



Global tax newsletter

Welcome to the second edition of the Global tax newsletter.



The purpose of this new publication is to keep our international tax practitioners and their clients up to date on world tax developments which impact businesses globally. It has been a busy time for many governments around the world issuing their respective budgets.

Tax authorities have also been very busy with pronouncements, rulings, and audits of international companies.

Finally there have been significant developments in the world of transfer pricing, treaties, and indirect taxation.

Against this background of continuous change, multinational companies and their international tax advisors must keep pace to revise tax strategies and structures in order to optimise global tax efficiencies.

To find out more about the topics featured in this newsletter do not hesitate to get in touch with our team. The contact details are included on the last page of this newsletter.

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Partial retreat by Swedish Supreme Administrative Court (SAC) concerning treaty override



Background



A long established principle in Swedish taxation law is the so called “golden principle”, stating that a tax treaty has precedence over domestic law if the treaty limits the right to taxation under Swedish law.

In the OMX-decision from 2008 the SAC however reached the conclusion that domestic law had precedence over a tax treaty since the domestic provision had been adopted into law after the tax treaty went into effect, ie. treaty override. The reasoning behind the decision was that the provisions about taxation of controlled foreign companies had been adopted into Swedish law at a later time than the tax treaty with Switzerland and that the provisions were more specific than the treaty.

Stefan Thomsson
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Clarification

In three decisions the SAC partially retracted and clarified the decision it had reached in the OMX-verdict. The domestic provision in question was the so called ten-year rule. The provision states that Sweden may tax share gains derived upon emigration from Sweden if the shareholder, during a ten year period prior to receiving the share gain, had occupancy in Sweden or, on a regular basis, had spent time in Sweden.

In three applications to the board of preliminary tax rulings the applicants asked if share gains derived upon emigration from Sweden to Greece, Switzerland and Thailand could be taxed in Sweden, with reference to the ten-year rule, even though the Swedish tax treaties with these countries stipulated that such gains should solely be taxed in the other location.

The board of preliminary tax rulings stated, with reference to the OMX-decision, that taxation could take place in Sweden seeing that the ten-year rule was incorporated into Swedish law after the tax treaties with Greece and Switzerland. In the application regarding Thailand the board, on the contrary, found that no taxation could take place in Sweden despite the fact that the ten year rule was incorporated into Swedish law after entering into the tax treaty with Thailand.

Upon appeal the SAC overruled the decisions reached by the board of preliminary tax rulings regarding Switzerland and Greece and declared that the tax treaties had precedence over domestic law. The court confirmed the decision reached by the board of preliminary tax rulings regarding Thailand.

The SAC stated that in general the provisions set forth in a tax treaty should be applied regardless of what has been stated in a later domestic provision. However, if the legislator has clearly expressed that the new provision should be applied regardless of what has been stated in a tax treaty this later provision has precedence. If the intentions of the legislator are not completely clear it should be assumed that the treaty has precedence.

In the cases brought forth the SAC found that there was no clear intention that the ten-year rule should take precedence over the tax treaties and that the treaties therefore had precedence, resulting in the conclusion that the share gains could not be taxed in Sweden.

Conclusion

The SAC's decisions was not taken in plenum, i.e. with all the justices of the SAC, which would have been necessary if the court had wanted to change the precedent set in the OMX-decision. The decisions should therefore be seen as a clarification as to when treaty override is possible. It should be noted that the decisions do not state whether treaty override is possible in a conflict between the Swedish tax evasion act and a tax treaty. This question was sent back to the board of preliminary tax rulings for its upcoming decision.

Stefan Thomsson

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EMEA news

Austria



In Haribo and Salinen the issue addressed was whether Austria's

dividend exemption for dividends at the purely domestic level should also apply to dividends received from the EU and the European economic area (EEA), as well as to dividends received from third countries, such as the United States. In its final judgment in the joined cases, the European court of justice's main findings were as follows:

- dividends received by Austrian corporations from third countries are entitled to the tax benefit if it applies to domestic dividends
- the benefit does not necessarily have to be a tax exemption
- a credit for the tax paid by the dividend distributing corporation upon generating the distributable profit is also sufficient
- the carry-forward of any excess credit must be allowed

- the question of whether withholding taxes on dividends of the source state are taken into account in the resident state is a question of the involved countries' income tax treaties, and not a question of the EU principle of free movement of capital
- requiring an enforcement agreement in order to provide a tax benefit for dividends from EEA member states is not proportionate to the aim of the rule and therefore cannot be a condition for granting the tax benefit.

Austria's Ministry of Finance has published draft legislation proposing to expand the tax exemption for foreign dividends received by an Austrian corporation.

Since 2005, corporations may deduct **interest expenses** even in connection with the acquisition of tax exempt participations. According to the Austrian tax authorities, the privilege of deducting such expenses was used to artificially create business expenditures through a leveraged share purchase within the group, thereby reducing the overall tax burden. The Budget Accompanying Act 2011 has eliminated the possibility of benefiting from such structures, in line with the anti abuse regulation. The amended provision is applicable on all financial years starting after December 31, 2010. Consequently, even interest on loans before 2011 for the financing of intra group share purchases is now excluded.

Belgium



The Belgian Constitutional Court recently rendered two

decisions in which it found **economic double taxation** to be justified. If a Belgian company grants a "non-arm's-length remuneration for the sale of goods or services, the amount of that advantage may be added to its taxable profit. In two Constitutional Court cases, the companies entered into agreements under which they paid monthly management fees. Both companies deducted the fees as business expenses. The tax authorities argued that no actual services had been received by the paying companies and that the expenses were therefore not made or borne in order to acquire or maintain taxable income. The tax authorities disallowed the deductibility of the management fees.

Belgian domestic law provides for a 95% **exemption of the dividends** received if the parent company holds at least 10% of the capital of the subsidiary or participation with an acquisition value of at least €1.2 million. The Taxpayer is a Belgian parent company, which received dividends from EEA Member States, as well as from Japan, Korea (Rep.) and Taiwan. The Taxpayer claimed a carry forward for the excess dividends received deduction (DRD), but this claim was rejected by the Belgian tax administration for the dividends received from Korea (Rep.) and Taiwan. The participations in the Korean and Taiwan companies varied from 50% to 100%. The excess DRD was allowed for the domestic dividends under the EU free movement of capital principal, and for the Japanese dividends under the treaty. The denial of the excess DRD from Korea and Taiwan was upheld and did not violate the Belgian Constitution.

A Belgian **permanent establishment** (PE) that was part of an international group was established to carry out a limited R&D activity for the group's internal projects. The PE intends to apply the cost-plus method and charge the foreign parent the direct and indirect costs with a 5% mark-up. The parent company of the group will remain the owner of all patents granted. The Commission observed that from a functional and risk analysis, it follows that the Belgian PE will only carry out R&D activities. This means that the PE can be classified as a service provider. The Commission held that application of a cost-plus method with a 5% mark-up was at arm's length.

Cyprus



Russia's **thin capitalisation** rules limit or prevent the deduction of interest if a Russian payer fails to pass the debt to-equity test. The Federal Arbitration Court of the Moscow region reversed the long-standing position that the nondiscrimination provisions in income tax treaties override domestic thin capitalisation restrictions. In this case, tax authorities denied the taxpayer's deduction of interest it paid on loans provided by its Cypriot shareholder. The tax authorities asserted that the Russian company, as a 100 per cent subsidiary of the Cypriot company, was managed by the Cypriot shareholder and therefore should be treated as a Cypriot enterprise for treaty purposes. As such, it did not qualify for a tax reduction based on the nondiscrimination clause of the treaty.

Czech Republic



The Czech Supreme Administrative Court issued a decision confirming that a taxpayer is entitled to a tax **deduction for interest expenses** related to loans used to finance dividend distributions and distributions of other equity. The deductibility of those costs has been debated in the Czech Republic for some time. According to the general reasoning of the court, incurred expenses do not always need to be immediately reflected in the income of a taxpayer. Thus, a direct correlation between costs and revenues is not necessary and there is no reason for interest on a loan meant to finance operations and investment costs to be tax deductible but interest on a loan meant to cover dividend payments is not tax deductible.

