment was deemed to be a dividend paid to Adechsa under section 56(2) and liable to withholding tax under the income tax act.

Glaxo Canada's income was increased by CAD 51 million.

The case has had a long judicial history:

- against the assessment, Glaxo Canada appealed to the tax court of Canada
- the tax court, substantially upheld the reassessment made by the Minister in the prices paid by Glaxo Canada to Adechsa
- Glaxo Canada appealed against this order to the court of appeal
- the court of appeal set aside the order of the tax court and remanded the matter to the tax court to rehear the matter based on the observations of the court of appeal
- an appeal was made to the Supreme Court by the Minister against the order of the court of appeal. A cross-appeal was also filed by Glaxo Canada against the order of the court of appeal remanding the case to the tax court
- the Supreme Court upheld the order of the court of appeal remanding the matter to the tax court for determination of the arm's length price.

The Supreme Court held that the purchase price paid by Glaxo Canada for ranitidine under the supply agreement with Adechsa included a payment for the rights and benefits received by Glaxo Canada under the licensing agreement with Glaxo Group Ltd. Therefore, the licensing agreement could not be excluded, as had been done by the tax court, in determining the arm's length price under the supply agreement.

The Supreme Court upheld the finding of the court of appeal that in determining what should be the arm's length price for ranitidine purchased at higher than market prices by Glaxo Canada, due regard should also be had to the benefit obtained by Glaxo Canada under the licensing agreement which imposed a condition to make such purchases, and consequently remanded the matter to the tax court to make that determination.

Brazil

A Brazilian multinational company underwent a major corporate restructuring in which it contributed shares in a number of its offshore investments to a Spanish holding company, which was subject to a special regime, under which revenue derived from controlled foreign corporations was not taxed in Spain. The Brazil-Spain tax treaty ensured that profits from the Spanish entity were not taxed in Brazil.

The Federal Revenue Department (FRD) contended that the new corporate structure served only as a means to channel profits to Brazil while avoiding tax and therefore lacked economic substance. The FRD attempted to tax the profits accrued by the indirectly controlled entities (held by the Spanish holding company). In essence, the FRD argued that the foreign subsidiaries profits were taxed as earned irrespective of any repatriation.

In the decision of the Administrative Council of Tax Appeals (CARF), the majority of counsellors held in favour of the taxpayer, saying that there is no legal basis to disregard treaty provisions, which must take precedence over national law. The CARF held that the Spanish holding company had economic substance, evidenced by the fact that it carried out its activities as a holding company and was not constituted solely for the purposes of tax avoidance. Also, Brazilian CFC rules should only reach the profits of the directly controlled entities (since the profits accrued by the indirectly controlled ones should be consolidated by the treaty). Thus the CARF considered the usual investment position of a holding company as sufficient evidence of economic substance.

France

The French court of appeal rejected the use of secret comparable in the case of a large based Swiss multinational.

Nestle Enterprises, a French subsidiary of the Swiss-based Nestle group, was appealing a 2011 ruling by the lower Administrative Court regarding the transfer of an internal cash pooling service to a Swiss affiliate. The lower court, siding with the French tax administration, found the relocation of the cash pool management function was a transaction that required arm's-length compensation.

In overruling that judgment, the Paris appeals court said the tax administration failed to prove its basis for calculating a compensation amount for Nestle France's transfer of the cash pool management activity to the Swiss Nestle entity. The ruling lists required criteria for a comparable that the administration had not provided. The tax administration provided no precision about the identity of the comparables or about how their cash pool management function works, or about whether these comparables or these cash pool management functions of the comparables include guarantees similar to the guarantees of Nestle Finance France.

In France, the government is not supposed to use a secret comparable because they hamper a taxpayer's ability to defend itself by disproving the validity of the comparables offered by the tax authority. The court stated that one of the reasons why the comparable should not be acceptable is that the tax authorities have not disclosed to the taxpayer the identity of such comparables.

Indirect taxes news

Bahamas

Although this location is popular as a low tax jurisdiction and often referred to as a tax haven, it appears that the popular VAT has crept in the back door.

On 14 February, the Bahamian government issued a white paper on the proposed VAT that was announced in the 2012-2013 budgets. The VAT, which would be charged at 15%, 10, or a zero rate, would be effective from 1 July 2014. The standard VAT rate would be 15%, while export sales and international transport of goods and passengers would be zero rated. A discounted rate of 10% would apply for hotel services, including food and drink supplied on their premises. That rate is the same as that of the current hotel occupancy tax, which the VAT would replace. Of course this is a concession to tourist trade.

The following products and services would be exempt from VAT:

- healthcare and education services
- transfers and leases of land and residential buildings
- financial services
- social and community services
- agriculture and fisheries.

VAT would apply to every supply of goods and services made in the Bahamas in the course of a taxable activity carried on by a VAT registrant. The concept of a taxable supply includes a zero rated supply for exempt products and services.

