

# international tax alert

Issue 4 – March 2010  
All Regions

## Chairman's Note

Welcome to the 1<sup>st</sup> edition for 2010 of PKF International Tax Alert, a publication designed to summarise key tax changes around the world. This publication is issued three times per year in soft copy format only and can also be found on the PKF International website [www.pkf.com](http://www.pkf.com)



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# BELGIUM

## Belgian Dividend – Received Deduction becomes more attractive

In the Cobelfret-case (CJ February 2009, 12th, C-138/07), the European Court of Justice has given judgement that the Belgian participation exemption regime is not in line with the parent-subsidiary directive whereas an excess dividend-received deduction could not be carried forward. As from 1 January 2010, the Belgian tax authorities have amended the Belgian tax legislation in this respect.

### Dividend received deduction

Belgian tax legislation provides a 95% dividend-received deduction (hereafter 'DRD') for inter-company dividends. The dividends concerned are first included in the taxable basis. Afterwards 95% of the dividends received can, in principle, be deducted if both a minimum participation and a taxation condition are fulfilled. The remaining 5% remains included in the normal taxable basis and can be subject to the standard Belgian income tax rate of 33.99%.

The minimum participation condition includes:

- a participation threshold: The recipient company must have, at the moment of attribution, a participation of at least 10% in the share capital or an acquisition value of at least EUR 2,500.000 (as from 1 January 2010) in the distributing company.
- a permanency condition: the recipient company must have been holding the full legal ownership of the underlying shares for at least one year prior to the dividend distribution or commit to hold it for a minimum of one year (share-per-share test). Moreover, the shares should be accounted as financial fixed assets.

The taxation condition is met in case the subsidiary is subject to a corporate income tax similar to Belgian corporation tax. Furthermore, the DRD regime will in principle not be applicable for dividends paid by a tax haven company (for non EU companies the minimum nominal effective tax rate or effective tax burden must be 15%). Other anti-avoidance legislation also exists.

### Excess DRD

In the past, problems arose if the DRD exceeded the taxable profit of the taxable period during which the dividend was received. Initially, this "excess DRD" could not be carried forward and thus was definitely lost in case of insufficient taxable profit available.

In the Cobelfret case, the Belgian State has been condemned because the DRD-regime was not compliant with European law, more precisely with the Parent-Subsidiary directive that is aimed at avoiding economic double taxation. Consequently, the Belgian tax legislation has been amended by law of 21 December 2009 in order to comply with European law, i.e. as from 1 January 2010 excess DRD can be carried forward indefinitely to future assessment years.

The judgement of the European Court of Justice implies that, as from 1 January 1992, excess DRD can be carried forward provided that in the meanwhile no final corporate tax assessment has been issued on the outstanding excess DRD.

This implies that companies that already have claimed the excess DRD (and have an administrative or judicial complaint running) and some companies that were not able to claim the excess DRD because they have been in a loss making position ever since, can already benefit from the new excess DRD regime even for the period before 1 January 2010.

### Conclusion

Belgium already had a favourable tax regime for holding and financial companies.

Capital gains on shares are often tax exempt, dividends received are benefiting most of the time from a 95% deduction while interest paid on loans borrowed for the acquisition of shares is, in principle, tax deductible. Additionally, an extensive treaty network is available and tax rulings can be negotiated with the Tax Authorities.

The new legislation, allowing the excess dividend-received deduction to be carried forward indefinitely, is an additional incentive for choosing Belgium when setting up group structures.

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# CANADA

## Federal Budget

On 4 March 2010, federal Finance Minister Jim Flaherty tabled his 2010 Budget in the House of Commons. It is his fifth Budget since assuming the finance portfolio.

Titled "Leading the Way on Jobs and Growth," the Budget presents a wide-ranging package of provisions that provides for \$19 billion in new spending to create and protect jobs.

The Budget forecasts a deficit of \$53.8 billion for 2010, falling to \$49.2 billion in 2011, but sharp declines thereafter leading to a deficit of only \$1.8 billion in 2015.

This overview, and the more detailed comments that follow, focus on the significant proposed tax changes that we believe will be of interest to you.

Among other tax changes, the Budget tightens the rules for employee stock option benefits, curtails the use of losses on conversions of income trusts, and relaxes the disbursement quota rules for registered charities. The Budget also presents a federal information reporting regime regarding "aggressive tax planning" for public consultation.

## Personal Measures

### Employee Stock Options

#### Cash Outs

Currently, a stock option deduction of 50% of the gross stock option benefit is available to employees where qualifying criteria are met. The employer is not allowed to claim a tax deduction for the issuance of its shares. However, where the employee "cashes out" their stock option rights without first acquiring the underlying shares, the employee may still qualify for the 50% deduction and the related payment by the employer is fully deductible by the employer.

For transactions occurring after 4:00 pm (EST) on 4 March 2010, the Budget proposes to limit the 50% stock option deduction to the employee to situations where the employee first acquires the shares. Consequently, this 50% deduction would not generally be available where the employee cashes out their stock option rights without first acquiring the shares. However, the employer can elect to forgo the deduction for the cash payment and thereby allow the employee to claim the 50% stock option deduction.

### Public Corporation – Deferral Election and Remittance Requirements

Currently, employees of publicly traded companies can potentially elect to defer tax on up to \$100,000 of employee stock option benefits vesting in a particular year.

This deferral may cause financial difficulties for some employees where the value of the optioned securities is less than the deferred tax liability on the underlying stock benefit. The Budget repeals this tax deferral election for employee stock options exercised after 4:00 p.m. (EST) on 4 March 2010.

In conjunction with the repeal of the deferral, the existing withholding tax requirements will be clarified to ensure that the applicable tax on the stock option benefit is required to be withheld and remitted by the employer at the time the stock option is exercised. These measures will prevent situations in which an employee is unable to meet their tax obligations as a result of the decrease in the value of these securities.