Denmark



Denmark's National Tax Tribunal dealt with the **beneficial ownership** of

dividends, interest, and royalties paid by Danish companies to nonresident holding companies. A Jersey parent company acquired a Danish group and an internal reorganisation took place under which the ownership of the Danish group, in a series of transactions, was placed under two tiered inactive Swedish holding company structure. The Jersey parent pushed a loan down two levels to the Danish operating subsidiary. The tax authorities asserted that the interest payments were subject to Danish withholding tax because neither holding company was the beneficial owner of the dividends under the Nordic tax treaty or the EU interest and royalties directive. The two Swedish holding companies were deemed to be mere conduit companies. The national Tax Tribunal agreed.

Finland



The Supreme administrative court has ruled that the interest

rate of **an intra group loan** of an individual group company has to be determined based on the credit worthiness of an individual group company and not based on the circumstances of the group. The separate entity principle can be considered to have its foundation in Finland because entities are taxed separately on their income.

On 31 January, the Finnish supreme administrative court (SAC) requested a ruling from the European court of justice in a case concerning the tax treatment of the **cross-border exchange of shares** between a Finnish limited liability company (Oy) and a Norwegian LLC (AS). The request concerns a situation in which the Finnish Company "A" Oy transferred the shares it owned in the Finnish company "C" Oy to the Norwegian company "B" AS (an LLC comparable to a Finnish Oy). In exchange, B AS issued its own shares to "A" Oy. Before the transaction, "B" AS owned 80 per cent of "C" Oy's share capital. If "B" AS were a Finnish company or a company situated in another member state, the provisions concerning the tax neutral exchange of shares would be applied. But since that is not the case, the exchange of shares may generate taxable gains for "A" Oy.

France



The French tax administration (FTA) provides guidelines for a

special tax system for multinational companies' **French headquarters** that are responsible for managing, leading, coordinating, or controlling the business activity of the group within a specific geographic area. On approval of the FTA, a headquarters' taxable results can be determined using a simplified rule based on a cost plus margin on service costs to other group companies.

The FTA audited a French headquarters, Seyfert SAS, and determined that some of the expenses it claimed should not have been incurred by the company because they were personal expenses of the shareholders. The FTA recalculated Seyfert SAS's corporate tax liability and determined that the company was responsible for the payment of withholding tax on profits distributed to the CEO and the

CEO's wife because they are not residents of France. The Conseil d'Etat agreed with the FTA.

France's newly published 2011 Finance Act extends the scope of the **French thin capitalisation** rules to loans granted by third-party lenders if the loans are secured by a company related to the French borrower. Under the previous rules, third-party financings did not qualify as related-party loans for purposes of the thin capitalisation rules even when they were secured by parties related to the borrower – which French tax authorities regarded as a loophole. Under the new legislation, loans granted to a French entity by third-party lenders now fall within the scope of the thin capitalisation rules if they are guaranteed by a company related to the French borrower or by a third party whose commitment is itself secured by a company related to the French borrower.

Germany



The European commission has asked the European court of justice (ECJ) to declare that Germany's discriminatory tax treatment of **foreign pension funds** violates EU rules on the free movement of capital. The issues are the German rules according to which dividends paid to pension funds subject to limited tax liability (non-resident funds) and interest which is paid to such pension funds and to pension insurance schemes subject to limited tax liability are taxed less favourably than dividends or interest paid to pension insurance schemes subject to unlimited tax liability (domestic schemes) or pension funds subject to unlimited tax liability.

There is a German **reorganisation** clause, or "Sanierungsklausel", under German corporate tax law that enables an ailing company to offset losses in a given year against profits in future years despite changes in its shareholder structure. The clause departs from the general principle in the corporate tax law of Germany, among other EU countries, that prevents the carry forward of losses for fiscal purposes precisely when there has been a significant change in the shareholding structure of the company concerned. This is to prevent companies avoiding taxes by taking over failed companies for the sole purpose of using their fiscal carry-forward value.

Greece



The European Court of Justice (C-155/09) has held that by granting an **exemption to transfer taxes** on immovable property to permanent residents, Greece violated EU guarantees on the freedom of establishment and the freedom of movement, among other provisions of the EC Treaty.

New provisions will apply to the taxation of corporate profits based on **financial statements** for periods ending December 31, 2010. Profits of domestic public and private limited companies (SAs and LTDs) will be taxed differently depending on whether they are retained or distributed. Retained profits will be taxed at a 24 per cent rate, while distributed profits will be taxed at a 40 per cent rate. The corporate income tax rate on retained earnings will be reduced

by one percentage point per year until it reaches 20 per cent for accounting periods commencing after January 1, 2014. Profits of previous years that are distributed starting January 1, 2011, will be taxed at a rate of 40 per cent less the corporate income tax paid when they were accrued. The same rates will apply to profits of a branch of a foreign company that are remitted or credited to the head office.

Ireland



The Irish Revenue has issued guidance on amendments made by the Finance Act 2011 to the corporation tax treatment of interest on **intra group loans** used to finance the acquisition of assets from another company in the group.

The Court of Appeals for southeastern Norway found that a **permanent establishment** was created when a resident company (Dell AS) acted as a commissionaire for a nonresident principal (Dell Products). Dell Products is incorporated in the Netherlands but is resident for tax purposes in Ireland. Dell AS is resident in Norway. Both companies belong to the same group; both are sub-subsidiaries of Dell Computer Corp. Dell AS sells products in Norway as a commissionaire for Dell Products. The income of Dell AS was taxed in Norway.

However, because the Norwegian tax authorities claimed that Dell AS also acted as a PE for Dell Products, Dell Products was also taxed in Norway. The court used Article 5 of the Irish-Norwegian treaty.

Italy



The 2010 budget allows EU-resident companies to set up and begin business activities in Italy requesting the application of **another EU country's tax law** in lieu of the Italian tax regime. The law provides that request and ruling process be filed and that:

- the ruling will be legally binding for three fiscal years
- the applicant may seek to apply any other EU country's tax regime, and not only that of the country where the company is resident
- the request will affect only federal corporate taxes, and not regional, provincial, and local taxes.

Luxembourg



The Luxembourg direct tax authorities issued a circular which clarifies the tax treatment of Luxembourg **group financing** companies. The circular applies to group companies whose principal activity consists of intra-group financing transactions. Mixed holding or financing companies will be subject to the circular, whatever the ratio between their holding and intra-group financing activities. This general part of the circular sets out three main principles: (1) functions performed by group financing companies regarding borrowing and on-lending are in substance comparable to those performed by independent financial institutions; (2) group financing companies must perform a risk analysis, which will affect their remuneration; (3) the financing company should be able to bear that risk, which means that it should have enough capital to be able to face the risk.

Liechtenstein

Liechtenstein has introduced a **major tax reform**. The new taxation system entered into force on 1 January 2011. To a large extent, the former tax privileges have been abolished. The new taxation system is fully compliant with EU law.

General taxation

Corporate income tax at a flat tax rate of 12.5 per cent with a minimum tax of CHF 1,200.00. Relief of this minimum tax can be obtained if the balance sheet total is less than CHF 500,000.00.

This is a very attractive tax base. In particular:

- a) gains resulting from sale of participations are tax free (no minimum holding period and no minimum shareholding requirement)
- b) dividend income is tax free without limitations

- c) a notional interest deduction of four per cent can be made on interest income (thus interest income is only taxable income in as far as the rate is above four per cent)
- d) from gross royalty income, 80 per cent can be booked as expenditure in case the intellectual property is publicly registered
- e) attractive group taxation rules
- f) unlimited loss carry-forward
- g) no withholding taxes on distributions, interest or royalty payments.