Netherlands

The ECJ found that VAT paid by a group of Dutch companies for the management of assets in a pension pooling scheme is not deductible for the group.

The case involves a group of related companies that created a separate entity to pool employee pension resources. The companies were all part of a tax group, but for Dutch legal reasons, the pension fund was a separate legal and VAT entity.

The taxpayer, a member of the group, contracted with third parties for pension management, administration, auditing, and consulting services and paid directly for those services. In 2001 and 2002, the company paid an approximate amount of VAT on pension-related services and sought to deduct those invoiced payments against its output tax.

The Dutch tax administration determined that the VAT paid on the pension services was not deductible by the group and issued a reassessment, against which the taxpayer appealed. The company argued that the VAT was deductible because it was an expenditure made for the benefit of its employees and that it was part of the overhead for the company's taxable activity.

For VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions, giving rise to a right of deduction. The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct.

The Dutch tax authorities argued that the costs related to the pension fund did not have a direct and immediate link to the outputs of the company while the taxpayer, joined by the European Commission, argued that the legal requirement for providing employees with a pension meant that the costs were a necessary component of its business.

The UK intervened in the case to argue that a limited portion of the costs, such as those associated with setting up the fund, should be deductible, but that the costs of the management of the fund assets should not be.

The ECJ sided with the argument raised by the UK and reiterated legal and fiscal separation between the fund and the company that created it and held that while the fund could deduct the input VAT paid by group against the VAT due on its own activities, there is no direct and immediate link with the activities of the group.

Thus, the ECJ rule that while group has no right to deduct the VAT paid on the management of fund assets, it may deduct VAT paid on fees related to the setting up of the fund, the enrolment of employees, and the assurance of timely payments into the fund.

Ireland

The ECJ held that allowing non-taxable persons to join a VAT group does not violate the VAT directive.

The case involved a complaint by the European Commission that Ireland's VAT consolidation act allows a non-taxable person to join a VAT group. The commission argued that this violated the VAT directive and could lead to the creation of an entirely non-taxable VAT group, a situation contrary to the goals of the VAT system.

Of key importance in the case is the wording of VAT directive, which says that member states may allow 'any persons' to join a VAT group. The commission argued that although the word 'taxable' does not appear between 'any' and 'persons', it is implicit that taxable persons, as defined in the VAT directive, is intended and furthermore, that the use of the word 'grouping' implies that all VAT group members should occupy the same VAT category.

The court agreed that the directive's wording does not limit potential members in a VAT group to taxable persons, writing that the insertion of 'any' and the omission of 'taxable' clearly expanded the potential VAT group membership to non-taxable entities. The court said that based on the wording there is no reason to exclude non-taxable entities from a VAT group.

Canada

A recent decision dealt with automated banking machines (ABMs) in the taxpayer's convenience stores across Canada. The taxpayer lost one issue and won the other at the tax court of Canada.

The taxpayer had an agreement with CIBC to place CIBC banking machines in many of its stores. The taxpayer received fees from CIBC based on the fees that CIBC charged to non-CIBC customers who used the machines. The taxpayer did not charge Goods and Services Tax (GST) on these fees, taking the position that they fell within the definition of a 'financial service' because taxpayer was 'arranging for' financial services that CIBC provided.

The tax authority (CRA) assessed the taxpayer on the basis that the fees were simply fees for a license to use real property, by allowing CIBC to place its machines in taxpayer stores for a fee.

After reviewing the case law on 'arranging for', the judge concluded that the taxpayer was simply not sufficiently involved with CIBC' s financial services provided through the ABMs. All the taxpayer did was provide space for the machines and this was a taxable supply of a license to use real property.

Finland

Company A had purchased two aircraft from a manufacturer in France and, instead of using them for the purpose of carrying out international air transport for consideration, company A designated company B as the user of the aircraft. Company B organised international charter flights. After a short period of time, A resold the aircraft to an undertaking registered in Cyprus.

The administrative court, Helsinki decided that, since it did not carry out international air transport itself, company A had to account for VAT on the intra-community acquisition of the two aircraft.

In response to questions referred to it by the Supreme Administrative Court, the ECJ declared that the directive must be interpreted as meaning that the zero rate for which it provides, also applies to the supply of an aircraft to an operator which is not itself an 'airline operating for reward chiefly on international routes' but which acquires that aircraft for the purposes of exclusive use thereof by such an undertaking. In the light of ECJ judgment, the Finnish Supreme Administrative Court declared that, by purchasing the aircraft, company A had not effected an intra-community acquisition of goods for which it was liable to pay VAT.

Norway

Services supplied by an entity established in Norway to a non-resident business customer are zero rated if the services by their nature are capable of being delivered from a remote location. As the services of lawyers that consist of representing a non-resident client in judicial proceedings before a Norwegian court are to a certain extent linked to a specific place in Norway, in so far as the lawyer represents his client at the hearing, the question was whether or not the remaining part of the service, in particular the preparatory work for the hearing, could be considered to be delivered from a distance, i.e. in the case of a non-resident business client, could be zero rated. Alternatively, the various activities of the lawyer in the framework of representing his client in judicial proceedings could be considered to constitute a single service and the treatment of that service would then be determined by what is deemed to be the principal element of the service.

