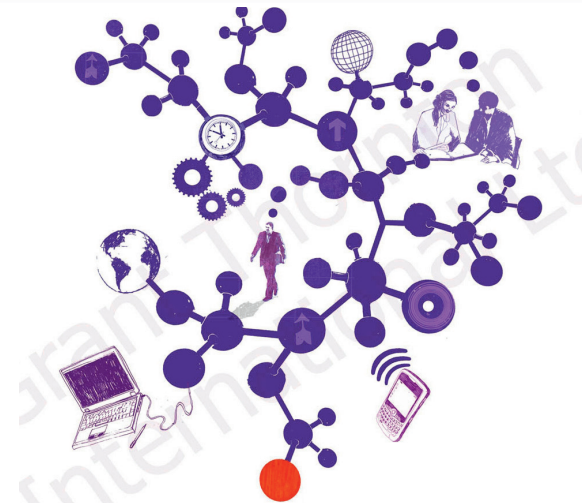




# Global tax newsletter 1/2011



Der «global tax newsletter» gibt einen Einblick in internationale Entwicklungen im Steuerwesen und deren Auswirkungen auf das Geschäft. Globale Fragen werden ebenso beleuchtet wie länderbezogene Themen, welche den ausländischen Investor interessieren. (Englisch)

Le «global tax newsletter» donne un aperçu des évolutions internationales des régimes fiscaux et de leurs répercussions sur les affaires. Les sujets mondiaux y sont tout autant examinés que les thématiques spécifiques à un pays mais d'intérêt général pour les investisseurs étrangers (en anglais).

The purpose of this publication is to keep our clients up to date on world tax developments which impact businesses globally. We will address tax issues of a global nature as well as domestic tax developments of interest to foreign investors.

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# EMEA news

## Belgium



Incoming dividends are always included in the taxable basis of the recipient, and the dividends received reduction (DRD) regime takes the form of a tax deduction of 95 percent of the dividends received. Traditionally, if the Belgian recipient had insufficient taxable income to deduct the full amount of DRD, such excess DRD could not be carried forward. As a result, the Belgian recipient would be faced with a de facto taxation of dividends received because such incoming dividends were “eating up” current-year losses, which the recipient would otherwise have been able to carry forward.

The European Court of Justice (ECJ) found this loss of excess DRD to be incompatible with the EU parent-subsidiary directive. Belgium has now made its domestic tax law compliant with the ECJ's position by allowing a carry forward of excess DRD on dividends received from companies established in Belgium or other EU member states.

## Czech Republic



The Czech Supreme Administrative Court issued an important decision confirming that a taxpayer is entitled to a tax deduction for interest expenses related to loans used to finance dividend distributions and distributions of other equity.

The deductibility of those costs has been debated in the Czech Republic for some time. In the past, the Ministry of Finance had argued that such interest expenses are not deductible because they are not incurred in order to generate, secure, or maintain taxable income.

The court stated that expenses must be incurred in order to make a profit and there must also be a direct and immediate relationship between those costs and expected revenues. This direct and immediate relationship implies that without incurring the expenses, a company would not have gained or even had a chance to gain expected revenues. It is always necessary to consider whether an actually incurred expense will generate income (profit), ensure such income in the future, or at least help maintain revenues achieved as a result of previous activity conducted by a company, the court said.

## Denmark



The Danish Parliament has adopted comprehensive tax

reform resulting in making Denmark one of the most attractive countries in which to establish a holding company.

From January 1, 2010, a Danish company receiving dividends from subsidiaries qualifying as subsidiary shares or group company shares will be exempt regardless of holding period. Dividends from portfolio shares are subject to a 25% tax. The dividends may be subject to local withholding tax, dividends paid from EU resident subsidiaries to a Danish parent are exempt from withholding tax if the 10% ownership/12month ownership requirements are met. Withholding taxes on subsidiaries outside the EU will vary based on treaty.

## Finland



Finland has issued official instructions concerning the taxation of foreign

companies with operations in Finland.

The instruction specifically addresses:

- Finland's taxing rights in presence/absence of a treaty
- impact of tax treaties
- creation of permanent establishments
- income attributable to a permanent establishment
- assessment procedures
- tax consequences upon exit of permanent establishment.

## France



The French Supreme Court has ruled in Zimmer Ltd that under

French law, a company that acts under a commissionaire arrangement cannot be regarded as a dependent agent with authority to bind its foreign principal, and therefore cannot create a permanent establishment of the principal in France, despite the fact that the commissionaire is dependent on the principal.

The case involved a UK company, Zimmer Ltd, which manufactures orthopedic products. Zimmer Ltd previously sold its products in France under a distribution agreement with its French subsidiary, Zimmer SAS. In 1995, Zimmer SAS was converted from a distributor to a commissionaire, acting in its own name but on behalf of the principal (Zimmer Ltd). Zimmer SAS had the ability and authority to accept orders from clients, present quotes and documentation in bid processes,

negotiate price discounts, and agree on payment conditions. No prior authorisation from the principal was required for those activities.

Zimmer SAS did not engage in any activities other than selling Zimmer Ltd's products under the commissionaire agreement.

The French tax authorities assessed French corporate income tax to Zimmer Ltd on the grounds that it had a PE in France because it was carrying out a business in France through a dependent agent.

France's Administrative court of appeal of Lyon, in a recently released decision, held that a Swiss company had a permanent establishment in France and that the PE was required to withhold tax from profits deemed distributed to its Swiss parent.

The court concluded that the Swiss company, Ste Medicine Beauty, had a PE in France because the company had no activity in Switzerland and had offices in France and because it appointed French companies to ensure the administration of orders and sales (including the receipt of goods, packaging, order fulfillment, after-sales service, and the processing of telephone calls, mail, billing, and advertising and consumer responses).

France's amended 2009 Finance Law has significantly changed the transfer tax territoriality rules applicable to transfers of shares in foreign companies with French real estate assets. Under French domestic rules, transfers of shares in French real estate companies are usually subject to a 5 percent transfer tax unless the companies are listed on a regulated market. A non-listed company is deemed to be a real estate company for the purpose of the 5 percent transfer tax if its assets are mainly composed, at

any time during the year before, the transfer of French real estate assets or shares in companies of the same kind. Investors usually took the position that they did not have any legal obligation to pay the 5 percent French transfer tax on purchases of shares in foreign companies predominantly owning French real estate assets. The French tax authorities have published new guidelines confirming their refusal to change their broad interpretation of the territoriality rules governing the 5 percent transfer tax.

