Global tax newsletter

Welcome to the third edition of the Global tax newsletter.

A common theme emerging from tax developments around the world relates to tax enforcement, information sharing, and increased audits and enforcements.

Some of the common provisions found globally include:

- increased penalty provisions and penalty amounts
- restrictions on advanced rulings processes and procedures
- curtailment of appeals processes within the tax administration
- introduction of substance over form into legislation
- step transaction doctrine increased usage
- tax position disclosure reporting
- increased tax agent training
- required registration of tax professionals
- required tax audit reports by CPA's submitted to tax authority in addition to tax return
- faster tax examination through e-filing
- general anti-avoidance rule (GAAR) introduced into more jurisdictions.

As you look at this publication you will find many of these provisions are dealt with by the jurisdictions covered in this edition.

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

Ian Evans
Global leader – tax services
Grant Thornton International Ltd

Go to page...

2 Brazil featured article
3 Italy featured article
4 EMEA news
16 APAC news
22 Americas news
28 Transfer pricing news
32 Indirect taxes news
36 Treaty news
42 Who's who

Mega sport events in Brazil and tax incentives

Brazil is now the focus of direct and indirect investments due to the rise of new social classes, new investments in energy and sporting events like the World Cup and Olympic Games.

The federal government is encouraging companies and professionals involved in projects related to sporting events and in December 2010 enacted Law 12,350 and, more recently, the 1173 Normative Instruction in July 2011.

The Act aims to establish new tax incentives for companies wishing to take advantage of business opportunities with the realisation of the 2013 FIFA Confederations Cup and 2014 FIFA World Cup taking place in Brazil.

The measures associated with various tax incentives already in place, comprise a complex set of strategies and tax benefits that result in a competitive advantage for companies working on projects directly or indirectly related to these events.

These innovations include federal tax exemptions on the importation of goods or merchandise for exclusive use or consumption in the organisation of the events.

The combination of these taxes can get tax relief to approximately 49-55 percent depending on the products or goods. Other exemptions were granted to FIFA itself. The incentive tax programme was also awarded to service providers that FIFA established in the country in the form of a special-purpose company for the development of activities directly related to the realisation of income at events, including an exemption from federal taxes, income tax and social, IOF, and contribution to PIS and Cofins.

The exemption applies only to taxable events arising from the activities themselves and directly connected to the organisation or holding of events and special requirements are necessary to become eligible for those benefits.

The fact is that companies are rarely aware of these incentives. Recent studies show that many businesses ignore the existing tax incentives, or sometimes do not use them because they do not have consistent tax and accounting information to enable calculation of the amounts eligible for the tax incentives. As an example, there are tax incentives for technological innovation that only from 2010 have recently gained greater visibility by companies.

Currently, there are various ancillary obligations, legal and tax requirements that sometimes frighten the local entrepreneurs, but foreign investors often see the country as an opportunity to focus on consistent and long term investment. However, it is necessary that the executives responsible for the financial and tax areas and entrepreneurs, understand the range of tax holidays and benefits that arise from the Brazilian economy and that they are prepared for a competitive environment, where the knowledge of tax laws is a difference in decision making and winning new projects and business.

VAT and income tax developments

VAT developments

A number of Italian VAT developments have occurred within the past several months.

New measures have been put in place that are intended to fight VAT-related avoidance in transactions with black-listed countries. All taxpayers trading with persons or entities operating in tax havens are now required by law to file a special report with the Inland Revenue Office by electronic means.

The electronic filing is mandatory for any and all VAT payers carrying out purchase and sales of goods and/or services with economic operators established, residing or domiciled within a black-list territory.

The scope of application of this measure encompasses any and all transfer and purchase of goods and services, including all importations and exportations as well as transactions that do not meet the territorial requirement for VAT purposes. As for contents, the information/data to be notified includes:

- the counterparty's taxpayer code (or any other identifying code)
- the overall amount of the sale and purchase with separate indication of taxable, non-taxable, VAT'able and VAT-exempt transactions for both the seller and the buyer
- the VAT amount payable for each party.

Force of attraction doctrine

Another interesting development in Italy relates to this income tax principle. A provision was recently enforced which is meant to encourage foreign companies to start doing business in Italy. According to this new provision, any EU-resident company can now apply for the tax regime currently in force in one of the EU member states to be applied in lieu of the Italian one. Companies that are fiscally resident in Italy are not allowed to apply for this option. The international ruling allowing benefit from this provision is valid for three fiscal years. Companies are entitled to apply for this optional regime provided that they fulfill various conditions.

EMEA news

Austria

Austria's income tax law provides a list of items that are considered operating expenses and may be deducted from profit. Donations from operating capital that are given to certain research and educational institutions are deductible operating expenses only if the recipients are Austrian institutions. The European Court of Justice (ECJ) held that Austria has violated EU and European Economic Area provisions on the free movement of capital by restricting tax deductions for donations to research and educational institutions to institutions located in Austria.

Belgium

A Belgian company granted call options to a manager resident in Belgium. The manager had to pay an option premium equal to a deemed taxable benefit-in-kind for stock options granted. As a result, the manager was not taxed at the time of granting of the call options.

The court of appeal took the view that the option premium immediately had to be included in the taxable profits. It held that the option premium was equal to the taxable benefit-in-kind. Therefore, the court held that the premium had to be immediately taxed as definitively realised profits, because the amount of the premium was not related to the risk of the option.

Bulgaria

The Customs Agency withdrew Lukoil's licence to operate a tax warehouse. Legislative amendments approved in 2010 required facilities that produce or store spirits and fuels to have meters that monitor the quantities, in order to calculate the exact amount of taxes and excise duties owed. The deadline for installing such meters was September 2010, but Lukoil asked for a further delay of implementation until the end of 2011, which was denied. The Sofia Administrative Court ruled to suspend the execution of the Customs Agency's decision to withdraw Lukoil licence to operate a tax warehouse. The Sofia Administrative Court said that Bulgaria's sole petrol refinery owned by Russian oil company Lukoil, should still have its licence until its dispute with the Customs Agency is settled.

Cyprus

A recent Russian guidance letter demonstrates the importance of having Cyprus as a strategic location for Russian investments. The Russian Ministry of Finance adopted a guidance letter clarifying whether a Cypriot legal entity and an Estonian legal entity that does not operate in Russia through permanent establishments create a gain which results in taxable income in Russia if they sell to a Russian legal entity their stakes in Russian entities. The Ministry of Finance stated that under the 'Tax Code', income earned by a non-resident that does not conduct business in Russia through a permanent establishment (PE) from the sale of shares in resident legal entities, is not treated as Russian-source income. The Ministry of Finance therefore held that a Russian legal entity that purchased from a Cypriot or Estonian legal entity that does not operate in Russia through a PE, should not withhold and pay corporate tax on income paid to the non-resident legal entities for the purchased stakes.

Czech Republic

The Czech Supreme Administrative Court issued an important decision outlining certain principles for the application of the beneficial ownership concept in tax treaties. The UK company, International Power plc transferred its shares in a Czech joint-stock company, International Power Opatovice a.s., to a Dutch entity, National Power International Holdings B.V.. Once this Dutch entity became a UK tax resident, it transferred these shares to International Power Holdings B.V., which was tax resident in the Netherlands. The Czech tax authorities took the position that International Power Holdings B.V. was established solely for the purpose of avoiding withholding tax on dividends before the Czech Republic joined the European Union.

The Czech Supreme Administrative Court highlighted that the evidence collected by the Czech tax authorities was not sufficient to support their conclusions.

Denmark

In a recent ruling dealing with the issue of beneficial ownership, a Danish company was held by two non-resident holding companies via another non-resident intermediate holding company. The ultimate corporate shareholders and the intermediate holding company were all resident in the same country.

The Danish company requested a ruling as to whether the dividends it would pay to the intermediate holding company would be subject to withholding tax in Denmark.

The issue was whether the intermediate holding company was the beneficial owner of the dividends paid by the Danish company and would, as such, qualify for a reduced withholding tax rate under a tax treaty, or an exemption from withholding tax under the directive, considering that the intermediate holding company was to subsequently redistribute most of the dividends to its two corporate investors, and finally to the ultimate investors.

The government concluded that as the redistributions were premeditated, the intermediate holding company and its two corporate shareholders were merely conduit companies.

Egypt

The Egyptian Cabinet recently approved a measure that would have introduced a capital gains tax (CGT) starting on 1 July, the start of the new fiscal year. The CGT was to be set at 10 percent and would have accompanied tax increases aimed at funding the budget's 25 percent increase in spending on the poor. The Egyptian stock market did not react well to the CGT news, which triggered the largest fall in over seven weeks. Reacting to strong objections by investors and the Egyptian Exchange, the Egyptian government announced that it had scrapped the planned 10 percent capital gains tax on dividends and revaluations of assets in mergers and acquisitions.

Estonia

The European Commission announced that it sent Estonia a request to amend Estonia's discriminatory tax provisions for non-resident investment funds. Under Estonian law, investment funds resident in Estonia are tax exempt in respect of their real estate income, whereas comparable funds, established in other EU member states or EEA countries are subject to tax. The Commission considers that these rules could dissuade citizens from investing in funds established in other EU member states or in EEA countries and is thus contrary to:

- the free movement of capital
- the freedom to provide services.

If Estonia does not satisfactorily respond to the reasoned opinion within two months, the matter may be referred to the ECJ.

Finland

The Finland Supreme Arbitration Court ruled that a Finnish company's Singapore subsidiary was not covered by the tax rules in Finland's Controlled Foreign Corporation Act because the Finance Ministry decree on blacklist countries had not yet entered into force. The issue was whether Singapore could be considered a jurisdiction with a level of taxation that significantly differed from Finland's company taxation in the absence of the decree.

A Finnish limited liability company (A) owned 100 percent of the share capital of a Dutch LLC (C). Company C in turn owned 100 percent of the share capital of a Singapore-resident company (B). The activities of B, was to hold and manage the shares of subsidiary companies. Company A had indirect control in B within the meaning of Finland's CFC Act. Accordingly, all income of B could be taxed in Finland as A's CFC income if B Ltd., would be regarded as a CFC. Although the control and income tests for a CFC existed, the effective date for blacklisting had yet to occur for the years under examination.