The Supreme Court observed that it could find no arguments for application of the zero rate because a larger or smaller part of the service of representing a client in judicial proceedings will often consist of work that can be done at a distance, but that work forms an integral part of the main service. The Supreme Court concluded that services that consist of representing a client in judicial proceeding including the written preparatory work, must be considered to constitute a single service and that the principal component of that service is representing the client at the hearing. Consequently, the entire service is subject to 25% VAT.

United Kingdom

A hotel business (the taxpayer) had bought accommodation in hotels established in other member states of the EU and sold the accommodation, unaltered, to travellers resident in the UK. The taxpayer argued that it acted as an agent for the hotels and, consequently, its intermediary services were deemed to be supplied at the places where the hotels were located, meaning that no UK VAT was due on its services.

The contracts under which the taxpayer operated suggested that it acted as an agent. However, its behaviour did not support this position. The taxpayer set the price for which it sold the accommodation to the travellers and the overseas hotels, not know the selling price, as the taxpayer only paid the hotels an amount that was net of its 'variable commission'. Consequently, the hotels could only account for local VAT on the amount they received from the taxpayer and the taxpayer's services were not subject to any VAT at all. That result is not consistent with the taxpayer's status as an intermediary.

In first instance, the first-tier tribunal concluded that, in this respect, the taxpayer acted as a principal (commissionaire) and, since it was established in the UK, had to account for UK VAT under the special scheme for travel agents, i.e. the taxpayer had to account for UK VAT on its margin (the difference between the selling price and purchase price of the rooms). However, the upper tribunal had reversed the first-tier tribunal's decision on the basis of the contracts under which the taxpayer operated.

The appeal court decided that the upper tribunal had been wrong to base its decision on the contracts alone. It agreed with the first-tier tribunal that it may be necessary to look beyond the written contracts and have regard to all the facts to establish the actual nature of the supply. On those grounds, the appeal court restored the decision of the first-tier tribunal and concluded that the taxpayer hotels had to account for UK VAT on its margin.

USA

A publishing company distributed a free weekly local newspaper and once a month, inserted coupon books into the newspapers. The company also distributed the coupon books by placing them on news racks. The coupon books contained only advertisements and did not contain any news content. The publishing company's salespersons solicited advertisements for the coupon books as well as for the newspaper.

The coupon books differed from the newspaper in size, format and method of distribution. The coupon books were prepared and printed separately from the newspaper (they were not part of the newspaper print run) and they were not separately indexed sections of the newspaper. Thus, since they were fundamentally different from the newspaper, the coupon books did not qualify for exemption as a component part of the newspaper.

In addition, the coupon books did not qualify for exemption as goods that are consumed or destroyed, or lose their identity in the manufacture of other goods (the newspapers).

On those grounds, the Vermont Supreme Court decided that the coupon books were not exempt from Vermont sales and use tax under the exemption for newspapers, which had the effect that the publishing company had to pay sales tax on the cost price of the free coupon books.

Treaty news

Russia/US

The Ministry of Finance in Russia issued a guidance letter clarifying that the profits earned by a US resident legal entity from the provision of web-based intellectual services to Russian clients are taxable only in the US unless the activities result in the creation of a permanent establishment in Russia.

The Ministry of Finance indicated that the business profits of a resident of a contracting state are taxable only in that contracting state unless the resident carries on or has carried on business in the other contracting state through a permanent establishment situated there. If the resident carries on or has carried on such business, its business profits may be taxed in the other contracting state, but only to the extent they are attributable to the assets or activity of that permanent establishment.

Under the treaty, a permanent establishment is a fixed place of business through which a resident of a contracting state, whether or not a legal entity, carries on business activities in the other contracting state.

The Russian tax code specifies that a permanent establishment of a foreign legal entity is a branch, representative office, division, bureau, agency, any other structural subdivision, or any other place through which a foreign legal entity regularly carries on business in Russia, including:

- the performance of works and provision of services involving the installation, assembly, adjustment, servicing, and operation of equipment
- the sale of goods from warehouses located in Russia
- the use of subsoil or other natural resources
- the performance of other works, the provision of other services, and other activities, except those listed in tax code article 306, section 4.

Australia/US

A limited partnership formed in the Cayman Islands (RCF), bought shares in an Australian company that conducted a gold mining enterprise in Australia (SBM). In 2007, RCF sold some of its shares in SBM to unrelated parties and realised a profit on the sale.

RCF has one general partner, which is also a partnership formed in the Cayman Islands, a number of limited partners, most of which are US residents. RCF's affairs were managed by a Delaware LLC and neither RCF, its manager or any of the partners were resident in Australia. It could be assumed that neither RCF nor any of its partners paid income tax in Australia in respect of the sale.