### Germany



Germany's 2008 business tax reform included two significant counter

financing measures in return for a reduction of the overall business tax rate from approximately 40 percent to approximately 30 percent. Those measures were a general interest deduction limitation that limited current deductions to 30 percent of taxable earnings before interest, taxes, depreciation, and amortisation (EBITDA) and reduced loss transfer possibilities following a change in shareholder.

According to the original change-in-ownership rule, a direct or indirect share transfer of more than 25 percent to one shareholder will result in a pro rata forfeiture of tax loss carry forwards. As a result of the 2008 business tax reform, share transfer of more than 50 percent to one shareholder will result in a forfeiture of all tax loss carry forwards.

Germany's upper house of parliament approved a bill that will provide relief to German businesses affected by the economic downturn.

The bill relaxes the strict rules for the change-in-ownership regime, which has made it almost impossible to keep German tax losses or interest carry forwards following a direct or indirect shareholder change, even within a group.

The bill, which was approved by the lower house on December 4, will take effect January.

The German Federal Tax Court has ruled that the German controlled foreign corporation rules as they existed before 2008 did indeed infringe primary EU law and that a consequent switch from the exemption method to the credit method for permanent establishments equally infringes EU law, contrary to the ECJ decision in *Columbus Container Services* (Columbus). In Columbus, a Belgian partnership was held by German

resident partners and constituted a PE in Belgium under the Belgium-Germany tax treaty. Its income would normally be exempt in Germany under the treaty. The economic activity of Columbus consisted mainly of capital asset management. Since the tax rate in Belgium was lower than the threshold in the German CFC legislation and the activity qualified as designated passive income, the German tax authorities in the year of the claim (1996) held that the CFC legislation would have applied had Columbus been a corporation. Accordingly, no tax treaty exemption was granted and the income of the PE was taxed in Germany with credit for the Belgian (low) tax. The ECJ concluded in this case the switch from the exemption method to credit method did not infringe on EC treaty freedoms so there was no discrimination in the cross border case.

Businesses located in Germany are subject to local trade tax in addition to federal personal or corporate income tax. The municipality where a business is located levies the trade tax. The trade tax base is equal to the corporate income tax base. However some special add backs to, and deductions from, the business income tax base are made when determining the trade tax base to make trade tax revenue more stable over the normal business cycle. If a business maintains permanent establishments in different municipalities, its (common) trade tax base is allocated in proportion to the ratio of wages paid to employees in the municipality to the total wages paid by such business. Each municipality then applies its local trade tax rate to the portion of the tax base that is allocated to it. The trade tax rate is denominated in a coefficient (currently between 200 percent and 490 percent), resulting in an effective trade

tax rate between 7 percent and 17.15 percent. To avoid unfair trade tax competition between municipalities, the federal Trade Tax Law was amended in 2004 to require municipalities to levy at least 7 percent (200 percent coefficient) trade tax. Before then, municipalities were free to reduce their trade tax rate to 0 percent, and some, including the plaintiffs, did so. Germany's Federal Constitutional Court, held that the minimum municipal trade tax rate is not unconstitutional.

A foreign company is not entitled to withholding tax relief on distributions from its German subsidiary under a treaty or the EU parent-subsidiary directive if its shareholders would not be entitled to such relief if investing directly into the German subsidiary and:

- there are no economic or other relevant business reasons for the interposition of the foreign company (the business purpose test); or

- the foreign company does not generate more than 10 percent of its income from its own business activity (the 10 percent gross receipt test); or
- the foreign company does not have adequate business substance to engage in its trade or business (the substance test).

The European Commission made a formal request asking Germany to amend its anti-treaty-shopping rules as they apply to withholding tax relief. Foreign companies facing a denial of withholding tax relief are advised to appeal the denial on the basis of the pending EU procedure.

### Greece



Under Greek law, dividends from non-Greek companies are

subject to income tax in Greece, whereas dividends from domestic companies are exempted from tax. The European Commission has decided to open a new infringement procedure against Greece. Member states are obliged to take the necessary steps to put an end to the infringement and to inform the Commission accordingly. However, to date the Greek authorities have not formally communicated any amendments to the legislation at issue.

### Ireland



The Irish Revenue has announced that following the enactment of the

Finance Act 2010, qualifying nonresident companies will be able to use a self-certification system to provide a declaration to a dividend-paying company or qualifying intermediary that it is exempt from dividend withholding tax. The Finance Act 2010 removes the requirement for certain non-resident companies receiving dividends from Irish resident companies to provide a tax residence and/or auditor's certificate, along with a signed non-resident declaration form in order to obtain exemption from Dividend Withholding Tax (DWT) at source. Instead, a self-certification system will apply under which a qualifying non-resident company will provide a declaration to the dividend paying company or qualifying intermediary to claim exemption from DWT.

### Israel



The Tel Aviv District Court ruled in Landau Insurance Agency that a

transaction undertaken by the taxpayers did not qualify as a sale of goodwill and thus was not eligible for beneficial capital gains tax treatment. The taxpayers, who are insurance agents, entered into an agreement under which:

- the parties would establish a corporate insurance agency in which the taxpayers would hold a major equity interest and
- a buyer would purchase 49 percent of the goodwill of the taxpayers' existing agency and transfer it, together with the remaining goodwill of the taxpayers (51 percent), to the new corporate agency.

The taxpayers agreed not to compete with the new corporate agency and to be in its employment for a lengthy term. The taxpayers claimed capital gains tax (CGT) treatment on the sale of the goodwill. The assessing officer countered that the subject matter of the sale was not goodwill, which in the tax year under consideration was eligible for generous tax relief while other, noninflationary capital gains were subject to ordinary income tax rates.