France

The Supreme Administrative Court ruled on a case in which the French tax authorities had challenged the application of the participation exemption regime. Alcatel CIT, a French holding company, subscribed for new shares issued by Alcatel FinCo, a Belgian corporation acting as a coordination centre for the group, and retransferred those shares after two years to another affiliate of the group for a price corresponding to the acquisition price. Cash amounts contributed by Alcatel CIT upon subscription of the new shares were made available to other entities of the group by Alcatel FinCo through loan agreements, the proceeds of which were exempt from corporate income tax in Belgium, under the specific coordination centre regime.

The subsequent dividend payment made by Alcatel FinCo to Alcatel CIT during the tax year following the subscription of new shares was also exempt in France under the participation exemption regime for which Alcatel CIT had elected.

Under the French participation exemption regime, dividends received by a French corporation from eligible French or foreign subsidiaries are, upon election, excluded from the parent company's tax basis and therefore exempt from corporate income tax, except for a flat portion equal to five percent of the gross dividend, which is deemed to reflect the costs and expenses associated with the shareholding.

The French tax authorities challenged the application of the participation exemption in that situation, claiming that Alcatel CIT had abusively used Alcatel FinCo as an intermediate company to convert taxable financial proceeds into exempt dividends.

The French Administrative Supreme Court held that the subscription of the new shares issued by Alcatel FinCo could not be regarded as fictitious or as exclusively tax-driven because the Belgian coordination centre, with the assistance of 48 employees, actually performed financial pooling and currency hedging functions for the group, generating a BEF 660 million turnover for the tax year.

Germany

The ECJ held a German restriction on the deduction of interest does not violate the EU interest and royalty directive.

SST, a limited liability company, incorporated in Germany, is wholly owned by SSS, a Dutch LLC. SST obtained several loans from and paid interest on those loans to SSS which it deducted as operating expenses in determining its profit.

German tax authorities found that SST was only entitled to deduct 50 percent of the interest claimed in calculating business tax in Germany. SST contested the tax authority decision, contending the addition back of interest to its business tax basis amounted to taxation contrary to the EU interest and royalty directive. The ECJ found that the directive does not preclude Germany's treatment of loan interest paid to an associated company.

Greece

A new tax law provides that expenses of companies arising from transactions with companies established in one of the countries included in the list of the non-cooperating countries will only be recognised as tax deductible under certain conditions. In particular, Greek companies must prove that the transactions are authentic and are effected in the ordinary course of business and do not result in the transfer of profits, revenues or capital to the non-cooperating country aiming at tax evasion or tax avoidance. A similar condition continues to exist for deductibility of expenses relating to transactions with companies established in countries with preferential tax regimes.

Preferential tax regimes are determined as those in which the tax rate is equal to or less than 60 percent of the Greek tax rate, ie 12 percent. Therefore, Cyprus and Bulgaria are considered as preferential tax regimes.

Hungary

Hungary is the first country of the Central and Eastern Europe region to introduce the innovative structure of investment into real estate investment trusts (REITS).

The preferential tax regime available to REITs includes a full exemption from corporate income tax (except for transfer pricing adjustments) and local business tax. It follows that corporate or individual income tax may only be payable by the shareholders of a REIT in the form of capital gains (for individuals or companies) or withholding tax on dividends (for individuals only). Additionally, all real estate acquisitions by REITs are subject to transfer tax at the preferential two percent rate (as opposed to the generally applicable two percent and four percent progressive rates).

Iceland

The European Free Trade Association (EFTA) announced that it had approved, under the Icelandic State Aid Guidelines on research and development and innovation, a scheme by Iceland under which companies carrying out research and development projects may apply for a tax credit. The credit is 20 percent of ISK 100 million of the costs of the project (the total project costs may be higher). The tax credit is granted against the corporate income tax the company has paid for the year in which the qualifying costs have incurred. The credit is in force from 1 January 2010 to 31 December 2014.

Ireland

The dispute between Ireland and France over Irish corporate tax rates continued when the Irish Prime refused to accept French demands that Ireland increase its 12.5 percent corporate levy which is one of the lowest in the European Union.

France and Germany insisted that in exchange for the financial support as part of the bailout, it is difficult to ask other countries to bail out Ireland when it is determined to keep the lowest tax on profit in Europe.

France and Germany tried to make raising the corporate tax rate a condition for Ireland's multibillion-dollar bailout package. However, that attempt was unsuccessful and was not included in the bailout terms announced by the International Monetary Fund (IMF) and the European Commission.

Germany and France have also previously insisted that Ireland raise its corporate tax rate of 12.5 percent to 25 percent if it wants a reduction on the bailout interest rate. But Ireland continues to lobby other euro zone countries for support of its corporate tax rate despite the intense political pressure. The competitive Irish corporate tax rate has attracted a large number of US companies, such as Google, IBM, and Intel to base their European operations in Ireland.

Israel

In an Israeli dividends stripping transaction, the taxpayer purchases the shares of a company before the distribution of a dividend by that company. Soon after the purchase, the company distributes the dividend and the taxpayer then sells the shares at their post-dividend value (which is usually lowered by the amount of the dividend). Because a dividend between two companies in Israel is tax exempt and the post-dividend price of the shares is reduced by the amount of the dividend, the taxpayer can record a capital loss without suffering any real economic loss.

The Israeli Supreme Court has held that a company's dividends stripping manoeuvre should be considered a sham transaction. The holding is considered unique because the court's application of the sham transaction doctrine significantly amends the rules. In its previous decisions, the court held that a transaction would not be characterised as a sham transaction if the taxpayer could demonstrate that the transaction had a commercial (non-tax) purpose.

Italy

The Italian Supreme Court recently rendered an important decision concerning an Italian PE. The structure involved an Italian subsidiary operating as both an independent subsidiary of a foreign parent and also as a hidden PE of a nonresident. The court held that the income generated by the hidden PE of the nonresident entity is taxable in the hands of the nonresident's Italian subsidiary if the subsidiary acts as the dependent agent of the nonresident.

The decision contrasts to previous court decisions on the same subject. The decision creates possibilities regarding the concept of taxable person when a foreign entity is found to have a hidden PE in Italy.

Liechtenstein

The European Free Trade Association announced that it approved the Liechtenstein tax deduction scheme for income from intellectual property rights. The tax benefit provides for an expense deduction of 80 percent of the income derived from intellectual property rights. The Association considered that the scheme does not constitute incompatible state aid because the deduction is available to all businesses, irrespective of their size, legal structure and sector. Consequently, the tax benefit does not favour any product or services.

Luxembourg

The ECJ issued a decision in a case that involved the application to a Luxembourg resident company that owned two inland navigation vessels in the ports of Amsterdam and Antwerp, Belgium, but operated its refueling business from Luxembourg. The taxpayer was denied the investment tax credit on the grounds that the vessels were not actually used in Luxembourg. The ECJ concluded that Luxembourg law violated the freedom to provide services principle of the Treaty on the Functioning of the European Union and that Luxembourg cannot deny the investment tax credit on the sole ground that the investment is physically used in another EU member state. In response the Luxembourg tax authorities expanding the geographic scope of the investment tax credit.

Malta

The Inland Revenue announced a new provision for a tax incentive for qualifying expatriates. The tax incentive (ie 15 percent flat income tax rate) was introduced as a further incentive aimed at attracting foreign investment to Malta.

'Qualifying expatriates' who receive employment income in respect of a 'qualifying contract of employment' in an 'eligible office' may opt to be subject to tax on such income at a flat rate of 15 percent, provided that the income amounts to at least €75,000 (excluding the annual value of any fringe benefits and adjusted annually in line with the Retail Price Index). As a further incentive, income derived from a 'qualifying contract of employment' and exceeding €5 million is exempt from tax in Malta. The option is available from year of assessment 2011 (year of income 2010).

The option is available for a consecutive period of:

- five years for EEA and Swiss nationals
- four years for third-country nationals.

Malta introduced a new provision in its Income Tax Act which stipulates that royalty income derived from the licensing of 'qualifying' patents is exempt from tax in Malta. Dividends payable to non-residents out of this exempt income are free of any other form of taxation in Malta.

There are certain conditions that need to be satisfied for the exemption to apply, the more important ones being:

- the patent is eligible as a 'qualifying' patent provided the invention is considered patentable under Maltese law or is the result of Fundamental Research, Industrial Research or Experimental Development
- the patent must be registered (not necessarily in Malta)
- the right to use the patent must be granted to a business for use in a productive economic activity, such as manufacturing, software development and data processing
- each licence must be approved by the competent authority (Malta Enterprise) by way of application.

Netherlands

In a Dutch Supreme Court case, a taxpayer, a company resident in the Netherlands, held participations in other companies and managed and financed those companies which were established in France, Italy, Spain and Switzerland.

The taxpayer requested a loss relief decision from the Dutch tax inspector who indicated that the loss relief possibilities were restricted because the taxpayer was a holding company. The Taxpayer appealed against that decision.

The Court observed that the taxpayer carried out both holding and financing companies. Thus, the Court decided that the provision at issue is not incompatible with the EU freedom of establishment.

Separately, the Dutch Government released their plans for the budget and one of the most significant plans announced are the changes to the 30 percent ruling regulations. The following planned changes were announced:

- the specific expertise test will now be determined by a salary level. The taxable level after application of the 30percent ruling must now be €50,619. This means an increase in the salary level requirements compared to the current situation
- a review period of 25 years will be applicable. This means that periods of previous stay/work in the Netherlands in the last 25 years will be deducted from the maximum 10-year period of the ruling. In practice, this means that fewer or no employees with Dutch nationality will qualify for the ruling
- employees hired from abroad, but within 150 kilometres from the Dutch border, will no longer be eligible for the ruling. This may affect (future) employees hired from not only Belgium and Germany but potentially also from Denmark, France Luxemburg and the UK
- doctoral candidates under the age of 30, who obtain their doctorate and find a job within one year of obtaining their doctorate and have a taxable salary of at least €26,605, will qualify for the ruling. This covers not only doctorate graduates from Dutch institutions, but also doctorate graduates from foreign institutions. The text of the new regulations will be released at a later date this year and will hopefully provide more guidance on the current plans.