In 2010, the commissioner of taxation issued RCF a default assessment that included a net capital gain from the sale of shares of some AUD 58 million and imposed an administrative penalty of 75% of the tax liability. In other words, the commissioner considered that the profit of RCF was taxable in Australia and in the absence of an income tax return, issued a default assessment requesting a tax payment at 30% of the gain calculated by the commissioner. RCF lodged an objection to the assessment on the basis that the commissioner is not allowed to tax RCF and the gain was calculated incorrectly. The commissioner reduced the penalty to 25%, but did not change the default assessment. In 2011, the RCF's objection to the assessment was deemed to have been automatically disallowed, as the relevant time period for the amendment had expired, and RCF lodged an appeal against the default assessment to the Federal Court.

The court was asked to rule on two questions:

- was the Commissioner able to issue an assessment to RCF or whether the Australia – United States Income Tax Treaty (1982) (the treaty) precluded him from doing so
- was the commissioner able to issue the assessment – whether the gain realised by RCF was subject to tax in Australia under the domestic provisions.

Under the domestic law, RCF, by virtue of being a limited partnership formed and operating overseas, is treated as a non-resident corporate entity. Under the domestic rules, RCF was the taxpayer that realised the gain. The gain realised by RCF was a capital gain.

Capital gains of non-residents are subject to tax in Australia only if they relate to assets used in the business of a permanent establishment in Australia or realised in respect of 'taxable Australian real property' (TARP) assets. Shares in an Australian company are a TARP asset where the sum of the market values of the company's TARP assets exceeds the sum of the market values of the company's non-TARP assets.

Australia does not have a tax treaty with the Cayman Islands, but has a comprehensive treaty with the US, which says that a partnership will be a treaty US resident if the partnership is resident in the US for the purposes of its tax, provided that income is subject to US tax as income of a resident, either in the hands of the partnership or in the hands of its partners.

The treaty allows Australia to tax gains realised by a US resident from a disposal of shares in a company, assets of which consist wholly or principally of real property situated in Australia.

Thus, if RCF is a US treaty resident, Australia will be allowed to tax the gain.

The commissioner argued that RCF is a US treaty resident on the basis that:

- partnerships must be recognised by the US as a resident
- the partnerships' income must be taxed in the hands of US resident partners.

RCF, on the other hand, argued that as RCF is a foreign partnership and a flow-through entity under the US tax law, it is not a US tax resident, and the first residence requirement in the treaty cannot be met and therefore RCF is not a treaty US resident.

The court agreed with RCF and ruled that since RCF is not a US treaty resident, the treaty does not authorise Australia to tax the gain to RCF.

RCF submitted that the gain was realised by the limited partners in RCF on the basis of the wording of the treaty, the US treasury's technical explanations and US model.

Based on the valuations proved by RCF, the court found that the shares disposed by RCF were not a TARP asset and therefore the domestic provisions should exempt the gain from taxation in Australia.

As such, the commissioner lost on both questions. It is expected that the commissioner will appeal to the full Federal Court.

Sweden/Finland

The Swedish Supreme Administrative Court (SAC) delivered a judgment regarding the capital gains taxation of privately owned houses and apartments. The judgment addressed the tax treatment of fictitious income – namely, interest charged on deferred capital gains.

According to Swedish tax law, the deferral of capital gains on privately owned houses and apartments is possible if the capital gain is used to buy a new home. From a fiscal point of view, this system permits considerable tax revenue to be deferred. Interest is imposed on the tax deferral.

The interest is determined by calculating an annual fictitious income on the deferred capital gains. This fictitious income is calculated as 1.67% of the deferred capital gains at the end of the tax year in question. That income is taxed at the general capital income tax rate, which is 30%.

The litigation involved a couple who had moved from Sweden to Finland. They had sold their home in Sweden and bought a new one in Finland. They were granted tax deferral in Sweden on the capital gains but were taxable annually on the fictitious income calculated on the capital gains.

The SAC had to decide how this income should be classified under the multilateral Nordic tax treaty, which includes Finland and Sweden. The court concluded that the only potentially applicable classification was 'other income' (which is similar to article 21 of the OECD model tax convention).

If the income was classified according to this article, the state of residence – Finland in this example – would have an exclusive taxing right on that income. Presumably, no other country except Sweden taxes deferred capital gains with an additional fictitious income that is calculated as 1.67% of the deferred capital gain, and the consequence would be double non-taxation.

The SAC interpreted the concept of fictitious income according to the Nordic tax treaty, concluding that it was not income. The court stated that the fictitious income was merely a 'technical construction' created to allow the state to earn interest on a deferred capital gain.

Russia/Germany

The Ministry of Finance published a 'letter ruling' clarifying whether a Russian entity may deduct all the advertising costs incurred in 2012 further to advertising services, provided by one of its shareholders resident in Germany.