**Italy**

The Italian tax laws provide reporting requirements for

transactions with blacklisted countries, which have included transactions with business parties such as Swiss companies. The reporting requirements only apply to purchases of goods and services from non-EU suppliers, whether intragroup or third parties. The reporting system only requires taxpayers to list the total volume of purchases from blacklisted suppliers in two separate, matching lines of the annual income tax returns, with no further details required. The Italian government, has introduced new reporting requirements for transactions with blacklisted countries or transactions otherwise deemed as high risk from a tax standpoint.

**Luxembourg**

BTP World S.A. dealt with the deductibility of foreign exchange losses.

The taxpayer was a Luxembourg resident that made available to its Swiss branch a determined sterling amount. The accounts of the Swiss branch were held in sterling, but the tax balance sheet of the Luxembourg head office were held in Euros. The Luxembourg head office recorded in its accounts as capital for its branch which was the Euro equivalent of the sterling amount transferred, using the exchange rate as of the date of the allocation. Those funds were then partially repatriated by the Luxembourg head office, to be distributed as dividends to its UK parent.

On the repatriation, the euro-pound exchange rate resulted in a lower euro amount than initially recorded. Thus, a foreign exchange loss occurred at the level of the Luxembourg head office due to the decrease in value of Euros against UK pounds.

The tax authorities denied this deduction under the Swiss treaty which allocates the taxation rights to the state of the permanent establishment, the mirroring rule should apply for losses realised by the permanent establishment. The court agreed with the taxpayer and admitted that the deduction of foreign losses in the hands of a Luxembourg resident company would entail the risk of a double deduction for the foreign losses but stated that it is the duty of the legislature to take appropriate steps to introduce a mechanism for recapture.

**Netherlands**

In X Holding, the European Court of Justice found that the

Dutch fiscal unity regime did not have to be extended to cover a nonresident subsidiary because the profits of that nonresident subsidiary were not subject to taxation in the Netherlands. This judgment could have a direct effect on all European member states with some kind of consolidated tax group system (including France, Germany, Italy, Portugal, Spain, Sweden and the UK).

### Norway



Prior to 2007, shipping income was basically tax free. Taxation would take

place if profits were distributed to shareholders. In principle, a taxpayer could control when a taxable event would occur, and no taxable event would occur if the profit was lost before the distribution took place. In that event, the taxpayer was subject to a modest tonnage tax.

In 2007, Parliament decided that two-thirds of the latent taxes under the old regime – estimated at approximately NOK 14 billion – should be paid to the state over 10 years at a rate of at least 10 percent per year, regardless of any distribution of profits to shareholders. Norway's Supreme Court agreed with ship owners Farstad Shipping, Bergshav Tankers, and BW Gas that transitional

rules relating to amendments in Norway's tonnage tax regime violated the Norwegian Constitution, which forbids retroactive legislation.

### South Africa



Dividend distributions from South African corporations are

currently subject to Secondary Tax on companies (STC), but as STC does not qualify as a withholding tax, treaty benefits are not available to mitigate the cost of STC to foreign investors. There are now existing proposals that a new dividends tax would replace STC, and that the new dividends tax could qualify as a withholding tax under double tax treaties to which South Africa is party. Overseas investors should consider their repatriation structures and the timing of repatriations from South Africa in light of these proposals.

### Spain



Spanish legislation establishes the obligation to withhold tax on

dividends distributed by foreign entities if the securities are deposited in Spanish resident institutions or in foreign institutions acting in Spain through a permanent establishment. The Directorate General of Taxes (DGT) had held that the withholding tax was to be applied on the gross amount of the dividends and not the net amount (after the deduction of any withholding tax at source). Spain's Central Economic-Administrative Court (TEAC) disagreed with the DGT's view, stating that the basis of the withholding tax is the net amount of the distributed dividend, after deducting withholding taxes at source.

## United Kingdom



The UK is in the process of proposing revisions to its CFC legislation. The main proposals in HM Treasury's discussion document on the reform of the CFC regime are summarised below.

### Scope of the proposals

- the rules will operate on an "entity basis"
- there will be objective tests to exclude subsidiaries where there is low risk of artificial diversion
- the rules will be drafted on an "exemption" basis. Thus, a CFC meeting certain prescribed criteria is exempted from the regime
- chargeable gains of a CFC remain excluded

- a new test will replace the "lower level of tax" test. The effect of the new test should be to exclude companies in territories with tax rates and tax bases similar to the UK. If implemented as expected, HM Treasury hopes that this would obviate the necessity for a white list.

### Exemptions from the new rules

- there will be objective tests that will exclude from the regime CFCs undertaking genuine trading activities. Here, special attention will be given to intra-group activities. The legislation will need to be drafted carefully to ensure that such activities are not caught if they do not pose a risk to the UK tax base

- extension of the "trading company exemption" to bring within its ambit genuine offshore treasury operations and the active management of intellectual property
- extension of the "trading company exemption" to non-trading income of a trading company where such income is incidental or ancillary to the trade
- specific exemption for particular activities where there is no artificial diversion of profits from the UK, eg certain reinsurance subsidiaries and property subsidiaries
- increase in the de minimis limit from GBP 50,000

- two further routes to exemption, to apply where other exemptions are not available. One will apply where exemptions are narrowly missed, or where a one-off transaction results in a test being failed. The intention is to legislate for some flexibility in these areas. The second avenue is a reformed motive test
- proposals to extend the current "period of grace" motive clearance arrangements.

# APAC news

## Australia



A recent Australian Tax Office (ATO)

Interpretive decision

indicated that where an entity is required to withhold an amount from a payment that it makes to a non-resident in relation to royalties, the withholding is based on the goods and service tax (GST) inclusive amount of the payment. According to the decision, a resident entity, AusCo, makes payments to ForCo, a non-resident. The payments include amounts which are royalties and for the purposes of Australia's various tax treaties. ForCo is registered for goods and services tax (GST) in Australia. The payments from AusCo are for goods and services which are taxable supplies.

The contractual agreement between the parties specifies the payment of a base amount calculated by reference to the use made by AusCo of the rights granted to it by ForCo without the addition of GST (the GST exclusive amount). The contract also includes a 'GST clause' that provides (where applicable), an amount for GST will be added which is calculated on the base or GST exclusive amount resulting in final payments that are GST inclusive.