Norway

The current exit-taxation rules are applicable if a Norwegian tax resident company transfers the effective management (tax residency) to another country, either by reallocating or by a cross-border merger. The company's assets and liabilities are regarded as realised for tax purposes (all hidden reserves). The shares of the company are also regarded as realised for the shareholders of the company.

Recently the Norwegian Tax Directorate concluded that shareholders resident in Norway could not be taxed on capital gains on shares in a company that moved from one foreign state to another with so-called company law continuance. The ruling says, such an emigration of companies does not amount to a realisation of the shares, which is required for a taxable capital gain to arise. This means that the company is neither liquidated in the exit state nor incorporated in the other state.

Poland

In recent years, Polish partnership forms were extensively used as tax-efficient vehicles allowing for tax neutral transfers of assets and stepped-up tax values. Some of the new partnership legislation provides that:

- in-kind contributions to partnerships are income tax neutral (both for corporate and individual partners)
- the tax valuation of assets contributed to partnerships should be continued in accordance with the principles applied by the contributing party
- tax-deductible costs at the moment of disposal of assets by the partnership should be based on the historical acquisition costs of the contributing party
- distributions of liquidation proceeds by the partnerships in cash are tax neutral whereas in regards to in-kind proceeds taxation is deferred until a subsequent disposal by the former partner.

Portugal

According to Portugal's Corporate Income Tax Code, nonresident corporate bodies are subject to corporate income tax on income sourced in Portugal. Dividends paid by entities resident in Portugal to nonresident shareholders are considered to have been sourced in Portugal. Such dividends are subject to withholding tax at a rate of 21.5 percent, or to the lower rate in the relevant income tax treaty.

The Tax Code clarifies that dividends paid to resident pension funds are not subject to withholding tax provided that the payer of the dividends is notified of the exemption. The European Commission argued that the difference in the Portuguese tax treatment of dividends paid to domestic and foreign pension funds makes investment by foreign funds in Portuguese companies less attractive and therefore constitutes a restriction that is not justified by any overriding reason of public interest presented by the Portuguese government. A ruling by the European Court of Justice is the next step in this controversy.

Russia

Shareholders of Russian companies are facing the same economic consequences as other parts of the world. A recent Russian tax letter ruling could be found of assistance to shareholders of Russian companies. The receipt of assets, work, or services without consideration is generally subject to profits tax. Among the exceptions is the receipt of assets from a majority shareholder. As a rule, profits tax also arises on any forgiveness of debt, but court practice and a number of clarifications from tax authorities have confirmed that if a debt of a Russian company is forgiven by its majority shareholder, this is not a taxable event, being equated to a tax-free receipt of assets from that shareholder. The Russian Federal Tax Service has issued a letter that states the forgiveness of debt by a shareholder or participant simultaneously with an increase in the debtor's net assets is not subject to tax provided the shareholders intentionally brought about the increase.

South Africa

The revenue authorities have always audited realisation companies with suspicion, due to taxpayers who sought to use the label 'realisation company' to characterise their assets as capital when they were actually trading assets. The advantage of disposing of assets through a realisation company is that the proceeds may be treated as capital for tax purposes instead of as fully taxable proceeds of revenue transactions.

South Africa's Supreme Court of Appeal revisited the question of the tax status of realisation companies, holding that a company's proceeds from the sale of land were taxable as gross income because the company had been formed for the sole purpose of acquiring, developing, and selling the land at a profit.

Spain

The treaty on the Functioning of the European Union, which applies to the Canary Islands, does not allow any difference between the taxation of local products and the taxation of products from Spain or other member states. However, the treaty provides the possibility of introducing specific measures for the Canary islands.

The treaty authorised Spain to apply, up to 31 December 2011 for exemptions from or reductions in the tax to certain products produced locally in the Canary Islands. Highly dependent on the revenues from tourism, the global economic crisis of 2009 had severe consequences on the economy of Canary Islands, with its impact in the reduction of travelling, . The reduction of the tourism sector work force has led to a major increase in the unemployment rate in Canary Islands.

Spain has submitted a request to the European Commission to extend the period for another two years and the Commission concluded that it is justified to grant this request.

Sweden

Volvo, a Swedish based multinational auto maker has seen some recent activity concerning its Brazilian subsidiaries. The issue involves whether Brazilian law discriminates against foreign investors despite the existence of a tax treaty.

The case was filed by Volvo do Brasil Veículos Ltda, the Brazilian subsidiary. The taxpayer is challenging the levy of a 15 percent withholding on dividends paid to nonresident equity holders when no such taxation applies to resident equity holders.

Volvo do Brazil claims that the nondiscrimination of the Brazil-Sweden tax treaty would prevent the levy of the 15 percent withholding tax imposed.

The lower court opinion ruled that the tax treaty would not apply to the case and accepted the government's argument that domestic tax law did not discriminate based on nationality (which would be the underlying right protected by the Brazil-Sweden tax treaty) but rather on residency meaning, Swedish nationals would be exempted from the withholding tax if they were residents in Brazil. Consequently, the treaty provisions would not apply to the case.

The case has been appealed to the Brazilian Supreme Court and will give an indication of any treaty investor into Brazil, as to how local courts will view income tax treaties.

Switzerland

Swiss banking laws have been under significant pressure from the US in recent years. The US Department of Justice (DOJ), and the US Internal Revenue Service (IRS) announced that US Federal District Court judges sentenced US individuals to three year's probation for hiding assets in offshore bank accounts. According to court documents and statements made in court, the US individuals filed false tax returns in which they failed to report that they had interests in or signatory authority over foreign financial accounts at Swiss banks, including UBS. They also failed to report income earned on these accounts on their tax returns.

The Swiss Federal Supreme Court has held that the Swiss Financial Market Supervisory Authority (FINMA) acted lawfully when it ordered the disclosure of information about 255 US clients of Swiss bank UBS under a deferred prosecution agreement with the US DOJ. The decision overturns a lower court ruling that FINMA did not have legal justification for breaching Switzerland's bank secrecy laws.

Turkey

From 2009 and thereafter, the investment tax credit mechanism was replaced by a 'reduced corporate tax' system. The requirements under this system varied depending on the region and industry. In order to qualify for the reduced corporate tax, the taxpayer needed an investment incentive certificate. Under the new system, a reduced corporate income tax rate of 20 percent applied. In 2010, a decision of the Constitutional Court considered the application of the investment tax credit to prior years. The Court held that taxpayers can continue to benefit from the investment tax credit for investments made in 2010 and subsequent years provided that they meet the conditions. However, taxpayers cannot benefit from the investment tax credit in 2009 because of the principle that decisions of the Constitutional Court cannot be retroactively applied.

Ukraine

The Ukrainian State Tax Administration (USTA) adopted guidance in which it clarified that fees paid to a nonresident agent for the provision of agency services to a Ukrainian resident are not subject to corporate tax in Ukraine. The Tax Code states that income derived by a nonresident legal entity from Ukrainian sources is subject to corporate tax in Ukraine. Ukrainian source income includes broker, commission, or agency fees paid by Ukrainian residents or the permanent establishments of other nonresidents in connection, with broker, commission, or agency services provided by a nonresident or its PE in Ukraine.

The USTA clarified that agency fees paid by the Ukrainian resident to the nonresident agent in connection with the provision of agency services abroad should not be considered Ukrainian-source income and therefore are not subject to corporate tax in Ukraine.

APAC news

Australia

The Federal Court of Australia reversed a lower court ruling, finding a nonresident individual was not subject to taxation in Australia as a trustee on the Australian-source trust income derived by two nonresident corporations.

The taxpayer is a non-resident of Australia for income tax purposes. He has not lodged income tax returns in Australia and lives and conducts business from Monaco. He and his wife were authorised by the Monaco government to operate an international corporate and trust administration business as a corporate partnership, organised under the law of Monaco, to provide services concerning the creation, management, administration or the running, control and monitoring of foreign companies or other similar foreign structures, having a legal existence as well as trusts.

The taxpayer was involved as director and trustee in two corporations, both were non-resident of Australia for income tax purposes and had brokerage accounts with Australian brokers. There were approximately 676 share buy and sell transactions in Australian shares that are the subject of dispute in these proceedings.

China

A multi agency issued a notice on the tax incentives for the western regions of China. The notice retroactively applies from 1 January 2011. From 1 January 2011 to 31 December 2020, the enterprises which are situated in western regions and engaged in the encouraged industries are subject to enterprise income tax at a rate of 15 percent.

Import of equipment used by the Chinese or foreign investment enterprises engaged in the encouraged industries or privileged projects are exempt from customs duty provided that the amount of import does not exceed the total capital of the importing enterprise.

The western regions include the city Chongqing, provinces such as Sichuan, Guizhou, Yunnan, Shanxi, Gansu and autonomous regions such as Tibet, Ningxia, Qinghai, Xinjiang, Inner-Mongolia, Zhuang minority of Guangxi, Tu-Miao minority of Hunan, En-Shi-Tu minority of Hubei and the Korean minority of Jilin.

The enterprises established before 31 December 2010 may continue to enjoy the incentives of 'two years exemption and three years 50 percent reduction' until these incentives expire. These incentives were granted to the enterprises engaged in transportation, power plants, water conservation, postage and TV media.

Hong Kong

The Hong Kong Inland Revenue Department released a ruling in which it was determined that a company incorporated in Hong Kong, with no directors, office, or staff in the jurisdiction is not liable for profits tax.

The company was incorporated in Hong Kong. Its directors are non-Hong Kong residents with no place of abode in Hong Kong. All the board of directors' meetings are held outside Hong Kong. The company does not maintain any office, employ any staff nor appoint any agent in Hong Kong. The company is a member of group A of which company B, a company incorporated in country X, is its ultimate holding company.