The Ministry of Finance concluded that advertising costs incurred by a Russian company could be tax deductible provided:

- the participation requirement provided for in article 3 of the protocol is fulfilled at the moment when the respective expenses are recognised as tax deductible
- the respective deductible expenses are set at arm's length (market) level.

However, in case the Russian tax authorities find out that the sole purpose of participation in the Russian entity pursued by the German shareholder is to obtain the treaty benefits, the above-mentioned provisions should not apply.

South African tax treaties

The South African Revenue Service (SARS) issued a binding general ruling dealing with the question as to whether the 'dividends tax' introduced on 1 April 2012 is covered under South Africa's tax treaties that were signed before that date.

Prior to 1 April 2012, South Africa had a secondary tax on companies (STC). An STC was imposed at the second stage on a resident company on the amount by which a dividend declared exceeded the sum of incoming dividends accrued during the 'dividend cycle' – the dividend cycle being a period that begins and ends each time a dividend is declared. An STC was therefore a tax on a company declaring a dividend and not a tax on the recipient shareholder.

From 1 April 2012, the STC was repealed and replaced by a dividends tax. Unlike an STC, a dividends tax is levied at 15% of a dividend paid by a company (exemptions apply). In the case of a dividend (other than a dividend in kind), the liability for the dividends tax falls on the beneficial owner of the dividend, even though the tax is withheld by the company paying the dividend. In the case of a dividend in kind, the liability for dividends tax falls on the company paying the dividend.

The question addressed, was whether dividends tax is covered by South Africa's tax treaties even though it may not be specifically named as a covered tax.

The SARS ruled that:

- dividends tax is a tax on an 'element of income'
- dividends tax is similar to STC since it is also a tax on income
- therefore, that dividends tax is covered under article 2 of the tax treaties.

Thus, the SARS has taken the view that dividends tax is an 'identical and substantially similar tax' to STC and that all treaty partner states were informed of both the introduction of the dividends tax and its similarity with STC.

UK/South Africa

B (Holdings) Limited is a company incorporated in the British Virgin Islands. Its sole shareholder is HSBC Trustee (Guernsey) Limited (HSBC trustee), a company incorporated under the laws of Guernsey. HSBC trustee holds the shares of B in trust for a discretionary trust established under the laws of Guernsey (G Trust). The beneficiaries of the G Trust include Mr K, a UK citizen, but a long-time resident of South Africa. Although Mr K is only one of the beneficiaries under the trust, he controls the entire structure. Mr K was charged with tax evasion and other criminal offences in South Africa for the years following those involved in this case.

B owed tax, interest and penalties to the SARS, totalling approximately USD 350 million for the years 1998-2000. The amounts owing were the subject of appeals in South Africa that were finally decided in 2010. The SARS alleged that Mr K arranged for B to transfer its assets to another BVI company. The SARS became aware that this other company had over USD 10 million in a London bank account and requested assistance from HMRC in collecting this amount under the assistance-in-collection-of-tax provision of the South Africa-United Kingdom income tax treaty (the treaty) .

The treaty was amended to provide that the contracting states will provide assistance to each other 'in the collection of revenue claims' and that such assistance is not limited to the taxes covered by the tax treaty or to persons resident in one of the contracting states.

The treaty defines the term 'revenue claim' to mean:

'... an amount owed in respect of taxes of every kind and description imposed on behalf of the contracting states, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the convention or any other instrument to which the contracting states are parties, as well as interest, administrative penalties and costs of collection or conservancy related to such amount'.

The treaty provides that a contracting state receiving a request for assistance must accept the request and collect the claim as if it were a revenue claim involving its own taxes. The revenue claim must be enforceable in the requesting state and the taxpayer must not have any right to prevent the collection of the claim in the requesting state, i.e. any appeal rights have been exhausted.

The defendants made several arguments including, that the request for assistance was invalid, as it was made in respect of years before the treaty became effective.

The tax treaty became effective with regard to South African taxes (other than withholding taxes) for tax years beginning on or after 1 January 2003. The request for assistance made by the SARS related to unpaid taxes for the 1998-2000 tax years, before the tax treaty became effective.

The UK High Court rejected the defendants' argument. The court noted that the UK legislation implementing the protocol recited it was 'for the purpose of assisting international tax enforcement'.

According to the court, this expression of purpose indicated the absence of any intention to impose a temporal limitation with regard to the enforcement of revenue claims other than the condition that the claims must be enforceable in the requesting state.

Switzerland/India

A recent treaty case involved a Swiss-resident company involved in international shipping through an agent in India for the years 1998-99 to 2003-04. The Swiss company's profits were taxable under Indian income tax law, so the only issue was whether or not the provisions of the India-Switzerland Income Tax Treaty (the treaty) prevented India from taxing the profits.

Until 2001, the treaty excluded international shipping profits from the scope of articles 7 and 8. Before 2001, the tax treaty did not contain an 'other income' article. The combined effect of these provisions was that the tax treaty did not deal at all with international shipping, with the result that profits from international shipping were taxable in accordance with the domestic law of the contracting states.