Australian companies have expressed concern that the ATO's approach of "reconstructing capital structures" to determine whether debt deductions are at arm's length, including the role that the credit rating of the parent entity plays, is contrary to prior industry practice. Australia's Inspector General of Taxation, in a report to Parliament, has concluded that the Australian Taxation Office changed its guidance on how the nation's transfer pricing rules interact

with thin capitalisation rules regarding related-party debt arrangements, but prior ATO statements never put taxpayers on notice of such a change in approach.

The ATO issued guidance concerning the migration of Australian resident trusts. The taxpayer, a foreign resident funds manager, owns 100% of the units of Australian Trust which is a resident trust for CGT purposes. The trustee of the Australian Trust owns assets that are not taxable Australian property. Australian Trust will cease to be a resident trust for CGT purposes. The change of residency of Australian Trust will trigger CGT.

Australian domestic income tax law requires companies to allocate retained profits between two notional accounts, one comprising profits that have borne the full company tax rate of 30 percent and the other comprising profits that have borne no tax at the company level.

The Australian domestic law exempts dividends paid from fully taxed profits from withholding tax while dividends paid from profits that were not taxed at the company level are subject to a 30 percent withholding tax. The Australia-US tax treaty reduces the Australian withholding tax rate on otherwise taxable dividends paid to a US shareholder to 5 percent if the US shareholder has a 10 percent or greater holding in the Australian subsidiary and exempts the dividend entirely from withholding tax if the US shareholder has an 80 percent or greater shareholding. The ATO in an interpretation decision has denied treaty benefits to a US limited partnership seeking to access the exemption from Australian withholding tax provided in the Australia-US treaty.

The Assistant Treasurer announced that the government will introduce legislation to make amendments to the capital gains tax (CGT) provisions to improve the ability for businesses to restructure. The government will:

- extend the CGT roll over for the conversion of a body to an incorporated company
- broaden access to additional CGT roll overs for Australian resident taxpayers holding interests in entities that restructure using a share or interest sale facility for foreign interest holders and
- allow CGT demerger relief for certain demerger groups that currently cannot access the relief.

### China



China's State Administration of Taxation (SAT) issued a circular which contains new rules for representative offices (ROs) of foreign enterprises regarding the enterprise income tax (EIT), business tax, and VAT. The Circular states that an RO will be required to set up accounting books in accordance with relevant laws, regulations of the State Council, and rules of the finance and taxation departments of the State Council; to proceed with accounting treatment using legitimate and valid vouchers; and to accurately calculate its taxable gross income and taxable income based on the matching principle of its functions and risks.

A cost-plus method will apply to an RO that can rightly compute its operating expenses but cannot accurately calculate its gross income or costs and expenses. A gross income-based method is available for an RO that can rightly compute its gross income but cannot correctly compute its cost and expenses.

The circular clarifies that an RO performing VAT and business tax activities will be subject to VAT and business tax that are calculated based on the relevant tax regulations.

### Hong Kong



The sourcing of profits continues to be an important tax issue as more local companies are involved in mainland China. The Review Board recently addressed the situation where a taxpayer, a company incorporated in Hong Kong, entered into a contractual agreement with a mainland factory in 1993. Only 50% of the taxpayer's profits were chargeable to Hong Kong profits tax. In 1994, approval from the relevant mainland authority was given to the taxpayer for changing the arrangement with the factory from a contract processing enterprise to a foreign investment enterprise. The factory thus became owned by a Mainland incorporated company ("PRC Co"). The taxpayer wholly owned PRC Co.

The taxpayer contended, and the Board of Review accepted, that the operation did not change despite the change of status of the factory to PRC Co. The taxpayer successfully persuaded the Board that the accounts of PRC Co did not reflect reality and that they were maintained to satisfy the tax authorities of the Mainland.

The taxpayer in *Ahn Sang Gyun v. Commissioner* was a Korean national who worked for Goldman Sachs (Asia) LLC (GSALLC). He was based in Hong Kong but spent a substantial part of his time each year working outside Hong Kong. He claimed that, under the territorial tax he was taxable only on the portion of his income that was attributable to work done in Hong Kong. The IRD did not accept the claim, and assessed tax on all his employment income. His appeal to the Inland Revenue Board of Review was unsuccessful.

In *Datatronic Ltd. v. Commissioner of Inland Revenue*, the Court of Appeal held that the taxpayer was taxable on all of its profits from the sale of goods manufactured in mainland China by a controlled subsidiary. The court took a formalistic view and said that the taxpayer could not be considered to have earned any part of its profits from manufacturing because, as a legal matter, the taxpayer derived its profits from the resale of finished goods that it had purchased from its manufacturing subsidiary.

*Ngai Lik Electronics Co. Ltd. v. Commissioner of Inland Revenue* involved a Hong Kong taxpayer that had purchased finished goods at a high price, thereby shifting profits to its mainland subsidiary, which presumably had the benefit of a tax holiday. The Inland Revenue Department (IRD) challenged the arrangement and assessed the taxpayer as though it had purchased the goods at cost. The Court of Final

Appeal held that the general anti-avoidance rule was applicable, but that the IRD had been wrong to include in the taxpayer's assessable income the profits properly attributable to the manufacturing activities of the subsidiary. The court remitted the case to the IRD for a determination of the profits that would have been realised by the taxpayer if it had paid an arm's-length price to its mainland subsidiary.

## India



McKinsey US provided a related party in India with consulting services, including the provision of financial information on specific business sectors and corporations that was required in the course of delivery of services by the related party in India. The Indian related entity paid McKinsey for the services it provided. McKinsey had no permanent establishment (PE) in India under article 5 of the income tax treaty. McKinsey maintained that the fees it received were in the nature of business profits and could not be classified as fees for included services because the services did not make available any technical knowledge, experience, skill, know-how, or processes, or transfer any technical plan or design to the Indian related party. McKinsey argued that because it had no PE in India, its fees were not subject to tax in India. The tax officer said the services provided by McKinsey made available knowledge to the Indian

entity and the payments for the services were in the nature of fees under the tax treaty and were subject to Indian tax. McKinsey appealed to the commissioner of income tax appeals, who agreed with McKinsey and overturned the assessment.