Private asset structures ("PAS")

A new regime for Private Asset Structures ("PAS") has been introduced. It is only eligible for legal entities which passively administer their private assets, respectively for entities which are not undertaking an economical activity and are not owned by an entity which is undertaking a commercial activity.

This regime has been formally approved by the competent European authorities and the PIS therefore is EU-approved. A PIS is only subject to the minimum corporate income tax of CHF 1,200 per year and will not be assessed.

Trusts and partnerships

Legal Structures without their own legal personality (such as trusts) are not assessed for tax and are only subject to the minimum tax of CHF 1,200.00 per year. Partnerships are taxed at the level of their partner(s).

Considering the Tax Act and the treaties which have been concluded and which are in the process of being concluded, it might become increasingly interesting to use Liechtenstein for the purposes of international tax planning.

Malta



Under the Malta tax model, a standard onshore Maltese

company is taxable on its income at the standard rate of 35 per cent. This is also true for profits derived by a Maltese company from passive sources situated outside of Malta and for profits allocated to a foreign permanent establishment of a Maltese company. However, the Maltese company's shareholder – either another Maltese company or a foreign company or individual – can claim a tax refund of either 6/7 or 5/7 of the corporate taxes paid by the Maltese company. That means that the shareholder receives a reimbursement of 25 per cent or 30 per cent of the taxes paid.

The German Parliament enacted an amendment to the **German controlled foreign corporation (CFC)** rules that specifically targets Maltese companies taking advantage of the imputation system. As a consequence of the amendment a German resident company or individual is deemed to have received a dividend from the Maltese intermediary company. These deemed distributions are not granted the same relief that applies to cash dividends.

Netherlands



A Dutch limited company is a group finance company that

granted a US-dollar loan to an affiliated company in Brazil. The interest income derived from the loan was subject to a 15 per cent Brazilian withholding tax. A currency loss was incurred on the principal amount of the loan. At first, the company took the currency loss into consideration in calculating its Brazilian withholding tax credit, using the currency loss to reduce the amount of interest income on the loan. The company then raised an objection to the tax assessment, claiming that the amount of interest it received should not be reduced on the basis of the **currency loss**. The lower court ruled that the currency loss should be taken into account in calculating the credit. The higher court ruled in the same manner as the lower court. The advocate general

ultimately concluded that the connection between the interest income and the currency loss is so insignificant that the currency loss cannot be considered a cost associated with the interest income.

The shares of a taxpayer were owned by a Swiss company, "Z" AG. The taxpayer purchased shares of various Dutch BVs and paid approximately €7.5 million for goodwill. To finance the purchase, the Taxpayer borrowed €6.5 million from "Z" AG. The taxpayer and the Dutch BVs opted to be treated as a **fiscal unity** from the moment of the purchase of the shares. The taxpayer is the parent company of the fiscal unity. The taxpayer claimed a deduction for the interest paid to "Z" AG. The tax inspector rejected part of that deduction based on the Dutch thin capitalisation provision, because the taxpayer was excessively financed with debt and the loan was obtained from a related

company. The taxpayer reasoned that the debt was not excessive because the goodwill should be taken into account, although the goodwill was lost as a result of the establishment of the fiscal unity. The court observed that with respect to the application of the thin capitalisation provision to a fiscal unity, the fiscal equity of the fiscal unity is decisive. The court held it was irrelevant that the goodwill paid and exploited by the taxpayer was lost as a result of the establishment of the fiscal unity.

Norway



Under Norwegian law, when a company transfers its seat to another EEA State in order to relocate its activities, unrealised capital gains on its assets must be included in the taxable base of that financial year. Furthermore, a tax on unrealised capital gains on the company's shares must be paid by its shareholders. In contrast, capital gains on assets or shares of similar domestic transactions are not taxable until they are realised. The EFTA Surveillance Authority Norway ruled Norway is in breach of the EEA Agreement by imposing an immediate tax on companies, or the shareholders of companies, that **transfer their seat to another EEA State**.

Poland



Poland has introduced additional conditions for applying the **withholding tax ("WHT") exemption on dividend payments** (resulting from implementation of the EU Parent-Subsidiary Directive into Polish Law. A dividend paid to an entity which is tax resident in Poland, the EU or any EEA country (Norway, Ireland or Lichtenstein) will be exempt from Polish WHT if, in addition to the existing conditions:

- the company receiving the dividend is not tax-exempt in its country of residence on all of its income, regardless of source

- a legal basis exists for obtaining tax information from the tax authorities of the dividend recipient's country
- the recipient of the dividend directly owns shares in the Polish company.

The reduced five per cent WHT rate on interest and royalties will also apply to an EEA country (i.e. Norway, Iceland, Lichtenstein). The three conditions above must also be met for interest and royalties.

Portugal



Concerns whether Portuguese **withholding** of corporate income tax

at 15 per cent on dividends paid to a nonresident company, while exempting **dividends** paid to residents, violates the freedom of movement of capital, freedom of establishment, and the parent subsidiary directive. The payer of the dividend was a Portuguese company that was acquired by a Spanish acquirer. The European court of justice has summarised its order which it held that in light of the Portugal-Spain income tax treaty, Portugal's rules on the deduction at source of corporate income tax for a nonresident company violate the EC Treaty. The Portugal-Spain treaty does not provide full credit for withheld tax.

Russia



The Russian Ministry of Finance (MOF) issued public Guidance

clarifying the corporate **taxation of nonresident legal entities** operating in Russia for the benefit of a third party. The MOF stated that if a nonresident legal entity carries out free of charge preparatory and/or ancillary activities for third persons in Russia that result in the creation of a permanent establishment in Russia, the corporate tax base for those activities should be determined as 20 per cent of the expenses incurred by the PE in connection with those activities.

The MOF adopted Guidance clarifying that **foreign athletes** who receive honorariums for participating in tournaments produced by a foreign legal entity in Russia are subject to individual income tax in Russia. Russian tax residents and individuals who are not Russian residents but who earn income from Russian sources are treated as individual income tax payers in Russia. The MOF therefore clarified that income obtained by individuals from their participation in tournaments held in Russia qualifies as Russian-source income, which is taxable in Russia regardless of whether the individuals receiving the income are Russian tax residents.

South Africa



Recent changes have removed barriers to **South Africa acting as a**

holding company jurisdiction for African investments. The barriers included: the controlled foreign corporation (CFC) rules, the secondary tax on companies (STC), and the thin capitalisation rules. The traditional inbound structure included: an Offshore holding company; a South African holding company which was a subsidiary of the offshore holding company; and African subsidiaries of the South African holding company. The recent amendments overcome the tax leakages of the traditional structure by having the South African holding company established as a headquarter company. To qualify:

- each shareholder of the South African holding company must hold 20 per cent or more of the equity share capital throughout the tax year
- 80 per cent or more of the base cost value of the assets of the South African holding company must represent equity or debt investments in foreign companies
- and at least 80 per cent of the total receipts and accruals of the South African holding company must be derived from foreign subsidiaries including management fees, interest, royalties, dividends, and the proceeds from the sales of shares in those foreign subsidiaries or from the sale of intellectual property.

As long as the South African holding company qualifies as a headquarter company, the following tax concessions will apply:

- the foreign subsidiaries of the South African holding company will not be treated as CFCs
- dividends declared by the South African holding company to its foreign shareholders will be exempt from secondary tax, or the new dividends tax, when it comes into effect
- the South African holding company will not be subject to the thin capitalisation rules when it on-lends its loan capital to foreign subsidiaries.

Sweden



Corporate tax rate

Since 1 January 2009 the Swedish corporate tax rate has been 26.3 per cent. However, the effective tax rate is somewhat lower after deducting a maximum of 25 per cent of the annual net taxable income to an “accruals reserve”, which must be brought back to taxation within six years.

Depreciation

Depreciation on fixed assets and acquired goodwill is allowed using two different principles. The first principle allows a fixed deduction of 20 per cent a year, meaning that from a tax standpoint, an asset is written off during a five year period. The second principle allows for a deduction of 30 per cent on a declining balance, meaning that in principle the asset will never be fully written off. A change from one principle to the other may occur.