The situation changed in 2001 with the addition of the 'other income' article. Article 22 of the treaty conforms to article 21 of the OECD model, except for the references to fixed base and article 14.

The Indian tax authorities made the argument that article 22 of the treaty did not apply to international shipping profits.

The tax authorities also argued that the intentions of the contracting states were originally clear that international shipping profits should be taxable in accordance with domestic law, unconstrained by the tax treaty and that this explicit understanding was not altered by the addition of article 22 in 2001.

The Indian Income Tax Appellate Tribunal (ITAT) rejected these arguments. According to the ITAT, the intentions of the contracting states changed with the addition of article 22 of the treaty and, according to the plain meaning of article 22(1), the exclusion of international shipping profits from articles 7 and 8 meant that such profits were not dealt with in those articles.

Having concluded that article 22 of the treaty applied to international shipping profits, the ITAT turned its attention to whether the Swiss company had a permanent establishment in India and whether the right or property in respect of which the profits were paid was effectively connected with the permanent establishment.

The ITAT found that the Indian agent of the Swiss company was legally and economically dependent on the Swiss company. The Indian agent cleared inbound cargo and booked outbound cargo on the Swiss company's ships. Accordingly, the agent could be considered to have and habitually exercise the authority to conclude contracts binding on the Swiss company.

However, the ITAT found that the ships owned by the Swiss company were not assets of the deemed agency permanent establishment in India or effectively connected to that permanent establishment, as the agents had no control of the ships. According to the ITAT, for the ships to be effectively connected to the permanent establishment, it had to have economic ownership of the ships.

Accordingly, the tribunal held that the international shipping profits of the Swiss company were taxable only in Switzerland.

Canada/US

The taxpayer, an American citizen, had worked for Ontario Power Generation (OPG) at its nuclear facility in Ontario for four years from 2000 to 2003. He spent over 330 days in Canada in each of those years. The taxpayer did not have a post-secondary degree, but had worked at nuclear facilities in the US for many years, although it is not clear in what capacity. He worked on a contract basis for Onsite Engineering (Onsite), a US company. Onsite arranged a contract with OPG for the taxpayer to provide engineering and management services on a boiler-cleaning project. The taxpayer and his wife bought a condo in Ontario in June 2000, but sold it in December of the same year when his wife returned to the US for medical care. The taxpayer immediately bought another condo. His wife visited and stayed with him

occasionally. In November 2002, he bought a home in Canada and continued to live and work in Canada until 2005.

The taxpayer and his wife retained their US home, which he visited once a month and on major holidays. He also maintained his gun club membership in Tennessee so he could continue his favourite hobby, skeet shooting. He had bank accounts and credit cards in both countries. He maintained his US medical insurance coverage until November 2003, when he became eligible for Ontario health insurance. On his US tax return, the taxpayer indicated that his 'tax home' was Canada. For Canadian tax purposes, the taxpayer claimed to be a non-resident.

The only issue in the case was whether or not the taxpayer was a resident of Canada for purposes of the Canada-United States Income and Capital Tax Treaty. The taxpayer was clearly a resident of Canada for purposes of Canadian tax law, and a resident of the United States for purposes of the tax treaty because of his US citizenship. Accordingly, the issue was the application of the tiebreaker rules.

As the taxpayer had a permanent home in both countries and the taxpayer had extensive personal and economic connections to both countries, his centre of vital interests could not be clearly determined. Consequently, it became necessary to have recourse to the third tiebreaker rule, i.e. habitual abode. Based on the habitual abode test as to where the taxpayer stays more frequently, the tax court found that the taxpayer normally lived in Canada and not in the United States, primarily because the taxpayer worked and spent more time in Canada.

India/US/Ireland

The taxpayer paid Google Ireland and Yahoo US for sponsored search results and online advertising. The advertising services offered by the search engines require the use of software codes and are automated. The advertising server is a computer or computer programme that stores and manages access to the advertisements.

The taxpayer withheld no tax on its payments to Google and Yahoo, arguing that the fees were not subject to tax in India. During the audit of the taxpayer's tax return, the tax officer said the fees were taxable in India as 'fees for technical services and royalties'. The officer also disputed the taxpayer's claim that neither service provider had a permanent establishment in India. The tax officer disallowed the taxpayer's deduction for the fees. The taxpayer appealed.

The tribunal agreed with the taxpayer and reinstated the tax deduction. It noted that the websites on which the advertising appeared do not constitute permanent establishment's in India under the applicable tax treaties.

The Yahoo and Google servers were outside India and the payments were made to the service providers outside India, the tribunal concluded that those companies' websites cannot be characterised as permanent establishments of Yahoo and Google in India.

The tribunal also ruled that the fees were neither royalties nor fees for technical services. There was no right given by Yahoo or Google to the taxpayer to use any property. Also, a service that has no element of human intervention or interface does not fall within the definition of a technical service.