In another PE decision involving a Mauritius resident company involved in shipbuilding, the company had three separate contracts. None of these contracts was for the duration of more than nine months, and for that reason, and according to the company, the case of the revenue failed the treaty PE duration test.

The taxpayer argued that the duration was to be tested on the basis of each of the contracts individually rather than collectively under all contracts as the tax officer maintained. The Indian tribunal held that, for the purpose of determining the existence of permanent establishment, all the contracts were to be considered independently as these were not inter connected.

The India-Mauritius tax treaty provides that capital gains derived by an entity are taxable only in the residence state. Thus, a Mauritius-based company deriving gains from the sale of shares in an Indian company will not be taxable in India; the gains will be taxable only in Mauritius, which does not tax capital gains. The result is that any gains on such transactions are tax free both in India and Mauritius. An advance ruling was recently issued to a US based taxpayer with an intermediate Mauritius holding company owning an Indian company. The taxpayers requested treaty relief but was initially denied on the basis of substance in the holding company. After pursuing the issue in courts the taxpayer was successful in receiving a favourable ruling.

### Japan



The controlled foreign co-operation (CFC) rules have been liberalised. The following provisions are all effective for CFC tax years beginning on or after 1 April 2010.

- the application of these rules partly depends upon the effective tax rate of the CFC. The effective tax rate that avoids application of the rules has been reduced from more than 25% to more than 20%
- the threshold CFC stock ownership by Japanese shareholders who are subject to current inclusion of tainted CFC income is increased from 5% to 10%
- under the new law, in determining the main business of a CFC that is both a holding company and carries on another business, the holding of shares will be disregarded if the CFC is wholly-owned (directly or indirectly) by a Japanese parent and directly owns 25% or more of the voting power and shares of at least two foreign corporations (controlled corporations) which conduct active businesses
- to relieve the double taxation of income from a lower-tier CFC through a non-CFC, dividends attributable to previously taxed retained earnings of a lower-tier CFC are now exempt, provided certain conditions are met.

**Korea**

The Korean National Tax Service announced a new tax audit plan on 24

September 2010 that sets out criteria for companies that will be selected for tax audits. Companies with sales revenue of Korean Won 500 billion or more will be subject to a tax audit every four years. Previously, large companies were selected for audit based on the results of their compliance with filing obligations or if they had not been audited for a long time.

Companies with sales revenue of KRW 5 billion or more will be selected for audit on the basis of results of analysis of their compliance with filing obligations. Medium-size companies were previously audited under the same conditions as large companies.

Companies with sales revenue of less than Korean Won 5 billion will be selected for audit, based on the results of an analysis of their compliance with filing obligations, as well as by random selection. There will be exceptions to these thresholds.

**Thailand**

The Board of Investment has released measures to promote investment in

activities related to energy conservation and alternative energy; activities related to manufacturing eco-friendly materials and products and activities related to high technology. Major incentives that will be granted are; exemption of import duties on machinery and equipment, eight year exemption of corporate income tax (except the projects located in Bangkok) and 50% reduction of corporate income tax for five years. Approved projects for upgrading machinery to conserve energy will be granted three year exemption of corporate income tax on the existing operation. The total amount of corporate income tax to be exempted must not exceed 70% of the total value of investment in machinery upgrade.

Approved projects concerning technology upgrades or the manufacturing of new products will be exempt from import duties on machinery and corporate income tax on new product(s) for three years.

# Americas news

## Argentina



The Argentine Income Tax Law classifies payments for technical advice given from abroad as income from local sources, despite the location of supply. Argentina's Federal Court of Appeals recently reversed a 2007 ruling by the Tax Court that had limited the concept of Argentine-source income to its strict legal boundaries. At issue was the business relationship between the Argentine airline Austral Lineas Areas and the Spanish service provider Amadeus. The latter provided access to a worldwide database designed to facilitate bookings and reservations for hotels, car rentals, and flights. Austral was required to pay a booking fee when a reservation was actually made. According to the Argentine

Revenue Service (ARS), that payment constituted Argentine-source income in the hands of the Spanish company and was therefore subject to withholding tax at source.

Argentina's National Tax Court, in a recently published decision, clarified the scope of the country's financial transactions tax (FTT) which applies on bank accounts, debits and credits and on any organised payment systems aimed at not using bank accounts. The issue is material because in addition to the domestic context, the provision can sometimes apply to cross-border payments for goods sold or services rendered.

## Brazil



Brazil recently introduced new rules dealing with the

drawback regime for local purchases and imports. The new rules address local purchases of materials used in the manufacturing of final products destined for export. The ordinance provides that the import tax (II), the federal excise tax (IPI), the Program for Social Integration contribution (P.I.S.), and the Contribution for the Financing of Social Security (COFINS) will be suspended on acquisitions in domestic markets and on imports of products used in consumption, on manufacturing of products destined for export.

Significant changes have been introduced for transfer pricing. Among the most relevant aspects of the changes is the revocation of the resale price less profit method (PRL), which was divided into PRL (Resale) and PRL (Production), the latter available for companies that import items subject to further manufacturing processes in Brazil. Those two methods have now been replaced by the sales price less profit method (PVL). Another important change empowers the Ministry of Finance to establish different profit margins based on the business sector for transfer pricing purposes.

## Canada



The taxpayer in RCI Environment Inc. is a trust settled under the laws of Barbados. In 2006 RCI Trust disposed of shares of a taxable Canadian corporation, RCI, resulting in a capital gain. The purchaser was a Canadian corporation. RCI Trust applied to the Canada Revenue Agency for a certificate that would relieve the buyer of its obligation to deduct part of the proceeds of disposition and remit the withheld amount on behalf of RCI Trust to the government. The government refused the certificate and the taxpayer appealed under the treaty that it was Barbadian resident.

The Tax Court of Canada allowed the appeal in TD Securities concluding that a Delaware limited liability company was liable to tax in and therefore a resident of the United States for purposes of the Canada-US income

tax treaty. This case overturns the Canada Revenue Agency's long-established position that LLCs that are fiscally transparent for US purposes cannot be US residents for treaty purposes before the application of the fifth protocol to the Canada-US. The Toronto-Dominion Bank is a widely held Canadian bank with several foreign subsidiaries. The appellant, TD LLC, is a Delaware LLC that is a disregarded entity for US federal income tax purposes. TD LLC is a registered US broker-dealer that provides financial services in capital markets and maintains a Canadian branch to provide some services to its US customers.