Depreciation on buildings ranges from two to five per cent depending on type and use. No depreciation on land is allowed. Stock in trade is valued at cost or market value, depending on which is lower, or at 97 per cent of acquisition cost on a first-in first-out basis.

Consolidation

A Swedish company is seen as a separate tax entity meaning that consolidation of company groups for tax purposes are only allowed under certain conditions. In brief, consolidation is only allowed for qualifying groups, ie. where the holding of capital exceeds 90 per cent during the entire fiscal year. If those conditions are at hand it is possible to offset operating profits from one Swedish company against another Swedish company with an operating loss by using group contributions. In this context companies within the European economic area are regarded as Swedish companies if the recipient is taxable in Sweden.

No tax on dividend and share gains

In 2003 Sweden abolished capital gains taxation for shares held for business reasons meaning that under certain conditions share gains and dividends are exempted of taxes. This also means that capital losses on these shares are not deductible.

Unquoted shares are always considered held for business reasons whereas quoted shares are considered held for business reasons if the holding corresponds to at least ten per cent of the voting right or the shares are held in the course of the business. In order to be tax exempt the quoted shares must be held for one year.

Controlled foreign companies

The regulations regarding controlled foreign companies have been adopted to make sure that resident Swedish shareholders with holdings in low-taxed foreign companies are taxed in Sweden.

The regulations state that a Swedish tax resident will be taxed on a yearly basis for the result in the controlled foreign entity. Such taxation requires that the Swedish resident, directly or indirectly has a holding of at least 25 per cent (capital or voting) in the foreign company. A foreign entity is regarded as low-tax if it levies taxes under 14.47 per cent. Certain approved countries, listed in an appendix to the regulation, can levy taxes under 14.47 per cent and still not be considered low tax countries. If a "real business" is carried out through an office located within the European Economic Area the entity is not considered a low-tax entity.

Sweden has lately entered into 30 information exchange treaties with so called tax havens. This has had the result that many Swedish tax residents with assets abroad have brought the assets back for taxation in order to avoid the penalty that is levied for not declaring assets and gains.

Debt and interest

No debt to equity ratio applies for tax purposes. Civil legislation however requires that a company can not lose more than half of its registered share capital without facing compulsory liquidation.

The Swedish tax system generally allows deduction for interest cost on debt. An anti-debt regulation adopted in 2009 means that deduction for interest payments on any intra-group loans related to acquisition on shares from an affiliate is refused unless the creditor is taxed for the interest at a rate of at least ten per cent or is commercially viable.

Withholding tax

Withholding tax is not levied on interest payments abroad. Nor are share gains taxable in Sweden in the hands of a foreigner selling Swedish shares.

Swedish withholding tax on dividends to foreign shareholders is generally levied at 30 per cent but is reduced or waived in most tax treaties.

Paid out royalties from Swedish source are taxed in Sweden as income from a permanent establishment and taxed at the regular corporate tax rate (26.3 per cent). The receiver is obliged to file a Swedish income tax return.

EU directives

The parent/subsidiary directive and the interest/royalty directive are of great importance when taking advantage of a Swedish company.

Switzerland



The Federal Supreme Court decided a case involving a **dual resident**

taxpayer.

The taxpayer, a Swiss national residing in Switzerland, moved to Singapore for professional reasons.

Under Swiss law, an individual is subject to unlimited tax liability as a resident if he has his permanent or temporary residence in Switzerland. The criteria used to determine whether an individual is resident in Switzerland is the intention to stay permanently. To determine such intention, the tax authorities look at the centre of the individual's personal and business interests.

Under the laws of Singapore, an individual is resident in Singapore if he:

- is physically present in Singapore for at least 183 days, or

- exercises an employment (other than as a director of a company) in Singapore for at least 183 days, or
- resides in Singapore except for temporary absences that are consistent with the claim to be a resident.

The Supreme Court rejected the appeal and ruled in favour of the tax authorities. The Court found that the taxpayer continued to be employed in Switzerland.

The taxpayer visited the municipality of prior residence for private reasons several times and retained full ownership of his former home. The court also considered that the planned time to be spent in Singapore was limited to three years and all changes in the commercial register concerning the taxpayer always stated the municipality of prior residence in Switzerland as the taxpayer's domicile.

Turkey



The Turkish tax authorities published detailed guidelines

interpreting and clarifying transfer pricing rules. The guidelines describe in great detail the format and contents of the new Turkish tax authority (TTA) sample transfer pricing report, and specify what the annual documentation reports should contain in which chapter. The TTA suggests that taxpayers adhere strictly to the sample report format to avoid future complications.

The TTA also emphasised its preference for the use of internal comparables whenever possible. The TTA insists on a thorough investigation of internal comparables by the taxpayer before it can move on to external comparables.

The documentation obligations for each type of taxpayer are listed in greater detail, with an emphasis on the fact that the documentation reports should be prepared annually.

United Kingdom



The Income tax appellate tribunal (ITAT) delivered a ruling in 'Wizcraft

International Entertainment Pvt. Ltd. (ITA No. 3208/MUM/2003)' on whether tax should be withheld on **payments to a non-resident agent** of foreign performing artistes.

The ITAT held in favour of the taxpayer and confirmed that the agency fees paid were not part of the fee payable to the foreign artistes and thus, taxable under the tax treaty, and that fees paid to an agent for services performed outside India were not taxable in India. The ITAT also held that the reimbursement of expenses were based on actual costs and as such, should not be subject to tax in India.

APAC news

Australia



The National Australia Bank (Bank) issued **Exchangeable capital**

units (Units) through its UK subsidiary to investors in the US and Europe. The securities had a AU\$25 principal amount, paid a 7.875 per cent rate, and were convertible, on or before 26 March 2007, into Bank ordinary shares at a rate of 1.6365 shares per unit. Following the issuance, the UK subsidiary forwarded the capital to the Bank under a loan arrangement.

As a result of the transaction, the Bank claimed interest deductions for the payments to the UK subsidiary. The tax authorities disallowed the interest expense deduction relating to the raising of capital. The transaction closely resembles an arrangement by St. George Bank which lost an appeal of the Australian Tax Office decision denying its claimed interest deductions.

The federal court of Australia opinion in St George Bank explained that the transaction allowed the bank to raise capital while producing interest deductions on the capital. As a result the Bank settled its long standing dispute with the Australian tax office.

The government will attract more investment by encouraging foreign-based companies to establish **regional headquarters** in Australia, as well as making Australian businesses with foreign entities revise the rules concerning legislation relating to Controlled Foreign Company (CFC) and Foreign Accumulation Fund (FAF) rules.

These reforms will improve the competitiveness of Australian companies with offshore operations by reducing the costs of complying with the CFC rules and will also encourage foreign groups to establish regional headquarters in Australia and improve Australia's attractiveness as a continuing base for multinational companies.

Illinois Tool Works Inc. (ITW), a US Fortune 200 global diversified industrial manufacturer employs more than 60,000 people worldwide. ITW's revenues totaled \$15.9 billion in 2010, with more than half of these revenues generated outside of the United States. The Federal Court of Australia issued a favourable decision regarding the Company's dispute with the Australian Taxation Office over income tax deductions in connection with an **intercompany financing** transaction. As a result, there will be significant allowable tax deductions.

China



China is considering new tax incentives to boost the development of

strategic industries.

The seven strategic industries designated by the state council are:

- energy saving and environmental protection
- new-generation information technology
- biotechnology
- high-end equipment manufacturing
- new energy
- new materials
- alternative energy vehicles.

The new tax incentives for strategic industries will include various policies covering enterprise income tax ("EIT"), value-added tax ("VAT"), business tax ("BT") and consumption tax. Among these policies, the most significant incentive is the expanded "3+3 tax holiday" (a three-year tax exemption followed by a three-year 50 per cent tax reduction) in EIT.