The tribunal ruled that the fees were not subject to tax in the hands of Google or Yahoo and that the taxpayer had no obligation to withhold tax. As such, the fees were deductible.

Tax policy

EU

The European Parliament's Legal Affairs Committee has voted to negotiate changes to a draft law aimed at reforming EU audit services, so that only non-auditing services that could jeopardise independence would be prohibited; the law would also require companies to switch auditors regularly.

The law would require auditors in the EU to publish audit reports according to international auditing standards. For auditors of public-interest entities (PIEs), such as banks, insurance companies and listed companies, the committee agreed that audit firms would have to provide shareholders and investors with a detailed understanding of what the auditor did and an overall assurance of the accuracy of the company's accounts.

As part of a series of measures to open up the market and improve transparency, the committee backed the proposed prohibition of 'Big 4-only' contractual clauses requiring that the audit be done by one of these firms.

PIEs would be obliged to issue a call for tenders when selecting a new auditor. To ensure that relations between the auditor and the audited company do not become too cosy, there would be a mandatory rotation rule whereby an auditor may inspect a company's books for a maximum of 14 years, which could be increased to 25 years if safeguards are put in place. The commission had proposed six years, but a majority in committee judged that this would be a costly and unwelcome intervention in the audit market.

To preclude conflicts of interest and threats to independence, EU audit firms would be required to abide by rules mirroring those in effect internationally. Most committee members saw the proposed general prohibition on offering non-auditing services as counterproductive for audit quality. They agreed that only non-auditing services that could jeopardise independence should be prohibited. They also approved a list of services that would be prohibited under the new law.

For instance, auditing firms would be able to continue providing certification of compliance with tax requirements, but prohibited from supplying tax advisory services which directly affect the company's financial statements and may be subject to questions from national tax authorities.

South Africa

On 22 March 2013, the South African Revenue Service (SARS) released a draft interpretation note that provides an indication of how the agency intends to apply thin capitalisation in the context of transfer pricing.

The application of thin capitalisation applies to 'affected transactions which are broadly cross border transactions between connected persons that have been concluded on terms and conditions that would not have existed if the parties had been independent persons dealing at arm's length'.

The range of parties potentially falling under thin capitalisation has increased to include transactions between a non-resident and another non-resident's permanent establishments in South Africa or, alternatively, transactions between a resident and another resident's permanent establishments located outside South Africa.

A taxpayer will be considered thinly capitalised if it carries a greater quantity of interest-bearing debt than it could sustain on its own, the duration of lending is greater than would be the case at arm's length, or the repayment or other terms are not what would have been entered into at arm's length. In selecting cases for audit, SARS will adopt a risk-based approach in which a taxpayer is considered to be of a greater risk if the debt-EBIDTA (Earnings Before Interest, Taxes, Depreciation, and Amortisation) ratio exceeds 3 to 1.

The effect of thin capitalisation is addressed by means of two adjustments: the primary adjustment and the secondary adjustment. In the primary adjustment, any interest, finance charges, or other consideration for or in relation to that portion of the non-arm's-length portion of the debt must be disallowed as a deduction in determining the taxpayer's taxable income.

In the secondary tax adjustment, the amount of the disallowed deduction (which arises as a result of the primary adjustment) is deemed to be a loan by the taxpayer, that constitutes an affected transaction. This means that a taxpayer will have to calculate and account for interest income at an arm's-length rate on the deemed loan. Where the deemed loan has been repaid to the taxpayer, for example, by a refund of the excessive interest and the repayment took place by the end of the year of assessment in which the primary adjustment was made, the primary adjustment will not be treated as a loan.

OECD

The OECD has recently issued a report on personal taxation. New data shows that across OECD countries the average tax and social security burden on employment incomes increased by 0.1% to 35.6% in 2012. It increased in 19 out of 34 countries, fell in 14, and remained unchanged in just one.

The increases were largest in the Netherlands, Poland and the Slovak Republic (mainly due to increased rates and other changes to employer social security contribution) as well as Spain and Australia (due to higher statutory income tax rates).

This follows substantial increases in 2011 and since 2010, the tax burden has increased in 26 OECD countries and fallen in seven, partially reversing the reductions between 2007 and 2010.

Over the past two years, income tax burdens have risen in 23 out of 34 countries, largely because a higher proportion of earnings were subject to tax as the value of tax free allowances and tax credits fell relative to earnings. In 2012, only six countries had higher statutory income tax rates for workers on average earnings than they did in 2010.

The report provides details about the taxation of employment incomes and the associated costs to employers for different household types and at different earnings levels on an internationally comparable basis, key factors in whether individuals seek employment and businesses hire workers.

The tax burden is measured by the 'tax wedge as a percentage of total labour costs' or the total taxes paid by employees and employers, minus family benefits received, divided by the total labour costs of the employer. Taxing wages also breaks down the tax burden between personal income taxes, including tax credits, and employee and employer social security contributions.