In 1989, Imperial Oil issued debentures in US dollars and later redeemed a portion of those debentures in 1999. The U.S. dollar had appreciated against the Canadian dollar and Imperial Oil suffered a loss on redemption which represented the original discount and the

foreign exchange loss. It took the position that it was entitled to deduct from income the entire loss. The Minister of National Revenue decided that the loss was predominantly a capital loss and not deductible loss allegedly resulting from the purchase of the 1989 debentures. The Minister disallowed the deduction. The Tax Court of Canada confirmed the Minister's assessment, finding that the change in the value of the Canadian dollar during the term of the debentures had not resulted in any realised loss or cost.

## Mexico



The flat tax is calculated at 17.5 percent (17 percent in 2009 and 16.5 percent in 2008) on a base consisting of a company's revenue (excluding interest income and related party royalties) less certain deductions, all determined on a cash basis. Mexican residents and permanent establishments of foreign companies are subject to the tax. The deductions allowed for purposes of the flat tax include purchases of inventory, fixed assets and land, and payments for services and the lease of equipment or real property, but exclude interest payments, payments of royalties to a related party, and payments of compensation and federal payroll taxes. Because the flat tax law allows the immediate deduction of the acquisition cost of fixed assets, the purchase of fixed assets can eliminate a taxpayer's flat tax liability in the current year and future

years, but the IETU does not provide for depreciation of fixed assets, and it taxes the gross amount that a taxpayer receives on the sale of inventory or fixed assets. Taxpayers filed actions, known as amparos, challenging one or more provisions of the IETU law on a variety of grounds. The Supreme Court of Mexico has rejected challenges to the constitutionality of Mexico's single rate tax (IETU), which went into effect two years ago as an alternative minimum tax for the Mexican income tax.

### Peru



New capital gains taxation rules have been introduced for nonresidents (individuals and companies) regarding the transfer of shares, capital participations, investment shares, certificates, bonds, commercial papers, mortgage certificates, bearer obligations, bearer securities, and any other instruments issued by Peruvian entities. Until December 31, 2009, the sale of shares and securities of Peruvian entities by nonresidents were levied at the rate of 30 percent of the taxable net income. However, if the shares and securities were traded on the Peruvian Stock Exchange, the sale was exempted. In 2010 new rules brought about changes. If the sale occurs on the Peruvian Stock Exchange, the 100 percent tax exemption is no longer applicable.

The tax generated by non-residents must be collected on a source-based withholding structure. This structure requires a resident withholding agent.

### USA



Announcement 2009-10 generally affecting domestic matters, states that the Internal Revenue Service is developing a schedule that will require corporations that have more than \$10 million in assets and one or more uncertain tax positions to disclose those positions to the IRS. Each uncertain tax position for which the taxpayer or a related entity has recorded a reserve in its financial statements must be disclosed, as well as the maximum amount of potential federal tax liability attributable to each uncertain tax position.

The Tax Court held in Container Corp. that fees paid to a foreign corporation by its US subsidiary for guaranteeing the subsidiary's debt were foreign-source income not subject to 30% withholding. The case is significant since it modifies the US withholding and foreign tax credit regimes because the IRS has historically sourced such guarantee fees the same as interest paid by an obligor.

The Health Care and Education Reconciliation Act of 2010 codified economic substance. In the case of any transaction to which the economic substance doctrine is relevant, such a transaction shall be treated as having economic substance only if (a) the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and (b) the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction.

Persons domiciled in the United States at death are subjected to an estate tax on the value of the person's worldwide assets. Deductions and credits are available to reduce and defer the tax. Persons who are not domiciled in the United States at death, but who own United States situs property are subjected to estate tax.

Estate tax treaties modify the asset inclusions. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA 2001) reduced the maximum estate tax rates (from a high of 55 percent in 2001 to a high of 45 percent in 2009) and raised the exemption amount (from \$675,000 in 2001 to \$3.5 million in 2009) for US decedents.

While foreign domiciliaries were able to benefit from the reduction in estate tax rates, they were unable to benefit from the increase in the exemption, as it remained a constant \$60,000. EGTRRA had a sunset provision, which became

effective as of 1 January 2010, providing for suspension of the estate tax in 2010 and reinstatement at 2001 levels in 2011.

All domiciliaries, whether US or foreign, are exempt from US estate tax during 2010. While there is no estate tax in 2010, heirs will no longer be able to inherit assets and receive a full basis step-up to fair market value.

They will inherit assets with a carryover basis for other than foreign corporate stock or passive foreign investment company stock.

In 1995, Xilinx and XI entered into a Cost and Risk Sharing Agreement ("the Agreement"), which provided that all right, title and interest in new technology developed by either Xilinx or XI would be jointly owned. Under the Agreement, each party was required to pay a percentage of the total research and development costs in proportion to the anticipated benefits to each from the new technology that was expected to be created.

Specifically, the Agreement required the parties to share:

- direct costs, defined as costs directly related to the R&D of new technology, including, but not limited to, salaries, bonuses and other payroll costs and benefits
- indirect costs, defined as costs incurred by departments not involved in R&D that generally benefit R&D, including, but not limited to, administrative, legal, accounting and insurance costs
- costs incurred to acquire products or intellectual property rights necessary to conduct R&D. The Agreement did not specifically address whether employee stock options (ESOs) were a cost to be shared. Xilinx offered ESOs to its employees.

The IRS issued notices of deficiency against Xilinx contending ESOs issued to its employees involved in or supporting R&D activities were costs that should have been shared between Xilinx and XI under the Agreement. The tax court found that two unrelated parties in a cost sharing agreement would not share any costs related to ESOs and the appeals court concurred.