The State council of the people's republic of China recently released a new notice announcing new and renewed tax and non tax incentives for investment in the software and semiconductor industries in China. Existing incentives include:

- VAT refunds for domestic sales
- income tax holidays
- reduced income tax rates
- income tax deductions
- income tax refunds upon reinvestment
- exemption for import VAT and customs duties.

The recently announced new and renewed tax incentives include:

- business tax exemption on services
- new tax incentives for equipment manufacturing, testing and packaging
- special ten per cent tax rate
- bonded customs treatment.

Hong Kong



The rapid expansion of **Hong Kong's double tax agreement (DTAs)**

network is likely to create tax planning opportunities for global corporations. Consider a recently issued advance ruling.

The company is incorporated in Country "X" and is a wholly owned subsidiary of Company "A". The Company engages in the manufacturing, marketing, licensing and distribution of computer hardware and software in the Asia Pacific region. The company does not have any office or employees nor does it perform any business activities in Hong Kong directly or through an agent. Currently the company maintains a datacentre in Country "X" ("the country "X" Datacentre") providing hosting and storage services in Country "X". Company "B" is a company incorporated in Hong Kong and has been a wholly owned subsidiary of company "A".

The Company entered into a service agreement with company "B" for the latter to set up a Datacentre in Hong Kong ("the HK Datacentre") and provide maintenance, repair and replacement services for the HK Datacentre. The HK Datacentre mainly consists of computer hardware and networking equipment.

Company "B" will recruit an employee who will be based in Hong Kong. The employee will work with the third party company to monitor the hardware system maintenance, repair and replace the hardware pertaining to the HK Datacentre.

The company pays company "B" a service fee equal to all of company "B's" costs plus a mark-up of five per cent in return. The cost base in calculating the service fee consists of all the expenses incurred by company "B" including the depreciation cost of the HK Datacentre.

The service income earned by company "B" from the company is fully taxable in Hong Kong. Company "B" does not have and will not be given any authority to negotiate or conclude any purchase or sale contract on behalf of the company, or negotiate, conclude or execute any contracts with customers of the company or any other companies within the group. Company "B" does not carry out any profit earning activity on behalf of the company in Hong Kong.

The company will not be subject to tax in Hong Kong by reason of the arrangement nor will they be deemed to be carrying on business in Hong Kong by reason of the arrangement.

India



Classic Credit Ltd. (“CCL”) sold shares in the market. To meet the delivery of shares, it requested Global Trust Bank (GTB) to lend its shares. GTB credited the shares to the account of the CLL’s broker directly. In its tax return GTB treated the transaction as **lending of shares** and the value of shares was shown in the balance sheet as investment. The tax commissioner was of the opinion that the transaction resulted in sale and capital gains tax was imposed. The tribunal held that the lending of shares cannot be construed as transfer within the definition of “transfer” giving rise to capital gains tax.

Verizon provides **international connectivity services** through leased lines for data and voice communications. Under India’s telecommunications regulations, those services can be provided in India only by licensed entities, and the Indian customers must enter into subscriber agreements with Indian companies that are licensed to provide similar services in India. Verizon entered into separate, individual agreements with Indian customers that required international connectivity between their Indian and offshore offices. The Indian portion of the circuit services was provided by the licensed Indian telecommunications company (Indco), and the offshore portion of the services was provided by Verizon. Verizon installed the necessary systems and equipment at Indco’s premises to allow for the joint provision of services. The Indian customers paid fixed rental charges and usage charges separately to Verizon and Indco for their services.

The systems and equipment were installed at the customers’ premises by Verizon, which retained ownership of the equipment. The appellate court held that the payments that Indian subscribers made to a Singapore-based telecommunications company for the use of dedicated leased lines are in the nature of royalties and are subject to withholding tax in India.

Indonesia



Indonesia’s Tax Court issued a decision denying the application of the 0 per cent **withholding tax rate on interest** in the Indonesia-Netherlands tax treaty. The Tax Court held that PT Indosat, incorrectly applied the lower withholding tax rates available under the treaty for interest payments to Indosat Finance BV (IFC BV), which was domiciled in the Netherlands during fiscal year 2004, because IFC BV was not the beneficial owner of the income. The tax authority had argued that IFC BV should be deemed an Indonesian tax resident because Indonesia was its place of effective management based on the fact that its shareholders and its place of strategic decision-making were in Indonesia. The court ruled the beneficial

owner is the real owner that is economically able to enjoy the income and that income would thus be subject to tax in its resident country. The court held that IFC BV is only a conduit company because it does not enjoy and control the interest it receives from Indonesia.

Japan



Representatives from **Hong Kong** and Japan signed the first **double tax agreement (DTA)** between the jurisdictions. The major highlight of the Hong Kong-Japan DTA, particularly for Hong Kong residents investing in Japan, is the reduced withholding tax rates levied on dividend, interest, and royalty income. Japanese domestic tax law currently levies a 20 per cent withholding tax on such income. Other benefits of the DTA include a narrower permanent establishment definition, the ability to claim a foreign tax credit in Hong Kong on tax paid in Japan, and mutual agreement procedures.

New Zealand



There are new rules for **look-through companies**, which were part of recently enacted legislation in the taxation (GST and remedial matters) Act 2010. Under the look-through rules, the company's tax treatment is integrated with the tax treatment of the owners, on the basis that entities are agents for their owners. It ensures that shareholders who use a company's losses also pay tax on any company profit at their marginal tax rate. This removes the tax disincentive faced by the owners of closely held businesses who wish to operate through a company. They can attain the benefits of limited liability afforded by a familiar corporate form, as well as the ability to be taxed at the level of the owner.

Singapore



The Minister for Finance announced that businesses will have the option to defer a dollar of current year of assessment tax for every dollar of **Productivity and Innovation Credit (PIC)** qualifying expenditure incurred for the current financial year. The deferral is capped at SGD 100,000. The tax will be deferred and is due for payment when the first assessment for the following year of assessment is raised. The deferral option is available for years of assessment 2011 to 2014 based on the expenditure incurred in the corresponding financial years 2011 to 2014.

A **foreign tax credit** (FTC) pooling system will be introduced under which FTC is computed on a pooled basis for each particular stream of foreign income remitted into Singapore. The amount of FTC to be granted will be based on the lower of the pooled foreign taxes paid on the foreign income and the pooled Singapore tax payable on such foreign income, subject to the resident taxpayer meeting certain conditions.

Taiwan



Many acquisitions have been completed by **leveraging significant debt**, which is then consolidated and assumed by the acquired company. In almost all cases, profits of the acquired companies have decreased significantly. A new article of the Income Tax Act was enacted. This puts a cap on borrowings from related parties, at the discretion of the Ministry of Finance (“MOF”). Interest expenses resulting from excessive borrowings will not be tax deductible. The MOF has preliminarily set the cap at three times the level of shareholders’ equity.

Thailand



Thailand has enacted legislation that provides new tax incentives for regional operating headquarters. The special regime is available on request to Thai companies and partnerships that:

- provide general business management
- procure raw materials and parts
- conduct product research and development
- provide technical support
- conduct marketing and sales promotions
- provide personnel management and training in regional areas
- provide financial advice
- analyse and research the economy and investment
- manage and control credit
- provide other support.

Under the new tax regime, the reduced ten per cent corporate income tax rate is granted for income from services provided to onshore affiliates, while the full corporate income tax exemption is available for income from services provided to offshore affiliates or branches. Under the old tax regime, only the reduced ten per cent tax rate was provided for income received from services; no full tax exemption was available. The reduction or exemption under the new tax regime is given for ten years, which may be extended to 15 years if, in the tenth accounting period, the regional operating headquarters has operating expenses totaling more than THB 150 million paid in Thailand.