Australia

On 3 April 2013, the Australian Treasury released a discussion paper outlining three steps to give effect to the government's intention to improve the transparency of the country's business tax system.

Under the first measure, the Australian revenue authorities would be required to publish each year information taken from the tax returns of companies with annual revenue of AUD 100 million or more and companies liable for minerals resource rent tax (MRRT) or petroleum resource rent tax (PRRT) – that is, companies involved in the extraction of coal, iron ore, oil and gas.

The following information would be published:

- the company's name and Australian business number
- the company's total revenue (including amounts that are exempt from tax or receive other concessional treatment)
- the company's taxable income and the amount of tax payable (meaning presumably just the Australian tax payable).

The second proposal would amend legislation to protect the publication of aggregate revenue figures in cases where the identity of specific taxpayers could be guessed from that information.

The third measure involves adjusting the current information sharing arrangements between Australian government agencies.

European Commission

The commission has set up the 'Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation' (the platform).

The platform will allow for a dialogue on issues related to good governance in tax matters, fighting aggressive tax planning and preventing double taxation in which experience and expertise are exchanged and the views of all stakeholders are heard.

The platform will comprise of member states' tax authorities and up to fifteen business, civil society and tax practitioner organisations.

OECD

The OECD Secretary-General, Angel Gurría, has presented a report to G20 Finance Ministers and Central Bank Governors that highlights measures to ensure that all taxpayers pay their fair share.

The report covers three strategic initiatives:

- progress reported by the 'Global Forum on Transparency and Exchange of Information for Tax Purposes' including the upcoming ratings of jurisdictions' compliance with the forum's standards on exchange of information on request
- efforts by OECD to strengthen automatic exchange of information
- latest developments to address tax base erosion and profit shifting, a practice that can give multinational corporations an unfair tax advantage over domestic companies and citizens.

EU and internet taxation

Tax authorities across Europe are exploring a variety of modifications to tax laws in an effort to derive greater revenues from taxes on internet activities and transactions. Challenging economic conditions have led those governments to pursue all available options to generate greater revenues. Many European governments believe that more aggressive taxation of online corporate earnings provides an extremely attractive vehicle for enhancing revenues. These European tax initiatives are primarily directed towards large internet companies such as Amazon and Google. They can also significantly affect smaller businesses operating in Europe.

Efforts are underway to try to make the diverse national corporate tax policies across Europe more uniform to prevent companies from moving to jurisdictions that provide the most favourable tax structure. At present, Ireland is viewed by many companies as the most attractive tax haven in Western Europe and applies the lowest corporate tax rate in Western Europe. It also permits companies to shift a substantial portion of their profits to other low tax jurisdictions, such as Bermuda, a strategy not permitted by most other European nations.

Several European governments are actively exploring additional taxes directed toward internet companies. For example, French and Italian tax authorities are reportedly investigating major internet companies to determine if they have been systematically underreporting their income.

Who's who
Grant Thornton South Africa Tax Services

Cape Town
6th Floor
119 Hertzog Boulevard
Foreshore
Cape Town, 8001
T +27214178800

Anton Kriel
Principal
E anton.kriel@za.gt.com

Bruce Russell
Tax consultant
E bruce.russell@za.gt.com

Port Elizabeth
125 Cape Road
Mount Croix
Port Elizabeth, 6001
T +27413743222

David Honeyball
Partner
E david.honeyball@za.gt.com

Durban
2nd Floor
4 Pencarrow Crescent
Pencarrow Park
La Lucia Ridge Office Estate, 4019
T +27315765500

Ahmed Timol
Partner
E ahmed.timol@za.gt.com

Hawa Hoosen
Tax consultant
E hawabibi.hoosen@za.gt.com

Pretoria
121 Boshoff street
New Muckleneuk
Pretoria, 0181
T +27123461430

Lawrence Hummel
Partner
E lawrence.hummel@za.gt.com

Johannesburg
137 Daisy street
Sandown, 2196
T +27113224500

42 Wierda Road West
Wierda Valley, 2196
T +27113848000

Eugene du Plessis
Partner and head of tax: Johannesburg
E eugene.duplessis@za.gt.com

AJ Jansen van Nieuwenhuizen
Partner
E aj@za.gt.com

Louis van Manen
Partner
E louis.vanmanen@za.gt.com

Doné Howell
Partner
E done.howell@za.gt.com

Norma Church
Director
E norma.church@za.gt.com

© 2013 Grant Thornton International Ltd. All rights reserved.

This information has been provided by member firms within Grant Thornton International Ltd, and is for informational purposes only. Neither the respective member firm nor Grant Thornton International Ltd can guarantee the accuracy, timeliness or completeness of the data contained herein. As such, you should not act on the information without first seeking professional tax advice.

Grant Thornton International Ltd (Grant Thornton International) and the member firms are not a worldwide partnership. Services are delivered independently by the member firms.