Group A operates a number of websites (the group websites). The group websites are internet-based venues, through which the content providers can upload and post information created by them for access by registered individuals of the group websites (the viewers). All servers used by the group websites are housed in an out-sourced IT facility company in country Y. The intellectual property rights of the group websites are held by company C, a member of group A incorporated in country Y.

The right to operate the group websites is conferred on the company by company C. The company is not required to pay licence fees to company C. The company has entered into service agreements with the content providers (the Agreement) under which the company grants the right to the content-providers to upload and post photographs, video content, biographical information, contact information and other textual content created by them (the contents) in the group websites.

The contents are made accessible to the viewers. Under the agreement, the content-providers are allowed to charge the viewers a fee for accessing the contents. The agreement is not a document physically entered into between the company and the content providers. Instead, the content providers are required to register online in the group websites.

Similar to the content providers, individuals who are interested in becoming viewers can register online in the group websites and enter into agreements with the company. The group websites have never been and will not be supplied to any content providers and/or viewers in or through Hong Kong.

Whenever the content providers have charged a fee to the viewers, the company is entitled to a certain percentage of such fee as service income in return for providing the group websites to the content providers. The company has entered into a service contract with company B (Service Contract), which was concluded outside Hong Kong, such that the entirety of services that the company is obliged to provide to the content providers by virtue of the agreement is subcontracted to company B.

The service contract is deemed to incorporate the agreement, thereby rendering company B to be legally bound by all the terms and conditions established in the agreement.

Company D, a wholly owned subsidiary of company B incorporated in country Z, is responsible for the daily operation of the group websites, including IT and web development services, customer and sales support services. The services are performed in country Z.

All the services, including provision of the group websites to the content providers, processing registrations, design and maintenance of the group websites, handling of questions, complaints and notices to the company etc., required to be provided under the service contract are performed by company B or its group companies outside Hong Kong. No part of the services is provided in Hong Kong.

To ensure that the content providers would pay the service fee to the company, the fee charged to the viewers in accessing the contents is firstly billed by company B on behalf of the company.

The company is required to pay the entire service fee received from the content providers as consideration for services rendered by company B pursuant to the service contract. As such, no profits are earned by the company. Company B would, in effect, deduct the service fee from the amount received from the viewers before paying the balance to the content providers directly outside Hong Kong.

The company has engaged a third party service provider in Hong Kong for company secretarial services and provision of registered office address in Hong Kong.

India

The Mumbai Income Tax Appellate Tribunal has ruled that a portion of fees for technical services paid to a Japanese company is taxable in India as business profits, as the company's Indian PE was involved in the provision of those services.

For further information on this story, please visit India/Japan within the treaties tab of this document.

Indonesia

The government issued a decree which offers tax incentives to taxpayers in five pioneer industries namely:

- base metals
- oil refining and petrochemicals
- renewable resources
- machinery
- telecommunications equipment.

Under the incentive, a new company is eligible for a tax holiday for five to ten years provided it meets the following conditions:

- invests at least IDR one trillion in the above-mentioned pioneer industries
- places funds with an Indonesian bank amounting to at least 10 percent of the total investment amount, which cannot be withdrawn prior to the taxpayer beginning to implement the realisation of his investment
- has been incorporated for at least 12 months prior to the regulation taking effect.

The incentive can be utilised once the taxpayer has commenced commercial operations, which is to be determined in accordance to existing tax rules.

Japan

Japan should serve as a role model, for countries considering switching from a credit method to an exemption method to relieve international double taxation. Prior to April 2009, Japan's international tax system bore a remarkable resemblance to that of the United States. Japan imposed its corporate taxes on a global basis, including taxing dividends from foreign subsidiaries, while avoiding double tax by means of a foreign tax credit system. Japan deferred taxation of profits of foreign subsidiaries until repatriation but restricted deferral for profits of controlled foreign corporations operating in low-tax countries, unless an active business exception applied. It had transfer pricing rules based upon the arm's length principle, broadly similar to the US rules under Section 482 and the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines.

However, on 1 April 2009, Japan moved to a territorial tax regime by adopting a foreign dividend exemption system, pursuant to which 95 percent of the dividends received from qualified foreign subsidiaries will be exempt from Japanese national and local corporate taxes. At the same time, Japan abolished its indirect foreign tax credit system.

The Japanese government concluded that it was vital to encourage the repatriation of profits of foreign subsidiaries in order to assist in revitalising Japan's economy. Policy-makers recognised that maintaining the competitiveness of Japan's multinational enterprises in the global marketplace would ultimately lead to additional investments and job creation. The government was deeply concerned about the increasing compliance burdens imposed by the indirect foreign tax credit system.

Malaysia

The Inland Revenue issued a ruling on the residence status of companies and sets out the following:

- the differences in tax treatment of a resident and a non-resident company
- determination of the residence status of companies
- clarification on what constitutes 'management and control'.
- dual residence and the use of the tie-breaker rule under tax treaties
- required documentation which may assist in determining the residence status of a company when trading and management and control are exercised outside Malaysia but certain directors' meetings are held in Malaysia.

New Zealand

The Supreme Court held that the transfer of the taxpayers' medical practices to companies owned by family trusts was lawful, being a business structure choice that the taxpayers were entitled to make. There was nothing artificial or unusual for companies under the taxpayers' control to pay salaries to the taxpayers. However, fixing the salaries at an artificially low level to avoid paying tax at the highest personal tax rate did constitute tax avoidance The commencement of paying the lower salaries coincided with the introduction of an increase in the top personal income tax rate to 39 percent, while the corporate rate was 30 percent. In addition, the taxpayers maintained control of all of the companies' income and were able to, and did, transfer funds from the companies for their own, and their families' use.

Philippines

Real Estate Investment Trusts (REITs), enjoy special tax treatment and the Bureau of Internal Revenue has issued regulations for them to adhere to. The regulations prescribe the guidelines and conditions for the registration of REITs, the application of tax incentives granted to REITs, the availability of an exemption from dividend tax by an overseas Filipino investor, the application of VAT on gross sales or receipts of a REIT, the withdrawal of the tax incentives and the tax consequences of the delisting of a REIT.

REITs will be subject to a 30 percent income tax, a 12 percent VAT, and a 50 percent discount on the documentary stamp tax (DST). Income will be computed after considering allowable deductions and dividends paid. To receive the tax benefits, REITs are required to consist of a 40 percent public ownership for the first two years of existence, increasing to 67 percent in year three.

Singapore

The Monetary Authority of Singapore issued a circular which prescribes the tax treatment of specific Islamic financing transactions:

- where the effective return or mark-up derived by the financial institution is economically similar to interest in conventional financing, such return or mark-up will be regarded as interest for tax purposes
- where such return or mark-up falls under the definition of 'interest' under the interest article in a tax treaty, the tax treatment in that article of the tax treaty should prevail, subject to the conditions being met
- the supply of goods undertaken in a prescribed Islamic financing arrangement (such as the transfer of non-residential properties, leasing/sub-leasing of non-residential properties) which would not have otherwise arisen under a conventional financing arrangement, would be exempt from GST.

Thailand

The Thai government added another package of tax incentives for Regional Operating Headquarters (ROH) which include:

- reduction of corporate income tax (CIT) from the normal rate of 30 percent on net profits to 10 percent on net profits derived by the ROH on the following types of income:
  - services fees charged to Thai affiliates
  - sub-loan interests received from Thai/foreign affiliates and/or foreign branches
  - royalties on R&D performed in Thailand for the Thai/foreign affiliates and/or foreign branches.

All the above incentives will be applicable for ten consecutive accounting years. Such period may be extended for five years, provided that certain conditions are fulfilled.

- CIT exemption on net profits derived from the services provided to the foreign affiliates and/or foreign branches
- CIT exemption for dividends received by ROHs from Thai/foreign affiliates
- CIT exemption for dividends received by a foreign entity (with no PE in Thailand) which are paid out from the net profits derived from 'Qualified Income'.

Vietnam

The local tax authorities have issued a series of rulings:

- raw materials which are imported by a company to produce goods for export and are transferred to another company during a merger cannot apply the on-the-spot export mechanism. The merged entity can continue to use the same import method after merging. Circular 194/2010/TT-BTC should be followed in the event that the business wishes to change the purpose of the materials after merging
- a Singapore-resident company that transfers its capital from a Vietnamese joint-stock company is only subject to Singaporean tax based on the Vietnam – Singapore DTA
- business entities are not required to issue VAT invoices regarding the fines for breach of contract as they are not considered income from the sale of services
- raw materials purchased by a Vietnamese garment export processing company as authorised by an offshore principal under a toll manufacturing contract may be viewed as production expenses of the local company. Accordingly, the local company may generally claim the VAT regarding the raw materials, provided certain conditions are met.

Americas news

Argentina

The Supreme Court ruled that the minimum deemed income tax is unconstitutional. The minimum deemed income tax is a tax levied at the rate of one percent on assets held at the end of the tax period by the relevant taxpayer. The minimum deemed income tax payable in a given tax period may be credited against the income tax. Based on an accounting expert's report, the taxpayer proved that during fiscal years 1995, 1996 and 1998, it suffered losses; hence, it was impossible for it to pay the deemed income tax.

The Supreme Court decided that the minimum deemed income tax's applicability does not take into account the taxpayers' specific situation, and does not allow for relief if the income was not in fact derived. The court made a general statement that the minimum deemed income tax is inapplicable when there are accounting and tax losses.

Brazil

Under Brazil's Controlled Foreign Corporation (CFC) regime, the profits of a CFC are taxable in Brazil at the end of the calendar year in which they are accrued and registered in the balance sheet of the foreign companies, regardless of their actual distribution to the Brazilian company.

A taxpayer argued that the taxation of foreign profits regardless of its effective distribution to the Brazilian company would be against the Federal Constitution.

Although there have been a number of delays in the trial, it would appear that once all of the judge's opinions are in, the constitutionality of the CFC provision will be upheld.