Veritas (V) entered into a cost-sharing arrangement with its subsidiary (S) to develop and manufacture storage management software products. Under this cost-sharing arrangement, V granted S the right to use certain preexisting intangibles in Europe, the Middle East, Africa, and Asia. As consideration for the transfer of pre-existing intangibles, S made a \$166 million buy-in payment to V. V employed the comparable uncontrolled transaction method to calculate the payment. In a notice of deficiency issued to V, the IRS employed

an income method and determined a requisite buy-in payment of \$2.5 billion and made an income allocation to V of that amount. The IRS reduced the allocation from \$2.5 to \$1.675 billion and further determined that the requisite buy in payment must take into account access to V's research and development team; access to V's marketing team; and V's distribution channels, customer lists, trademarks, trade names, brand names, and sales agreements.

V contended that the IRS's determinations were arbitrary, capricious, and unreasonable and the comparable uncontrolled transaction method is the best method to calculate the requisite buy-in payment. In this case the tax court for the most part agreed with V's conclusions.

### Venezuela



The decision by the Supreme Court of Justice in the case of Agencia Operadora La Ceiba, S.A. analysed the enforcement of the Organic Tax Code, which allows the Tax Administration to disregard the incorporation of entities and the entering into agreements. Furthermore, as regards to the adoption of legal forms and procedures which are inappropriate for the economic reality pursued by the taxpayer resulting in a reduction of tax liabilities. The Supreme Court ratified its warning, however, that “these tools must be used with the utmost care by tax authorities, ensuring they do not degenerate into arbitrary actions affecting the principle of ‘tax avoidance’. In tax matters it is understood that no individual may be bound to structure its business in the most burdensome way from a tax standpoint.”

# Transfer pricing news

## Italy



The Italian tax administration recently issued the International Standard Ruling Report, the first report on its advance pricing agreement programme. Under Italian tax law, the APA (or international standard ruling) programme is available for multinational enterprises that want to reach an agreement in advance with the Italian tax administration concerning: the transfer pricing method applicable to transactions conducted with related parties and, in some cases, the comparables used as benchmarks; the tax treatment of dividends, interest, royalties, or other income paid to or received from non-resident persons in specific situations, including the application of tax treaty provisions; and the application of legal provisions in

specific situations concerning the attribution of profits or losses to the permanent establishments in Italy of nonresident enterprises, as well as to the permanent establishment (PEs) abroad of resident enterprises.

## India



Quark Systems (QS) is an Indian subsidiary of Swiss company Quark Systems SARL (QSS), which provides information technology, data management, business process solutions and specialised manufacture's software for media companies. QS assists QSS by providing technical assistance to the parent company's customers and is a dedicated service provider for that purpose. For providing those services QS charged its fees at cost plus markup, a method that it supported with a transfer pricing study. As the tested party, QS selected the transactional net margin method (TNMM) for computing the arm's-length margin, selecting certain companies from a publicly available database for consideration as comparables. During the transfer pricing

audit, the tax officer agreed that the TNMM was the most appropriate method. However, the tax officer rejected one of the comparable companies, which had a significant loss. The company at issue was a telemarketing firm. The Income Tax Appellate Tribunal, upheld the tax officer's transfer pricing adjustment on the ground that one of the taxpayer's selected comparables did not have similar functional assets and risks.

## Hungary



The Hungarian Ministry of Finance introduced new regulations

regarding transfer pricing documentation requirements. The documentation must be prepared for each contract separately (provided that any business performance has been made during the tax year). In special circumstances, documentation can be produced on a consolidated basis, if the consolidation of the relevant contracts and documents does not prejudice the comparability of transactions.

Furthermore it must ensure the correct determination of the arm's-length price. If the value of the controlled transaction remains under a specific threshold, taxpayers are entitled to prepare a simplified documentation. In all other cases, the documentation must include a thoroughly detailed list of the necessary

particulars of the; associated enterprise, controlled transaction, relevant market, pricing method as applied, reasons for choosing methods, steps of comparable search, and so forth.



# Indirect taxes

## Russia



The Russian Ministry of Finance on April 15 issued Guidance

clarifying the VAT treatment of contracted services provided by Russian resident legal entities. This involved payments to non-residents for goods (including services) purchased by Russian resident legal entities outside of Russia.

## EU



ECOFIN reached agreement on a general approach for simplifying EU VAT invoicing rules, particularly the rules for electronic invoices. The revision would take the form of a new directive requiring greater harmonisation of national VAT invoicing standards, which vary widely among the 27 member states.

Input from the European Parliament is needed before the finance ministers can adopt the final directive.

The European Commission has decided to refer Belgium to the European Court of Justice over measures which allow tax exemptions for interest paid by domestic banks, but not for interest paid by foreign banks. France has a reverse-charge system whereby the client is designated as liable

to pay VAT if the supplier or vendor is not established in the country. This is in line with EU rules. However, by derogation from this system, the vendor is allowed to declare in his own tax statement the tax owed by his clients, as reverse-charged, and to offset this from his own due VAT. To be able to do this, a non-established vendor must register for VAT in France and designate a tax representative to declare and pay the VAT on his behalf. This is incompatible with the VAT directive which provides that taxable persons established in the EU and certain third world countries should not have to designate a tax representative for VAT in another Member State.

### Singapore



The 2010 Singapore Budget announced a measure to ease the

import goods and service tax (GST) cash flow for goods and service tax registered businesses called the Import GST Deferment Scheme (“IGDS”). The IGDS allows an approved business to defer the payment of import GST until the submission of the GST return for the prescribed accounting period. This will alleviate the approved business’ cash flow because it can claim the import GST as input tax at the same time the import GST is paid, which is at the time of submission of the GST return. The IGDS will apply to both dutiable and non-dutiable goods which are direct imports into Singapore, imported goods released from Zero-GST/Licensed warehouses for local consumption and local goods released from the Excise Factory where a supply has taken place prior to the release.

### UK



The UK Tax Tribunal in Integrated Resources Ltd denied zero rating VAT

on Red Bull energy drinks a company claimed it transferred from the UK to distributors in Spain and Poland. The company failed to properly document that the beverages were delivered.