Vietnam



Before 2009, taxpayers could skip the **loss carry forward** during a tax holiday or reduction period. A loss in 2003 could be carried forward from 2004 to 2008, but if the taxpayer was eligible for a tax holiday in 2004 and 2005, the taxpayer could choose to carry forward the loss only in the remaining years 2006, 2007 and 2008. The five-year period remains unchanged under the new enterprise income tax law. However, a decree and a circular state that the loss carry forward period is consecutive. More recently, the Ministry of Finance issued an official letter which states that a loss incurred from 2009 onward must be carried forward entirely and consecutively in the subsequent five years.

On January 1, 2009, the requirement that services must be consumed outside Vietnam to be eligible for 0 per cent VAT was eliminated. Instead, services directly provided to organisations or individuals in foreign countries became subject to 0 per cent VAT. Organisations in foreign countries are defined as those that have no Vietnamese permanent establishment and don't pay Vietnamese VAT. Individuals in foreign countries are foreigners not residing in Vietnam or overseas Vietnamese residing outside Vietnam when certain services are provided. Therefore, service providers must determine the PE or residency status of foreign clients when applying the 0 per cent tax rate.

Americas news

Argentina



Argentina's **Financial transactions tax** (FTT) applies a 0.6 per cent rate

on bank accounts debits and credits. There is also a provision designed to charge a 1.2 per cent tax on any organised payment systems aimed at circumventing the use of bank accounts. In La Angostura S.R.L. the taxpayer whose main commercial activity was the retail of gas had paid its providers with cash deposits in their checking accounts and with third-party checks. The tax authorities only focused on the former deposits in cash and issued a notice of deficiency. By depositing the cash, the tax authorities determined that the taxpayer was circumventing the use of its own checking account and should be taxed at the 1.2 per cent rate.

The facts of the case clearly showed that the paying system was not chosen by the taxpayer but was the only remaining option considering its size and market. The tax court noted that the taxpayer had the right to handle its business the less burdensome way, as there was no evidence of intent to circumvent the use of bank accounts. Accordingly the position of the tax authorities was not allowed.

Barbados

Barbados is a jurisdiction commonly used for making commercial investments into China. Barbados is used by shareholders located in Canada, USA and Europe because of its favourable treaty network with these jurisdictions. Barbados also has a **favourable treaty with China**. Several China tax offices have been denying corporate applications to qualify Chinese sourced dividends for the five per cent rate offered under the Barbados-China income tax treaty. The denials are on the basis that the Barbadian companies are offshore entities with no substance and cannot be recognised as the beneficial owner of the dividend stream.

Under the circular a company is treated as a conduit company if it is established mainly in an attempt to evade or reduce taxes or to shift or shelter profits. Such companies generally do not conduct actual business activities such as manufacturing, purchases and sales, and management. Thus taxpayers with Barbadian/China structures should examine the functions carried out in Barbados.

Bermuda

Bermuda was recently the subject of extensive publicity as a **tax efficient location** for several multinationals. Bermuda was described as a favourable location with Double Irish or Double Dutch structures. Under these structures the Irish subsidiary invoices customers and pays a royalty to Dutch related parties which in turn routes the royalty to an Irish related party which has its centre of management in Bermuda. The royalty remittances into the Irish-Bermudan resident company suffer minimal withholding taxes along the way and are not subject to tax in Bermuda.

Brazil



Brazil's federal revenue department, in a recent private letter ruling dealing with software, clarified the tax treatment of imports of customised **software**. The Ruling says that imports of customised software are subject to withholding tax, the Program for Social Integration contribution (PIS), and the Contribution for the Financing of Social Security (COFINS) normally levied on imports of services (the hiring of foreign service providers), as well as the ten per cent royalty tax (CIDE).

Brazil's Federal Revenue Department issued another private letter ruling dealing with **software** exempting a taxpayer from the PIS and COFINS

normally levied on imports of goods and services in cases involving technology transfers. This ruling says the PIS and COFINS levied on imports do not apply to payments of royalties abroad because royalties do not fall into the definition of imports of goods or services.

A recent private letter ruling addressed the tax treatment of **cost-sharing** agreements between a Brazilian company and its affiliates. The ruling distinguishes between shared costs of the parent company and shared costs purchased from third parties. The ruling addresses the treatment of shared costs in terms of the nine per cent social contribution on net income (CSL), the PIS, and the COFINS.

Brazil's federal revenue department also published a clarification that exempts a taxpayer from the PIS and COFINS normally levied on imports of services (the hiring of foreign service providers) in cases in which the result of those services takes place outside the country. In the relevant case, the taxpayer had imported advertising services for commercials to be broadcast outside Brazil.

Canada



An **amalgamation** is generally considered to be tax deferred if:

- all property (except amounts receivable from, or any shares of, any predecessor) of the predecessors immediately before the merger becomes property of the amalgamated corporation by virtue of the merger
- all liabilities (except amounts payable to any predecessor) of the predecessors immediately before the merger becomes property of the amalgamated corporation by virtue of the merger
- all shareholders (except any predecessor) who owned shares of any predecessor immediately before the merger receives shares of the amalgamated corporation because of the merger

The recent decision of the tax court of Canada in *en vision credit union* addressed tax consequences to an amalgamated corporation flowing from an amalgamation that was deliberately structured to fail to qualify as a tax-deferred amalgamation.

A **Dutch co-op** can provide tax advantages to Canadian investors. Dividends paid by a Dutch co-op to a Canadian shareholder are exempt from Dutch domestic withholding tax whereas dividends from a Dutch BV to a Canadian shareholder are generally subject to five per cent dividend withholding tax under the Canada-Netherlands tax treaty. The imposition of foreign dividend withholding tax is a concern to Canadian-resident shareholders because this tax is usually not creditable in Canada under Canada's exempt surplus regime. It is important for the co-op to be characterised as a corporation for Canadian tax purposes) as opposed to, for example, a partnership.

The Canada revenue agency has confirmed in an advance tax ruling that the conversion of a Dutch company into a cooperative under the Dutch civil code could qualify as a tax-deferred reorganisation of capital under the Canadian income tax act; thus, the conversion would not trigger tax on Canadian-resident members of the company.

Chile



The Brazil-Chile **social security agreement** entered into force. The

treaty provides that individuals are subject to the social security laws of the country where they perform their work. One of the exceptions is the temporary transfer of individuals between the two countries. The treaty provides that such individuals are subject to the social security regime of their home countries as long as their compensation continues to be paid from the same home country and temporary work does not exceed two years.

Colombia



Interest payments made by Colombian taxpayers on loans from foreign

financial institutions and under **international financial leasing agreements** are not considered Colombian-source and thus most Colombian taxpayers could qualify for an effective exemption of tax withholding on any interest payments made to foreign financial institutions. The National council for economic and social policy changed the rules regarding withholding tax on interest payments made to foreign financial institutions. The decree stated that the general 33 per cent withholding tax rate will apply to most interest and leasing payments.

Mexico



The Mexican circuit court issued a ruling in a constitutional procedure

regarding the interpretation and application of the **permanent establishment** concept in the Mexican income tax law and Mexico's income tax treaties for services rendered in Mexico by a foreign (US) resident for a period exceeding 12 months. A US company, resident in California, entered into two agreements with a Mexican government institute to render strategic consulting services in the field of public politics, in particular the design and implementation of information technology systems. The circuit court established that there was not enough permanence for the existence of a fixed place of business. The Circuit Court therefore ruled that the US company has no permanent establishment in Mexico.

Peru



Until December 31, 2010, **interest paid** by a Peruvian-resident

corporate taxpayer to a nonresident individual was subject to a 30 per cent withholding tax in all cases. As of January 1, 2011 a reduced rate of 4.99 per cent applies unless the payment arises from a transaction carried out from or through a tax haven, or if the payment arises from a transaction with a related party, in which case the rate remains 30 per cent.

Peruvian-source interest from credits and loans paid to a nonresident entity is generally subject to a 4.99 per cent withholding tax if all of the following requirements are met:

- there is evidence that the funds entered Peru
- the loan accrues an annual interest rate that does not exceed the rate of the market in which it originated, plus three points
- the loan is not between related parties.