Canada

Foreign tax credit generators

The Canadian government has proposed amendments to the Income Tax Act designed to stop tax arrangements known as foreign tax credit generators.

Foreign tax credit (FTC) generators typically consist of a series of transactions that are substantively equivalent to a loan by a Canadian resident corporation to a resident of a jurisdiction that taxes based on economic substance. Had the Canadian taxpayer loaned the amount directly to the nonresident, the interest income would have been subject to Canadian tax without any foreign tax being paid. In a foreign tax credit generator, instead of making a loan directly, the Canadian taxpayer invests in a special-purpose entity (generally a partnership) that is subject to tax in the foreign jurisdiction.

A nonresident corporation will also invest in the partnership. The partnership then loans an amount (including the amount invested by the Canadian resident) to another member of the nonresident's corporate group. The loan creates interest income in the partnership and an offsetting interest deduction for the borrower, so there is no net tax to a nonresident's corporate group. Instead of receiving interest income with no offsetting credit, the Canadian resident receives an allocation of income from the partnership and claims a FTC for its share of the foreign tax paid by the partnership. The Canadian tax savings are divided between the Canadian lender and the nonresident through a reduced yield being given to the Canadian resident taxpayer on what is in substance, a loan.

Foreign affiliates of Canadian corporations

On 19 August 2011, the Department of Finance released its latest series of proposals to change rules applicable to foreign affiliates of Canadian corporations. The proposals deal with a number of pending changes that have been outstanding since February 2004, and also contain a number of new, unexpected changes that could adversely affect a number of companies.

Most notable are proposals to treat certain loans from a foreign affiliate to be income to the Canadian resident shareholder. Finance referred to such loans in their Explanatory Notes accompanying the proposed legislations, as 'synthetic dividend distributions'. Where a loan from a foreign affiliate to its Canadian shareholder or to a person related to the Canadian shareholder (specified debtor) remains outstanding for more than two years, it will be treated as income to the Canadian shareholder based upon the shareholder's equity interest in the foreign affiliate. A specified debtor would include a Canadian company's foreign parent or sister foreign companies related to it, but generally would not include a 'controlled foreign affiliate' of the Canadian shareholder, as specifically defined for the purposes of this anti-avoidance provision. A reserve for the income inclusion will be permitted if the foreign affiliate could have made a distribution to the shareholder that would be deducted from income as a dividend from exempt surplus or a grossed-up amount of underlying foreign tax. Accordingly, certain loans between foreign affiliates could be caught by these rules. Loans outstanding on 19 August 2011, are deemed to have been made on the date of the announcement, thus requiring an analysis of existing upstream and inter-affiliate loans to determine the potential impact of the proposals. While not yet considered substantively enacted, once introduced as draft legislation companies will have to assess the impact of such proposals on their deferred tax position.

The proposals will also create another notional tax account (hybrid surplus) in respect of a taxpayer's foreign affiliates which will track capital gains realised by foreign affiliates in respect of shares of a foreign affiliate, partnership interests of a foreign affiliate, and debts in respect of the shares of or a partnership owned by a foreign affiliate. Intra-group transfers of such entities or debts will be immediately affected, while the sale of such properties to arm's length persons will apply to transactions that occur after 2011. With the new hybrid surplus and upstream loan provisions the foreign affiliate rules will take a significant policy shift in that the Canadian taxation of such gains can no longer be easily deferred. Taxation can no longer be deferred by loaning the proceeds from the sale to the Canadian parent thereby deferring Canadian tax on a gain which suffered little or no foreign tax. Distributions from hybrid surplus will include the tax-exempt and taxable portion of such earnings, together with any hybrid underlying tax.

Revised proposals with respect to the tax treatment of non-liquidating distributions from foreign affiliates simplify earlier proposals, by treating all distributions as dividends, but will permit an election to treat a portion of the distributions as a return of basis (ie pre-acquisition surplus).

The proposals contain a number of revisions to the rules relating to transfers to and reorganisations of foreign affiliates and make various changes to existing stop-loss rules in favour of previously proposed anti-avoidance measures which were far too complicated.

To further curb perceived abuses a specific anti-avoidance measure is introduced to ignore tax avoidance transactions carried out with the purpose of manipulating the notional 'earned surplus' and 'taxable surplus' accounts in respect of a foreign affiliate. Other changes include:

- changes to the computation of 'foreign accrual property income' (FAPI) to preclude capital losses from offsetting investment income.
- modification to the foreign exchange rules applicable in the computation of certain gains and losses in respect of a foreign affiliate's earnings.

Chile

Chile is host to nearly all the world's major copper producing companies. Recent changes in tax laws concerning mining companies incorporate progressive tax rates which range from five percent to 14 percent (increased to 17 percent for earthquake relief), replacing the single tax rate of five percent. This amendment applies on mining projects with annual sales over 50,000 metric tons of fine copper. Mining companies, in addition to income tax, paid a royalty for the extraction of non-renewable resources. The royalty was levied on the margin of profits obtained on sales of mining products and was in force until 31 December 2010 at a rate of five percent. The legal amendment introduced to the royalty creates a progressive tax, with an effective tax rate between five percent and 14 percent (17 percent for earthquake relief), which replaces the single rate of five percent. The Chilean government is considering increasing mining taxes beyond 17 percent as a way to fund educational reforms.

Colombia

With respect to related party debt deemed equity, a recent change to the old rule broadens its scope to clarify its applicability and match it with the affiliated and related party standards currently in place for transfer pricing purposes. Pursuant to an amendment enacted, all related party debt would be deemed as equity for tax purposes. In certain cases, this could result in a direct increase of the taxable base for both the Alternate Minimum Taxable Income (AMTI) computation, and the newly adopted 2011 net-worth tax. Most taxpayer's income tax is assessed taking into account the greater between the AMTI and the taxpayer's regular net taxable income. The AMTI is assessed using the taxpayer's net-worth as of 31 December of the year immediately preceding the taxable year multiplied by three percent.

Dominican Republic

New law created the legal framework required for the establishment of International Finance Zones (IFZ). According to the new law, authorised companies operating within an IFZ may provide various financial services and related activities to non-resident individuals and companies. The services provided within the IFZ will benefit from a general tax exemption of 30 years as from the date of creation of the particular IFZ.

Honduras

The Honduras government has issued a mandatory minimum income tax for entities and individuals. The minimum tax will be levied at one percent on gross income. A taxpayer will be subject to the minimum income tax if the combined total of its income tax and temporary social contribution tax due at year-end is less than one percent of its fiscal year gross income. The tax may even apply to taxpayers reporting tax losses at the end of the fiscal year. The minimum tax rate will be reduced from one percent to half percent of gross income for taxpayers whose operations are based on prices regulated or legally set by the Honduran government.

Mexico

The Mexican Income Tax Law provides a restriction for entities to deduct tax loss derived from the sale of shares. Entities shall only deduct the tax loss without exceeding the gains obtained in selling equity in the same tax year or in the following 10 years. The Mexican Supreme Court of Justice (MSCJ) recently declared such restriction as unconstitutional, because it does not allow the entities to determine the taxes in accordance with the entities' taxpaying capacity.

Panama

A new dividend tax has been developed to apply to every loan or credit that the corporation grants to its shareholders. The applicable tax rate will be 10 percent, including those cases in which the tax rate is five percent (that is, corporations under the Colon Free Zone regime). The percentage will vary in the case of bearer shares, in which the corporation must withhold 20 percent as a dividend when a loan is granted to the bearer shareholder.

Peru

Peru has reinstated the previous narrower regime for the tax treatment of gains obtained by nonresidents from financial derivatives in the Peruvian market thus allowing fewer derivatives to fall into Peruvian taxation.

For derivative contracts entered into on or after 1 January 2010, results from financial derivatives obtained by nonresident taxpayers were considered sourced in Peru and therefore within the scope of the Peruvian tax net. This widened the scope of derivatives to be taxed in Peru.

These provisions expanded the scope of the above regime to encompass all results obtained from financial derivatives contracts negotiated on a market in Peru, whether or not centralised. As a result, it was possible to conclude that the results obtained from any financial derivative contract entered

into by a nonresident, that meets specified criteria to qualify as Peruvian-source income is subject to tax in Peru.

The overly broad scope of the rules drew severe criticism because of the impact on decision-making regarding the negotiation of derivative instruments in the Peruvian market. The government has responded to this criticism by enacting the new law reinstating the tax treatment previously applicable to results obtained by nonresidents from financial derivatives. Thus, nonresidents will be subject to tax in Peru on results obtained from foreign exchange derivative contracts only when those contracts meet more restrictive criteria and fewer contracts will be taxable in Peru.

Puerto Rico

On 25 October 2010, Puerto Rico enacted legislation which adds new rules that characterise certain income of nonresident corporations, partnerships and individuals (collectively, 'nonresidents') as effectively connected with the conduct of a trade or business in Puerto Rico (PR ECI) and therefore subject to Puerto Rican income tax. The legislation also adds an excise tax (ET) on a controlled group member's acquisition from another group member of certain personal property manufactured or produced in Puerto Rico and certain services performed in Puerto Rico.

In a recently issued notice the Internal Revenue Service (IRS) and the Treasury Department are evaluating the ET. The provisions of the ET are novel. The determination of the creditability of the ET requires the resolution of a number of legal and factual issues. Pending the resolution of these issues, the IRS will not challenge a taxpayer's position that the ET is eligible for US foreign tax credit.