# Treaty news

## Australia



The Australian Tax Office addressed a taxpayer who is a foreign resident, and is a resident of the United Kingdom (UK) for the purposes of the 2003 UK Convention. The taxpayer was employed by an Australian company. The taxpayer's employer decided to terminate the taxpayer's employment and paid the taxpayer a lump sum termination payment, part of which was calculated by reference to the number of years the employee had worked for the employer. The ATO determined that the payment was not governed by Article 14 of the treaty but instead was taxable under domestic Australian tax law.

In another ruling, the taxpayer was an individual and a resident of Australia for taxation purposes. The taxpayer received dividends from French sources, which were treated as dividends for French tax law purposes. The taxpayer did not carry on business through a permanent establishment in France. The issue addressed was whether the dividends were taxable in Australia but entitled to double tax relief for up to 15% of the French withholding tax.

## Belgium



The Belgian tax authority issued a new practice note on the application of Belgian income tax treaties' exemption (with progression) method for avoiding double taxation. The purpose of the practice note is to ensure that foreign-source income received by a Belgian resident will be exempted only if the taxpayer meets conditions established in the relevant article of the treaty (usually article 23). The practice note clarifies the rules and illustrates cases in which Belgium is required to exempt foreign-source income, as well as cases in which the exemption does not apply.

## China



China's State Administration of Taxation issued guidance clarifying the tax treaty treatment of technical know-how transfers and related technical services. They indicated that technical service activities relating to the transfer of usage rights to technical know-how constitute part of a technology transfer. Therefore income arising from those activities falls under the scope of royalties in China's tax treaties. It also says that if the licensor of the technology provides technical services in the location of the licensee by assigning personnel and has a permanent establishment in the location of the licensee according to the applicable tax treaty, the service income attributable to that permanent establishment will be subject to the terms of treaty article 7 (on business profits). Furthermore, the personnel will be subject to the

dependent personal service provisions of the treaty. Income from the technical services will still be subject to the royalty provisions if it is not attributed to the PE or if the services do not create a PE. The business profits rules will replace the royalty rules after the PE is created and the related income has been confirmed as being effectively connected with that PE.

In that case, income tax treatment previously subject to royalty clauses will be adjusted accordingly when subjecting the PE to enterprise income tax for the business profits, and the personnel to individual income tax.

China's State Administration of Taxation (SAT) rejected the application of the China-Hong Kong double taxation arrangement to interest income earned by a Hong Kong company from a wholly foreign-owned enterprise (WFOE) in China, according to media reports. This is a very common structure

between Hong Kong and mainland China. On behalf of the Hong Kong Company, the WFOE asked the tax office to approve a 7 percent treaty interest rate. The tax office investigated and concluded that the Hong Kong company did not manufacture, distribute, manage, or conduct any other substantial business activities, and that therefore it was a conduit company and did not satisfy the criteria for DTA benefits.

### Panama/Hong Kong



Tax treaty developments have occurred recently in jurisdictions not known for having extensive tax treaty networks.

The governments of Panama and Qatar signed a tax treaty and according to the Panamanian Economic and Finance Minister Panama will make it a priority to also conclude tax treaties with France, Luxembourg, Singapore, South Korea, India, Japan, Switzerland, Israel, and the U.K. In recent years, Panama has signed tax treaties with Belgium, Italy, Holland, Barbados, Spain, and Mexico.

The governments of Hong Kong and Kuwait signed a double taxation agreement. Under the terms of the agreement, cross-border dividend and royalty income will be subject to 5 percent withholding tax levied by the source jurisdiction.

## Russia



The Russian Ministry of Finance recently clarified the application of the

Cyprus-Russia income tax treaty to dividend payments made to Cyprus residents. The Ministry noted that dividends paid by a company that is a resident of a contracting state to a resident of the other contracting state may be taxed in that other state. Those dividends may also be taxed in the state in which the company paying the dividends is a resident and according to the laws of that state. However, if the beneficial owner of the dividends is a resident of the other state, the tax charged may not exceed 5 percent of the gross amount of the dividends if the beneficial owner has directly invested at least \$100,000 in the company. A 10 percent tax rate applies to the gross amount of dividends in other cases.

The Ministry stated that in accordance with the memorandum of understanding to the Cyprus-Russia treaty, the term “direct investment” for the purposes of the treaty means the acquisition of a company’s shares on initial and supplementary share issues and in the secondary securities market, including share acquisitions directly from the previous owner or on stock exchanges. The memorandum also provides that the \$100,000 investment requirement refers to the amount the investor actually paid at the time of the purchase of the shares and cannot be recalculated later because of currency or stock exchange fluctuations. The Ministry of Finance also explained that the reduced 5 percent tax rate applies if the Cyprus resident’s direct investment in the Russian company has reached \$100,000 by the dividend payment date.

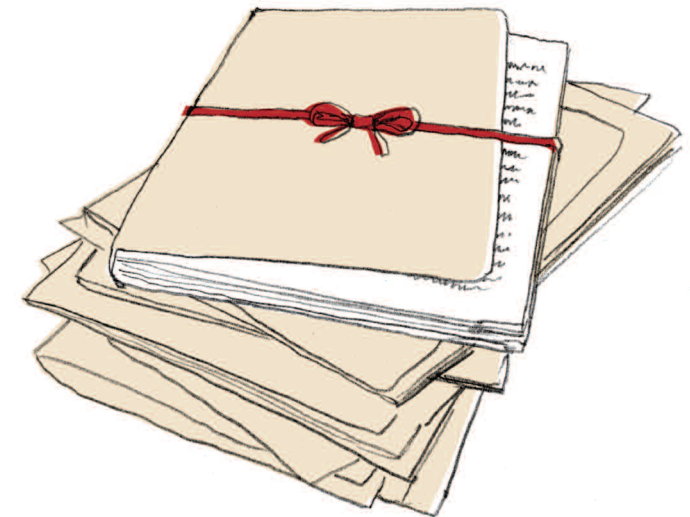
## Taiwan



Taiwan’s Ministry of Finance has issued an explanatory letter on new

audit criteria for applications for benefits under Taiwan’s income tax treaties. The new audit criteria consist of guidance:

- general rules
- jurisdictional income tax collection rights
- the reduction and exemption of various types of income
- the computation of taxable income
- applications for tax refunds
- the issuance of certificates
- mutual consultation
- exchange of information and supplementary provisions.



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