Puerto Rico



Claiming that a balanced distribution of the tax responsibility is needed

in order to promote economic development, the Puerto Rico legislature and governor enacted new legislation concerning the **sourcing of income** to Puerto Rico. It is the intention that the funds generated pursuant to the provisions of this Law will help fund, in great part, the tax benefits promised to individuals and businesses in Puerto Rico. The introduction to the law states the reason for the changes in the sourcing of income rules for Puerto Rico income tax purposes in the case of specified transactions that involve related parties.

This change will consider as Puerto Rico source income a portion of the worldwide income of a nonresident alien or foreign corporation or partnership if such individual, corporation or partnership is deemed to have an office or fixed place or business in Puerto Rico as a result of the application of the new rules. The reasons: in general, the Puerto Rico source income of these groups of entities should be computed on the group as a whole and not only based on the entity(ies) that operates in Puerto Rico.

Uruguay



Uruguay maintains **free trade zones** which are popular for supply chain structures coming into Latin America. The Uruguayan offshore company known as the SAFI was of the used in conjunction with such zones whereby the company engaged in offshore activities and paid a tax of 0.3 per cent of taxable net worth. The SAFI regime came to an end on December 31, 2010 but the tax consequences of the SAFI can be maintained with an ordinary corporation the assets and activities of which are offshore. Foreign sourced income and foreign located assets of an ordinary Uruguayan corporation are not subject to income, net worth and VAT taxes.

USA



The IRS in recent years has increased its focus on the reporting of foreign financial accounts by US persons, as evidenced by its renewed emphasis on the reporting of foreign financial accounts on **Form TD F 90-22.1**, "Report of Foreign Bank and Financial Accounts. US persons may be required to report financial interests in or signature authority over foreign financial accounts to the IRS. Treasury issued final regulations that clarify reporting requirements for foreign financial accounts. In part, the final regulations:

- clarify who must file reports of foreign financial accounts, and which accounts are reportable
- exempt some persons having signature or other authority over foreign financial accounts from having to file the reports
- include provisions intended to prevent US persons from avoiding the reporting requirements.

A US parent company assigned its French subsidiary to a new Danish holding company in exchange for shares and a €315 million vendor note. Shortly afterward, the French subsidiary distributed a €315 million dividend to its new Danish parent. Simultaneously, the Danish parent subscribed to **bonds redeemable in shares** for the same amount, with a seven-year term. The bonds carried interest at the euro interbank offered rate plus 50 basis points. The amount of interest was capped for each financial year at an amount not exceeding the profits of the French subsidiary and its own 95 per cent-owned subsidiaries. The subscription price of the bonds was paid by the Danish parent to offset its €315 million dividend receivable. Shortly after the subscription, the Danish holding company assigned the bonds to its US parent company in exchange for the repayment of its vendor note. The French subsidiary also distributed a second exceptional dividend one year later for €277 million.

The French tax authorities challenged the tax deductibility of the interest accrued on the bonds under the abuse of tax law theory and argued that the interest should be recharacterised as dividends. The French committee on abuse of law upheld the French tax authorities' position on the recharacterisation of the interest into dividends.

Where a US shareholder owns a **controlled foreign corporation (CFC)** and the CFC makes an investment in US property, the investment can be recharacterised as a dividend to the US shareholder. This is a provision of a recently released IRS legal memorandum. The taxpayer, a US entity, is a distributor of information technology products and services.

Taxpayer develops software in the United States pursuant to a cost sharing agreement (CSA) with its wholly-owned foreign subsidiary, a CFC. Pursuant to the CSA, the CFC acquires the rights to exploit copyrights in the US when the taxpayer has completed development of a software product intended for sale to end-user customers, a final version of the software code is transferred to a "gold master" disk and sent to CFC. CFC then reproduces and sells copies of the software to end-user customers in the United States. The definition of United States property includes any right to use intangible property in the US that is acquired or developed by a CFC for use in the US. The IRS advised that software sales to US customers by a controlled foreign corporation do not constitute an investment in US property.

An investment in US property occurred when the CFC acquired the rights to exploit the intangible property as a result of entering the cost-sharing agreement. However, no further investment in US property occurred when such rights – having already been acquired – are later used, resulting in sales to customers located in the United States.

Venezuela



The Venezuelan government recently **devalued the rate of the national currency**, the Bolivar. The devaluation rate resulted in US1.00=VEB4.30 for most imports. The devaluation action will result in taxable consequences for a multinational with Venezuelan operations.

Transfer pricing news

Hungary



The Hungarian ministry of finance introduced new regulations

regarding transfer pricing **documentation** requirements that entered into force January 1, 2010. The new ministerial decree completely replaced the transfer pricing provisions of the previous legislation, which were in force since 2003. However, the basic principles and some of the fundamental rules are essentially the same as they were before. Some taxpayers are obliged to set the arm's-length price and other relevant circumstances of controlled transactions in a register document the contracts that have been concluded with associated enterprises, and those taxpayers have to make the documentation available to the tax authorities immediately on request.

The obligation applies only to enterprises that are at least of medium size. This means that small companies are generally relieved from the burden of preparing transfer pricing documentation. If a taxpayer fails to prepare the required transfer pricing documentation, the default penalty can be applied. If the taxpayer produced some documentation but it does not comply with all the regulations, they can be penalised. And finally, if taxpayers breach their obligation by not making documents available to the tax authorities, a penalty can also be levied.

Luxembourg



Luxembourg is used very often by multinationals in international

structures for intra **group financing**. The Luxembourg tax authorities recently published a transfer pricing circular that provides essential guidance for intra group financing activities. Considering that the Luxembourg market is largely used to locate intermediary financing activities, the circular applies to many Luxembourg taxpayers and transactions.

India



India introduced a number of proposed amendments to the

current transfer pricing regime. Under the current regime, a taxpayer applies the most appropriate transfer pricing method to determine the arm's length price (ALP) in a transaction with a related party. If more than one price is determined by the chosen method, the ALP will be the mathematical mean of the two prices. If the actual transaction price is within five per cent of the ALP, the actual price can be considered as the ALP. The bill proposes to eliminate the five per cent variation standard and to empower the government to prescribe an allowable variation per cent for different businesses and types of transactions. The finance bill also introduces some anti avoidance

provisions. Most notably, any entity located in a country or territory designated as a tax haven by the Indian government would be deemed to be a related party for purposes of transfer pricing. Consequently, all transactions with that entity would have to be carried out at arm's length and would be subject to the usual documentation requirements. A country or territory will be designated as a tax haven if it does not effectively exchange relevant information with India.

Brazil



Some Brazilian transfer pricing legislation does not necessarily meet international standards. Some interpretations by the tax authorities do not meet the standards provided for by the local legislation itself. **The PRL60 (resale price method at a 60 per cent fixed margin)** transfer pricing method is an example of this, and so far, the development of the issue in the courts has brought some unpleasant surprises for taxpayers. The PRL60 method was created in 2000. It is used by taxpayers and the tax authorities in assessing a maximum cost on importations from nonresident related parties.

In late 2002, the Federal revenue department (FRD) replaced previous regulations with an instruction which is the tax authority's interpretation.

Under the instruction, there are conflicts with the law. Given the contradictory formulas for the PRL60 method calculation, taxpayers have considered two courses of action over the years: going ahead with the calculation in accordance with law 9,430 with the intention of going before the administrative courts if a notice of infraction is issued, or filing a lawsuit in the judicial courts to address the matter in advance of any future tax inspection.

OECD

The OECD's committee on fiscal affairs has launched a new project on the administrative aspects of transfer pricing. This project includes the following:

- a survey is currently being conducted of the administrative simplification measures that countries have developed in the transfer pricing area
- an Internet-based platform for transfer pricing administration was developed by the OECD to facilitate the sharing of information and experience among tax officials on the administrative aspects of transfer pricing, including issues such as the organisation of transfer pricing audits, the development of risk assessment techniques, the design of transfer pricing documentation requirements, the setting up of advance pricing arrangement programmes, etc

- the OECD is reviewing the existing guidance on safe harbours in Chapter IV of the OECD transfer pricing guidelines (“TPG”) with a view to possibly updating it in order to reflect the experience acquired since 1995.