USA

The US Treasury Department and the Internal Revenue Service (IRS) have announced their Priority Guidance Plan for 2011-2012. Among the noteworthy international projects are:

- guidance on Subpart F income, including:
  - contract manufacturing for purposes of determining foreign base company sales income;
  - the treatment of loans to related foreign partnership; and
  - passive foreign investment companies
- guidance on inbound transactions, including:
  - withholding agreements;
  - the reporting of bank deposit interest paid to non-resident aliens
  - conduit financing arrangements

- guidance on outbound transactions, including:
  - outbound asset reorganisations;
  - transfers of intangible property to foreign corporations
  - information reporting of transfers by partnerships to foreign corporations
- guidance on foreign tax credit issues, including:
  - creditability of UK remittance basis charges
  - separate application of the foreign tax credit limitation to items resourced under treaties
  - foreign tax credit splitting events
- guidance on transfer pricing, including:
  - cost sharing arrangements;
  - global dealing operations; and
  - the Advance Pricing Agreement program
- guidance on sourcing and expense allocation, including:
  - the allocation of interest expense
  - the source of income from a qualified fails charge; and
- guidance on US tax treaties, including:
  - beneficial ownership; and
  - the Competent Authority Program.

Uruguay

The Uruguayan government has announced that a tax incentive programme for manufacturers of high-tech products will be expanded to foster development of industries such as data processing, energy generation, telecommunications and pharmaceuticals.

Eligible companies will obtain material tax benefits that include exemptions from the business income tax (IRAE), net worth tax (IPAT), and import taxes, as well as the possibility of applying a tax credit for the VAT on purchases of goods and services.

Once an investment project is approved by the government, the company must make certain commitments, such as job creation, increased exports, the use of clean energy, or the development of research and innovation techniques.

In deciding on the scope of benefits to be granted to investment projects in the industrial sector, the government will also consider the technological level of the products manufactured, ranking them from zero for raw materials to 10 for high-tech content.

Transfer pricing news

Brazil

Brazil's General Taxation Coordination System (COSIT) has issued a ruling that supports the Federal Revenue Department's (FRD) position on the application of transfer pricing rules to so-called back-to-back transactions.

Back-to-back transactions are international trade transactions wherein a Brazilian taxpayer buys a foreign product outside Brazil and resells it to a foreign purchaser, also outside Brazil, without the product ever having entered Brazil or been subject to Brazilian customs clearance. The product is shipped directly from the foreign seller to the Brazilian taxpayer's buyer outside Brazil. As the transaction involves two buy and sell transactions, both with related parties, the taxpayer shall demonstrate, using transfer pricing legislation, a profit margin in the entire transaction that does not deviate from the one that would be adopted if the transactions had been carried out with unrelated parties. For this purpose, the taxpayer shall calculate two parameter prices, one for the purchase [transaction] and the other for the sale [transaction], and follow the legal restrictions applicable for each calculation method.

India

In a recent case the taxpayer provided software development and related services to its associated enterprise in the United States and to other third parties. The taxpayer benchmarked the transactions with its associated enterprise by applying the transactional net margin method (TNMM), comparing the margins earned from services rendered to the associated enterprise and non-associated enterprises. For this purpose, the taxpayer prepared two separate segmental accounts for transactions with associated enterprises and non-associated enterprises according to Accounting Standard 17 issued by the Institute of Chartered Accountants of India (ICAI).

To justify the reliability of its benchmarking exercise, the taxpayer obtained a certificate from a chartered accountant verifying the allocation keys used to allocate profitability and the accuracy of profitability computed through segmentation of transactions. The taxpayer claimed that it was not required to report in its financials, customer-wise separate segmented results according to Accounting Standard 17. Accounting Standard 17, requires only that the segments be distinguished on the basis of products and geographies and similar products or services were to be aggregated in a single segment. The taxpayer, relying on the OECD guidelines, asserted that, in applying the TNMM, the comparison of the net margin earned in related-party transactions with the margin earned from unrelated-party international transactions (internal comparables) entered into by the same enterprise (ie the taxpayer) provided more reliable and accurate results about the arm's length margin as compared to using external comparables on an entity level.

The Tribunal held that the lack of segmental reporting in the audited financials due to the absence of a statutory requirement of separate segmental disclosure of associated enterprise and non-associated enterprise transactions, cannot be taken as grounds to reject the benchmarking done by the taxpayer. The tribunal upheld the basis of allocation of different expenses, either by identifying them transaction-wise or using some scientific basis for allocation.

OECD

A report from the OECD, lists corporate reorganizations and transfer pricing as commonly used tax planning schemes and outlined strategies tax authorities can use to detect and respond to them.

The OECD report, 'Corporate Loss Utilisation Through Aggressive Tax Planning', states that global corporate losses have increased sharply as a result of the recent financial and economic crisis, with loss carry forwards as high as 25 percent of gross domestic product in some countries.

Some corporations find loopholes and use aggressive tax planning "to avoid taxes in ways that are not within the spirit of the law", the OECD said. For example, some financial instruments create artificial losses or multiple deductions for the same loss, while some corporations acquire loss-making companies solely to offset profits or artificially allocate loss-making financial assets to high-tax jurisdictions through non-arm's-length transactions.

The organisation said countries should implement comprehensive responses to these ruses, as well as to their promoters and users, and recommended early engagement between taxpayers and tax authorities in the framework of disclosure initiatives and cooperative compliance programmes as a way to convince some taxpayers not to use or promote particular schemes.

Spain

The Spanish Supreme Court of Justice published a decision regarding transfer pricing regulations and, specifically, analysing the development of the transfer pricing regime passed by Royal Decree.

Transfer pricing rules in Spain were modified on measures to avoid tax fraud, in the law applicable to transactions between related parties, which entered into force on 1 December 2006 (the Prevention of Tax Fraud Act). The modifications introduced by this Act aimed to:

- reflect under Spanish tax law the same criteria of valuation as accounting law; and
- adapt Spanish law concerning transfer pricing to conform to international transfer pricing standards and to OECD principles on this matter.

In this case, a Spanish association of business professionals filed an appeal regarding the amendment. The claimant asserted that some of the provisions of the amendment violated the Spanish Constitution and therefore, must be considered null and void.

The claimant argued that some provisions that were introduced by the Corporate Income Tax Regulation violate the below:

- the principle of legality
- the principle of legal certainty
- the principle of proportionality
- the principle of bringing an act or conduct within the scope of the law
- the principle of equality of rights in the eyes of the law
- the right to equal protection of the law
- the principle of prohibition of abuse of negligence by public authorities
- the principle of economic capacity.

As noted, the Prevention of Tax Fraud Act amended the Corporate Income Tax and, specifically, the transfer pricing regulation.

As a consequence of the new transfer pricing regulation, this modified the rules on the Corporate Income Tax approved previously and was a long-awaited rule that developed and completed the tax regime applicable to related-party transactions.

Although the Royal Decree governed different issues, such as comparability analysis and the tax deductibility requirements for expenses under cost-sharing agreements between related parties, the most relevant provision was perhaps that regarding obligations to document related-party transactions. These were based on the work of the European Union Joint Transfer Pricing Forum, and referred to two sets of documentation: one for the group that the taxpayer belongs to, and one for the taxpayer itself.

Although Royal Decree entered into force on 19 November 2008, the documentation obligations entered into force on 19 February 2009. The required documentation must have been available for the tax authorities after the end of the voluntary period for the self-assessment of the tax corresponding to the financial year in which the related-party transaction took place.

If, in a tax audit, the taxpayer has assessed the transactions according to the transfer pricing regulation (and therefore the tax authorities may not make any adjustment), but did not prepare documentation the taxpayer would be subject to specific fines

Based on the above, the claimant asserted that the amendments introduced in the Corporate Income Tax Regulation which expanded upon the regime of the Corporate Income Tax Act passed created a great burden for taxpayers.

In conclusion, after the claim filed by the Spanish association of business professionals, both the Supreme Court of Justice and the Spanish Constitutional Court are analysing whether the Spanish transfer pricing regime contravenes the Spanish legal system.

Mexico

The Mexican Federal Tax Justice overturned a transfer pricing tax assessment on transactions that took place between a Mexican distributor and foreign related parties.

In the case, the tax authority's notice of deficiency was based on its application of the resale price method. In applying that method, the tax authority accepted a limited number of adjustments to eliminate differences between the transactions under analysis and those conducted by comparable distributors, namely, differences in the relative levels of accounts receivable and inventories and concluded that the taxpayer's payments to the foreign related party exceeded the arm's-length prices.

The tax authority argued that the taxpayer excluded, without reason, three companies that should have been considered as comparables, and that in order to determine its gross profit margin, the taxpayer took into consideration the average of three fiscal periods when it should have considered only the fiscal period under review.

The taxpayer accepted the tax authority's use of the resale price method and its argument about the exclusion of the three comparables. However, it maintained that its consideration of the three fiscal periods was appropriate to account for inventory fluctuations and client turnover in the industry, and that the tax authority failed to take into account the taxpayer's operating expenses when making adjustments to eliminate differences between the target and the comparable transactions.

The taxpayer therefore asked the court to annul the tax authority's resolution and corresponding notice of deficiency.

The court noted that Mexico's Income Tax Law allows for reasonable adjustments to account for differences between the taxpayer and comparable companies that could significantly affect the result of a transfer pricing analysis, taking into consideration the characteristics of their operations, functions performed, contractual terms and conditions, economic circumstances, and business strategies.

The Court concluded that the correct application of the resale price method requires the consideration and application of reasonable adjustments to eliminate differences between the party under review and the comparable companies, and that those adjustments may include accounts payable, inventories, and differences in the ratio of operating expenses to revenues.

Indirect taxes news

Italy

EU Directives on VAT implemented in the Italian law

The decree implementing the 2008 EU Directives (Directives 2008/8-9-117/EC) on value added tax has been enforced. The place of supply of intra-EU services is generally where the customer is established, on condition that the customer is a VAT taxpayer (ie business-to-business rule).

The implementation of the EU Directives has given rise to several relevant changes also in relation to 'Intrastat lists'. Effective from 1 January 2010, these lists must include not only intra-EU purchases and sales of goods but also purchases and sales of services.

New procedures for VAT refunds

A Legislative Decree has recently amended the VAT refund application procedures for VAT amounts paid in a country other than the country of residence. In particular, the VAT refund application for the amount paid in other EU member states must now be submitted and managed through the tax authorities of the state of residence. For instance, a VAT refund application for VAT paid in Italy by an Irish resident company must be filed with the Irish tax authorities.

OECD

In December 2010 the OECD published its draft guidelines on VAT/GST neutrality for public consultation, with comments due by 22 March 2011. These guidelines are one of the building blocks of the OECD International VAT/GST guidelines. The development of these guidelines is a long term project aimed at providing guidance to governments on applying VAT/GST to cross-border trade, with a view to minimising the potential for double taxation or unintended non-taxation. The guidelines for which various comments were received included:

- the burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation
- businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation
- VAT rules should be framed in such a way that they are not the primary influence on business decisions
- with respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid
- to ensure foreign businesses do not incur irrecoverable VAT, governments may choose from a number of approaches
- where specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses.

Canada

Generally a deposit 'shall not be considered as consideration paid for the supply, unless and until the supplier applies the deposit as consideration for the supply'.

The taxpayer built kitchen and bathroom cabinets. It would contract with a purchaser for a new kitchen or bathroom and, under the contract, would take a 30 percent deposit (of the total price including GST and Quebec sales tax) on signing the contract. A further 60 percent was payable on delivery, and a final 10 percent payable on installation. However, the taxpayer did not remit GST and QST on the contract price until it completed delivery.

Revenue Quebec (RQ), which administers the GST in Quebec, assessed the taxpayer for a one-month period for the tax on the 30 percent it had collected, on the basis that the amount paid was a payment on account rather than a deposit. The taxpayer appealed to the Tax Court of Canada.

The Court dismissed the appeal, finding that the 30 percent was a payment on account, not a deposit. The Court reviewed in detail the meaning of 'arrhes' in French and 'deposit' in English, under the case law and in legal dictionaries. Tax Court took into account that this matter arose in Quebec, where the Civil Code applies (and where the term 'arrhes' was used only in the pre-1994 Civil Code), but concluded that the interpretation would be the same in common-law provinces.

A 'deposit' is typically an amount that the parties agree will determine the damages forfeited if the customer does not complete the contract so that both parties can walk away. It is a guarantee of the execution of the contract. In contrast, a 'payment on account is a partial payment towards the full contract price, which is payable in any event. In this case, the 30 percent paid up front was paid towards the taxpayer's materials costs in manufacturing the cabinets, but it was not described in the contract as damages payable if the customer refused delivery. Rather, the customer was liable for the full contract price. Furthermore, the contract itself called the 30 percent an 'acompte' (payment on account) and not a 'depot' (deposit). As a result, the 30 percent was not a deposit.

Taiwan

A Belgian taxpayer requested specific VAT advice from the Ministry of Finance (MOF), where no fixed place of business exists in Taiwan. The response will have consequences beyond Belgium.

The MOF proclaimed that foreign enterprises, institutions, organisations, or associations without fixed places of business within the territory of the Republic of China (ROC) purchasing the goods or services on which VAT is levied to a total of NT$5,000 (more NT$2,500 or more within 2010), may qualify for a VAT refund provided that reciprocal treatment, or exemption from similar taxes is given to the same institutions of the ROC by the foreign country in which they are performing such activities.

Brazil

Instructions published in the Official Gazette regulated the custom clearance of equipment brought into the Brazilian territory to be used during FIFA Confederation Cup 2013 and FIFA World Cup 2014.

According to this regime, a suspension of all taxes, normally levied on the import of goods, is granted on the import of the following equipment, provided that they are re-exported by 28 June 2016:

- technical-sportive equipment
- technical equipment for recording and broadcasting sound and image
- medical equipment
- technical equipment for office.

The suspension of taxes under the temporary admission regime is converted into exemption, provided that, after the FIFA Confederation Cup 2013 and FIFA World Cup 2014, such equipment remain in the Brazilian territory but is donated to:

- the Federal Union; or
- certified charitable entities, public entities or non-profit organisations related to sports, social development, environmental protection or child care.

Mexico

From 1 July 2011, amendments to foreign trade rules concerning the IMMEX program (maquila programme, i.e. process or assembly of imported goods for resale to the country of origin or other countries) are introduced as follows:

- a non-resident principal may transfer to Mexican residents the imported or processed goods without being deemed to have a permanent establishment in Mexico, even if the goods are delivered in Mexico
- Mexican entities registered as a 'certified entity' are allowed to transfer the imported goods to a Mexican resident. These goods are considered to have been returned to the foreign principal although they have not departed from Mexico
- the sale or transfer of the imported and processed goods by a non-resident principal to a Mexican purchaser is subject to VAT. The tax must be withheld and paid to the Treasury by the Mexican purchaser in accordance with the VAT Law. These goods are subjected to the same treatment as if it was a sale of goods in Mexico
- the tax withheld and paid to the Treasury will be input tax for the purchaser, who may credit it in the following month.

Finland

A university resident in an EEA state (the EEA University) was planning to organise education leading to a Master of Business and Administration (MBA) degree (the MBA course) in Finland. The EEA University applied for a preliminary ruling on whether its premises in Finland would create a PE for it in Finland. The EEA University had premises in Finland and would employ a manager and a programme coordinator and a marketing coordinator. The staff of the PE would advertise for the MBA course and take care of organising it.

The issues were whether the MBA course provided by a university established in another EEA state but organised in Finland:

- creates a PE for its organiser and consequently grants Finland the power to tax the PE's profits;
- qualifies for a tax exemption under the domestic law; and
- is subject to VAT.

Tax authorities ruled that the EEA University has a PE in Finland both under the domestic law and the applicable tax treaty while:

- it had registered its branch in Finland
- its activities, as described in its application for the ruling, went beyond being merely of a preparatory or auxiliary character.

Universities are under the Finnish law tax exempt for fulfilling their basic task (i.e. organising tuition which leads to a degree acknowledged by a government decree) but subject to tax on their business income. Tax authorities emphasised that a MBA degree is not a degree granted by the Finnish university system and its content is not defined by law or by a state authority. Consequently, the MBA course is regarded as voluntary additional education and is subject to tax in Finland even when organised by a university. The MBA course is, however, an educational service organised by a university and as such exempt from VAT.

Treaty news

India/Japan

The assessee (NKK) provides vessel inspection and certification services for the shipping industry. Ship classification is mandatory under international law and must be carried out by approved companies, such as NKK. The services are provided at the request of the ship owner (client) but the reports can be submitted either to the client or directly to the governmental authorities.

NKK established offices near major ports in India, creating a PE in India. The head office in Japan contracted directly with the clients and issued them service fee invoices. Depending on where a ship was located, NKK's head office would contact the relevant office to perform the survey and certification services. If the ships were in Indian waters, the head office would issue an appropriate job order form to the Indian PE and it would carry out the survey and certification activities, using its own employees. The Indian PE was paid an arm's-length fee (part of the fee received from the client by the head office), which was subject to tax in India.

There were, however, situations in which the Indian PE could not carry out the work by itself and therefore engaged independent surveyors. In those cases, the Indian PE communicated with the independent surveyor and provided instructions. The independent surveyor then issued its report, and a fee invoice, to the PE.

In turn, the PE asked the head office to pay the independent surveyor and to reimburse all expenses incurred by the PE. The PE considered that the profits made by the head office in connection with the services provided by the independent surveyors were not attributable to the PE and thus were not taxable in India.

During an audit of NKK's tax return, the tax officer agreed that the fees received by the head office in connection with the services provided by the independent surveyors were not effectively connected with the Indian PE. However, the tax officer held the underlying fee income (the arm's-length payment from the head office to the PE) to be in the nature of FTS. Further, because the services were provided in Indian waters, the FTS was Indian source, the officer said. He therefore assessed tax on the FTS at a rate of 20 percent on a gross basis.

On appeal, the first appellate authority held that 10 percent of the underlying fees were effectively connected with (attributable to) the Indian PE and were taxable at the applicable corporate tax rate. NKK conceded and agreed with that finding.

The Revenue Department appealed to the tribunal, however, arguing that the whole of the fees received by the head office was taxable as FTS or, alternatively, that the balance of the fees (after considering the attribution to the Indian PE) was taxable as FTS.

The tribunal sided with NKK, rejecting the Revenue Department's appeal. It held that although the Indian PE did not perform the survey itself, the underlying activity was effectively connected with the Indian PE.

Canada/Austria

The taxpayer's father, a resident of Austria, established an Austrian private foundation for the benefit of the taxpayer, his spouse and their children (all of the beneficiaries were resident in Canada). By an amendment to the foundation, the beneficiaries were changed to nonprofit organisations. The taxpayer was on the advisory committee to the foundation. However, on a revocation of the foundation by his father, the property would revert to the taxpayer. Shares of a Canadian company were initially sold to the foundation by the taxpayer without the voting rights or dividends to enable the Canadian company to continue to benefit from its status as a Canadian-controlled private corporation. By way of amendment, it was acknowledged that a separation of voting rights and dividends on a sale of shares was not possible under Canadian law. Shares of another company were also purchased by the foundation. The shares were then sold and capital gains relief was claimed under the Austria-Canada tax treaty. The Canada Revenue Agency assessed the taxpayer on the basis that all capital gains of the trust were attributed to the taxpayer. The Canadian income tax act applies to deem income and capital gains of a trust to be the income of the person who transferred property to the trust when the property either may revert to the transferor or pass to persons to be determined by the transferor

The issue was whether the capital gains attribution under Canadian income tax law would apply to the taxpayer who sold property to the trust and whether the property could revert to him or pass to the persons he determines. In that case, domestic Canadian income tax law would deem the taxpayer, rather than the trust, to have realised the gain on the share sales – effectively bypassing the treaty and using a domestic anti avoidance rule to tax the taxpayer on the gain. At the time of the creation of the trust arrangement (which predates the sale of shares), only the taxpayer's father was the settlor. The judge took a narrow view that the avoidance provision could only apply to the settlor. The sale of shares by the taxpayer to the trust was not a contribution (as it is not a voluntary payment) and at most was a substituted property.

The judge concluded that the treaty overrides the potential application of domestic Canadian income tax law if the trust is a resident in Austria.