Italy



The Italian government has issued Guidance on Choosing the appropriate transfer pricing method.

According to the circular there are two different **categories of methods** – basic methods and alternative methods. The basic methods include:

- price comparison method
- resale price method
- cost-plus method.

The alternative methods include:

- comparison of profits
- profit splitting
- gross margin of the economic sector
- yield from invested capital.

Under the circular, the adoption of alternative methods is supplementary to basic methods: They are used to avoid any uncertainties deriving from the application of basic methods or if the basic methods are not applicable.

Indirect taxes

Finland



In Finland, generally the **provider of a service** is liable to account for VAT.

When reverse charge mechanism is applied for certain types of construction services, the buyer will be liable for VAT instead of the seller. The reverse charge mechanism is applied to supply of construction services between entrepreneurs from the main contractor to downwards in each stage of the chain. The supply from the main contractor to subscriber is subject to VAT. The reverse charge mechanism will be applied if the construction work has started on April 1, 2011 or later. However, if the work has started before, and remains unfinished at that date, the reverse charge will not be applied. The reverse charge will apply on construction services supplied in Finland:

- when the construction work is performed in Finland or when construction workers are hired out to perform construction work in Finland
- when the buyer is selling construction services on an ongoing basis in Finland.

The reverse charge will not apply to sales of goods or to sales of construction services to private individuals. In addition, the reverse charge mechanism will not apply if the construction services are purchased by an entrepreneur, which provides construction services only on a temporary basis.

The change will also affect the periodic tax return (VAT return). The return will include separate boxes for the VAT in the construction sector.

China



China's State Administration of Taxation published a

bulletin which states that a taxpayer that **transfers part or all of its assets and related creditors' rights**, liabilities, and labour resources in a merger, split-off, or other reorganisation is not subject to VAT on the disposal of the related property. The bulletin abolished a prior circular, which provided that a taxpayer would be subject to VAT on the sale of taxable property in an asset reorganisation that involved the transfer of the taxpayer's assets, liabilities, and other relevant rights and obligations.

India



A Constitutional amendment Bill, was placed before the

Parliament by the Finance Minister. The Constitution of India does not provide concurrent powers of taxation to the Union and the States. The Bill proposes to amend the constitution to empower the Union and States to frame laws for levying **goods and service tax** ("GST") on transactions involving supply of goods and services. The Bill is a crucial step by the government to ensure introduction of GST regime by 2012 in India.

Luxembourg



Planzer was a Luxembourg company operating in the freight forwarding business in the European Union. It was a wholly owned subsidiary of Planzer AG, a Swiss company operating in the same business. Planzer had its registered office in Luxembourg and maintained that its place of establishment for VAT purposes was also in Luxembourg. Planzer's business activities in Luxembourg consisted of:

- its registered office in Luxembourg and office premises available to it in a business centre where other Swiss freight forwarders were similarly registered
- its two managers spent little time in the Luxembourg office

- two other persons resident in Luxembourg did work on behalf of Planzer, including bookkeeping and administrative activities
- also, five persons worked part-time for Planzer as freight drivers
- the vehicles for the transport of air freight were registered in Luxembourg
- Planzer's accounts were drawn up in Luxembourg at the registered office
- Planzer was registered for VAT and filed VAT and corporate income tax returns in Luxembourg
- Planzer received a certificate of residency for income tax treaty purposes from the Luxembourg authorities.

Planzer maintained that it had an establishment in Luxembourg for VAT purposes and no VAT taxable presence in Germany. The German VAT authority argued that Planzer's presence in Luxembourg did not constitute an establishment for VAT. The regional tax court upheld Planzer's appeal. The ECJ concluded that the place of a company's business is "the place where the essential decisions concerning its general management decision are taken and where the functions of its central administration are exercised".

Following the ECJ's guidance, German regional tax court in its second decision agreed with the German tax authority in holding that Planzer did not demonstrate that it had a business in Luxembourg.



Treaty news

UK



The UK Government will bring forward a new provision to prevent tax avoidance through the interaction of relief for pension savings and the provisions of certain double taxation arrangements. The new clause will provide that, notwithstanding the terms of a double taxation arrangement with another territory, a payment of a pension or other similar remuneration may be taxed in the United Kingdom where:

- the payment arises in the other territory
- it is received by an individual resident of the United Kingdom
- the pension savings in respect of which the pension or other similar remuneration is paid have been transferred to a pension scheme in the other territory

- the main purpose, or one of the main purposes, of any person concerned with the transfer of pension savings in respect of which the payment is made was to take advantage of the double taxation arrangement in respect of that payment by means of that transfer.

The UK court of appeal in test claimants in the thin cap group Litigation has reversed the UK High Court, finding that UK **thin capitalisation** rules that restricted tax deductions for interest paid on loans to UK subsidiaries of company groups based in other EU member states and not covered by bilateral income tax treaties do conform with EU law. The court of appeal, in a 2-1 majority judgment, accepted HM Revenue & Customs' argument that the European court of justice in test claimants in the Thin cap group

litigation found that thin cap legislation is permitted under EU law if it affects related-company transactions that are conducted on terms other than arm's length.

Belgium



The taxpayer, a resident of Belgium, operated an orthodontist practice in the Netherlands. The taxpayer was a director-employee of that practice. The only shareholder of the practice was A Holding BV, which was in turn 100 per cent owned by a Belgian company, A Holding BVBA. All the shares of A Holding BVBA were owned by the taxpayer and her spouse. Following an audit, the declared wage for the taxpayer was increased, and a supplementary assessment was imposed. The taxpayer argued that the **deemed wage provision** is incompatible with the good faith principle under treaty, which was rejected by the tax inspector.

The lower court rejected the taxpayer's argument that the deemed wage tax provision constituted an unilateral extension of the taxing rights of the Netherlands. The court of Appeal confirmed the decision of the lower court.

France



A French company in liquidation distributed, after payment of its debts, the remaining proceeds to its sole shareholder, a Swiss resident (taxpayer). The French tax authorities (FTA) considered this outbound payment to be a **constructive dividend** covered by the Treaty definition of dividends. The liquidation proceeds received by the taxpayer were, as a result, subject to a withholding tax at a reduced rate of 15 per cent. The taxpayer claimed that such payments were not genuine dividends, but that they should be classified as “capital gains” or “other income” for treaty purposes (i.e. exemption in the source state). The court ruled in favour of the FTA and held that the definition of “dividend” provided by the treaty encompassed constructive dividends as defined by domestic law. The FTA were therefore entitled to apply a withholding tax on the liquidation proceeds derived by the taxpayer.

Netherlands



The taxpayer was employed by a government university (“the University”). The University was privatised. The taxpayer became a resident of Thailand and received a pension from his past employment with the university (“the Dutch pension”). The taxpayer was employed both pre and post privatisation at the University. The taxpayer did not include the Dutch pension in his Dutch tax return arguing that the Dutch pension was only taxable in Thailand. The Dutch tax inspector argued that the Dutch pension was taxable in the Netherlands. The Treaty provides that **pensions** paid to a resident of one of the states shall be taxable only in that state. The Treaty further provides that pensions paid by one of the states or a political subdivision to any individual in respect of services rendered to that state in the discharge of functions of a governmental nature may be taxed in that state.

The lower court considered that the “pre-privatisation pension” was built up under a government service. Therefore, the court held that the pre-privatisation pension is taxable in the Netherlands. In addition, the court observed that the University after its privatisation still qualified as a public entity although the services rendered by its employees are no longer considered as a “government service”. Therefore, the court held that the “post-privatisation pension” built-up constituted a private pension, which is taxable in Thailand.

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