The judge followed Prévost Car Inc., in concluding that the 2003 OECD commentary should not be considered, as it was in conflict with the 1977 OECD commentary coincident with the entering into of the treaty. Based on the earlier commentary, specific mention should have been made in the convention to permit the application of domestic anti avoidance rules, such as the deeming of trust capital gains. The 2003 commentary would regard a domestic anti-avoidance rule (like the deeming of capital gains) to be part of the domestic rules that are not addressed in tax treaties and are not affected by them.

Although the taxpayer was on the advisory board of the foundation, he did not exercise sufficient control for the judge to displace the trust principles and conclude that the foundation was acting as the agent of the taxpayer.

Russia/US

The Russian Ministry of Finance issued tax guidance clarifying that under the Russia/US. income tax treaty, a PE of a US legal entity in Russia can deduct, for corporate tax purposes, expenses incurred by the US legal entity.

The Ministry of Finance held that if a foreign legal entity is a resident of a state with which Russia has concluded a tax treaty, the corporate taxation of that legal entity in Russia should be governed by the provisions of that tax treaty.

The Russia/US tax treaty provides, that when determining the taxable income of a PE, expenses incurred for the purposes of the PE will be allowed as deductions. Also, a reasonable allocation of properly documented expenses will be allowed between a resident of a contracting state and its PE situated in the other contracting state. Such allocable expenses include executive and general administrative expenses; research and development expenses; interest; and charges for management, consultancy, or technical assistance, whether incurred in the state in which the PE is situated or elsewhere. The business profits attributed to a PE must be determined by the same method each year unless there is good, sufficient reason to the contrary.

If a tax treaty concluded with a foreign state permits the deduction from taxable income of the foreign legal entity's PE expenses (including executive and general administrative expenses) incurred by the foreign legal entity in connection with the operations of the PE in Russia and abroad, those expenses should be deductible from the taxable income of the PE subject to compliance with the provisions of Tax Code.

The Ministry of Finance held that expenses incurred by a taxpayer, should be qualified as properly documented for corporate tax purposes if the relevant primary documents correspond to international accounting standards and do not contradict the principles of execution of primary documents applicable in any accounting standards and the principles. Any primary documents executed in foreign languages should be accompanied by a line-by-line Russian translation.

The Ministry of Finance also held that a foreign legal entity's PE in Russia cannot deduct for corporate tax purposes expenses incurred by the foreign legal entity in connection with operations of any of the foreign legal entity's divisions that are not located in Russia, including the foreign legal entity's head office. Expenses that the foreign legal entity's head office allocated to the foreign legal entity's PE in Russia, should be considered to be incurred and deductible for corporate tax purposes in Russia in the tax period in which those expenses were de facto allocated to the PE.

Based on the above, the Ministry of Finance held that the expenses a US legal entity incurred abroad for purposes related to the operation of its PE in Russia may be deducted from the PE's taxable income for corporate tax purposes, provided the foregoing conditions are complied with.

Netherlands/Germany

The taxpayer and his spouse are living in Germany. The taxpayer is a non-resident taxpayer in the Netherlands and earns Dutch social security benefits as well as private pension payments. The private pension payments partially relate to an employment exercised in the Netherlands and partially to an employment exercised in Malaysia.

Under the tax treaty between Germany and the Netherlands, the pension payments are taxable only in Germany. The taxpayer owns an owner-occupied dwelling in Germany which is financed with a mortgage loan. For Dutch tax purposes, the income from the owner-occupied dwelling amounts to a loss.

Under the treaty, the loss from immovable property in Germany, is taxable only in Germany.

The taxpayer opted for the possibility to be taxed in the Netherlands as a resident taxpayer. This enabled the taxpayer to partially offset the loss from the owner-occupied dwelling against his income from Dutch sources.

The issue was whether the Netherlands, under the provisions of the Treaty, is entitled to include the pension income in the taxable income from employment and dwelling.

The court noted that a tax treaty allocates taxing rights, between the contracting states and that the taxation in each state is based on domestic legislation. In opting for the application of the tax rules which apply to resident taxpayers, the taxpayer did not waive his right to apply the tax treaty between Germany and the Netherlands.

However, when a taxpayer has made such a choice, the consequences of the choice should be extended to the applicable tax treaty. This results that in this case, the Netherlands is entitled to take into consideration the worldwide income of the taxpayer with the obligation to grant relief for the avoidance of double taxation in accordance with the treaty for those items of income that may be taxed in Germany.

In the case at hand, the pension income and the loss from the personal home may be taxed in Germany. Consequently, the court rejected the taxpayer's appeal.

Netherlands/Canada

The taxpayer was resident in the Netherlands since 1974. Prior to this the taxpayer lived and worked in Canada for several years. From 1974 until his retirement in 2000, the taxpayer worked for companies A, B and C, all of which were resident in the UK. Since 1974, the taxpayer never stayed for more than 183 days in the UK or any other country.

In 2006, the taxpayer received the following items of income:

- income from the cessation of an enterprise in the Netherlands
- Dutch old age social security allowance (AOW)
- private pension from D in the Netherlands
- private pension from E in the Netherlands

- quarterly Canadian public pension payments from F
- monthly private pension payments from G in Canada
- quarterly pension payments related to past employment for the companies resident in the United Kingdom which belong to the M group and paid out by H which is a company resident in Bermuda.

The taxpayer did not include in his tax return for 2006 the payments he received from Canada and Bermuda.

The issue was whether the various pension payments received could be subjected to Dutch personal income tax.

With respect to the private pensions received from D and E, the court ruled that Dutch income tax is due on these pension payments. The payments classify as pensions under the Dutch Personal Income Tax Act. The court decided further that the Canadian private and public pension payments received from F and G classify as pensions the Dutch Personal Income Tax Act , and may be taxed in the Netherlands under the tax treaty between Canada and the Netherlands.

Regarding the payments received from H in Bermuda in relation to the past employment for the UK resident companies, the Court ruled that the payments have been made under an arrangement that under UK law does not classify as a UK pension scheme.

Therefore, according to the court, the arrangement does not classify as a pension scheme but as pensions for the Dutch Personal Income Tax Act.

OECD

On 29 April 2011, the OECD Committee on Fiscal Affairs (CFA) released a discussion draft to the commentary on Art. 10, 11 and 12 of the OECD Model Convention (MC) concerning the meaning of the term 'beneficial owner'. The term, as used in the MC, has been interpreted differently by courts and tax administrations, thus increasing the risk of double taxation or non-taxation. The CFA has included in the discussion draft proposals aimed at clarifying the interpretation that should be given to the term in the context of the MC. It is indicated in the proposals that the term 'beneficial owner' should be understood within a treaty context, and not necessarily have the same meaning provided by domestic law or other instruments.

In general, the proposal acknowledges that the recipient of dividends, interests or royalties should be considered as the beneficial owner when such person has the full right to use and enjoy that income without being constrained by a contractual or legal obligation to pass the received proceeds to other persons.

Belgium/France

The taxpayers, two individuals resident in Belgium, received in 2006 interest from France pursuant to the redemption of a life insurance. In France, a 15 percent withholding tax was withheld on the interest. The taxpayers reported the interest in their 2006 income tax return and claimed foreign tax credit (FTC) for the tax withheld in France. The Belgian Tax Administration refused to grant the FTC because, under Belgian law, such FTC is not granted to interest derived by private investors. As a result, the French interest was taxed in both France and Belgium at the rate of 15 percent.

The taxpayers argued that the Belgian system is discriminatory because, due to the refusal to grant the FTC, the tax burden on foreign interest is greater than that on Belgian-source interest.

Private investors, as well as professionals and entrepreneurs, who receive interest from France are in a comparable position because both are subject to a 15percent withholding tax in France.

This is, however, not the case under Belgian domestic law because foreign interest received by private investors does not have to be included in the income tax return pursuant to the fact that the interest is exempt from income tax pursuant to the movable prepayment, whereas foreign interest derived by professional investors and entrepreneurs must be included in the taxable profits and does not benefit from the exempted movable prepayment.

Under the Belgian system, interest derived from France by a private investor could indeed be subject to a higher tax burden than Belgian–source interest. This results, however, from the fact that the Treaty provides for the source state to impose a withholding tax with respect to interest, which deviates from the common method in Belgium and most EU states to grant the exclusive taxing rights to one of the treaty states.

The court held that this does not disproportionately infringe the rights of a private investor because he enjoys the benefit of the exemption from income tax due to movable prepayment and he has the certainty that the withholding tax in the source state cannot be higher than 15 percent.

Consequently, the court held that Belgian FTC system included in the treaty, is compatible with the principle of equality laid down in the Belgian constitution.

Who's who
Grant Thornton International

Ian Evans
Global leader – tax services
T +44 (0)20 7391 9544
E ian.m.evans@uk.gt.com

Claude Ledoux
Executive director – tax operations
T +1 312 602 8522
E claude.ledoux@us.gt.com

Bill Zink
Executive director – tax quality and training
T +1 312 602 9036
E william.zink@us.gt.com

Guenter Spielmann
Executive director, EMEA – tax services
T +49 (0) 163 895 2434
E guenter.spielmann@gti.gt.com

Regional tax resources

Winston Romero
Senior tax development manager – Americas
T +1 312 602 8349
E winston.romero@us.gt.com

Peter Rae
Tax development manager – APAC
T +852 3987 1403
E peter.rae@gti.gt.com

Mirka Vaicova
Tax development manager – EMEA
T +44 (0)20 7391 9561
E mirka.vaicova@uk.gt.com

Global coordinators

Geoff McKay
Global transfer pricing coordinator
T +1 416 360 3065
E geoff.mckay@ca.gt.com

Lauren Holmes
Global coordinator
T +44 (0)20 7391 9525
E lauren.holmes@uk.gt.com

Francie Kaufman
Global coordinator
T +1 262 646 3060
E francie.kaufman@us.gt.com

Marketing

Russell Bishop
Senior marketing executive – tax
T +44 (0)20 7391 9549
E russell.bishop@uk.gt.com

© 2011 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.