These amendments to the withholding and remittance requirements will apply to stock option benefits arising on the issuance of securities after 2010 to provide time for businesses to adjust their compensation arrangements and payroll systems. In addition, these proposals will not apply to options granted before 2011, pursuant to an agreement in writing entered before 4:00 pm (EST) on 4 March 2010.

### Public Corporation – Special Relief – Decline in Value for Shares Acquired under Option

The Budget also offers special tax relief for tax deferral elections where a taxpayer disposes of securities of a public company before 2015 and the related stock option benefit was deferred upon the exercise of the option. This special relief will ensure that the tax liability on a deferred stock option benefit will not exceed the sale proceeds from the optioned securities after taking into account the tax relief resulting from the use of the capital loss on the optioned securities against capital gains from other sources.

Individuals who disposed of their optioned securities before 2010 will have to make an election for this special tax treatment on or before the filing due date for their 2010 tax return.

## Mineral Exploration Credit

The Budget extends the mineral exploration tax credit for one year to flow-through share agreements entered into on or before 31 March 2011.

## Medical Expense Credit and GST/HST Exemption

After 4 March 2010, expenses incurred for purely cosmetic medical procedures that are aimed solely at improving one's appearance, such as liposuction, hair replacement and teeth whitening, are no longer eligible for the medical expense credit. The Budget also clarifies that GST/HST applies to supplies of such procedures and related goods made after 4 March 2010 and to earlier supplies where the supplier collected and remitted GST/HST in respect of the supply.

## Tax-Assisted Disability and Education Savings Plans

Tax-Assisted Registered Disability Savings Plans (RDSP) are enhanced by the following measures:

- A deceased individual's RRSP funds can be transferred tax-free to the RDSP (previously only transfers to an RRSP) of a financially infirm child or grandchild, effective for deaths occurring on or after 4 March 2010, subject to the beneficiary's lifetime contribution limit of \$200,000. A special transitional rule applies where an RRSP annuitant dies after 2007 and before 2011. Such transfers are taxable in the beneficiary's hands when withdrawn from the RDSP.
- A 10-year carry forward, retroactive to 2008 is introduced for unused entitlements to Canada Disability Savings Grants (\$3,500 annually) and Canada Disability Savings Bonds (\$1,000 annually). Access to the contribution room commences in 2011.
- Provincial payments to RESPs and RDSPs will be on equal footing with the federal stimulus and, as such, do not reduce the contribution room for private contributions or attract federal grants.

## US Social Security Benefits

This Budget proposes to reinstate the 50-percent inclusion rate for US Social Security benefits for Canadian residents who have been in receipt of such benefits since before 1996 and for their spouses and common-law partners who are entitled to receive pension benefits.

This change addresses changes to the Canada-US tax treaty that increased the inclusion rate to 85%, as of 1 January 2006, and applies to such benefits received in 2010 or later.

## Business Measures

### Income Trust Conversions and Loss Trading

In light of the tax on income trust distributions introduced in 2006, the tax rules allow income trusts, partnerships and other specified investment flow-throughs (SIFT) to convert to corporate form on a tax-free basis. The Budget contains measures intended to curtail what the government considers to be inappropriate use of the SIFT conversion rules to achieve inappropriate loss trading. The loss trading usually involves a reverse-takeover where an acquiring corporation's tax attributes, including its loss carryovers, are available without restriction to shelter future income earned by the acquired SIFT trust. Existing tax rules prohibit such loss trading if the acquired entity was instead a corporation. The Budget proposes to extend these existing rules to situations where units of a SIFT trust or SIFT partnership are exchanged for shares of a corporation.

These rules apply to transactions undertaken on or after 4:00 pm (EST) on 4 March 2010 (except for transactions that parties are obliged to complete under a written agreement entered before that date).

### Taxation of Corporate Groups

The Budget indicates that the government will explore new rules for the taxation of corporate groups, including a formal loss transfer system or consolidated reporting.

## Interest on Overpaid Corporate Taxes

To curb possible deliberate overpayments of tax by corporations to earn attractive rates of refund interest from the government, and to reduce its cost of borrowing funds, the prescribed quarterly rate of interest on amounts owing to corporations will no longer include the 2% premium above the prescribed quarterly rate of interest. This measure is effective 1 July 2010 and also applies to GST/HST, EI and CPP contributions.

## Accelerated CCA for Clean Energy Equipment

The Budget proposes to expand the assets eligible for accelerated CCA in Class 43.2 (50% on a declining balance basis). For assets acquired on or after 4 March 2010, Class 43.2 includes certain heat recovery equipment.

## Specified Leasing Property Rules

The Budget extends the leasing property rules to otherwise exempt property if the lease is to a government or other tax-exempt entity or to a non-resident provided that the value of the leased property is \$1 million or more. This measure applies to leases entered into after 4:00 p.m. (EST) on 4 March 2010.

# International

## Section 116 and Taxable Canadian Property

Pursuant to Canadian tax rules, non-residents of Canada are subject to income tax in Canada on gains arising from the disposition of "taxable Canadian property". However, many of Canada's tax treaties with other countries contain an exemption from such tax in respect of taxable Canadian property, except for taxable Canadian property that is real estate or shares that derive their value principally from real estate.

The Budget proposes a relieving measure to amend the definition of "taxable Canadian property" to exclude shares of corporations (and certain other interests) that do not derive their value principally from real estate situated in Canada, Canadian resource property and timber resource property in order to reduce deterrents to foreign investors to invest in Canada. This measure will eliminate, in most cases, purchaser withholding and Section 116 certificate compliance obligations for these types of properties. It will also eliminate the existing requirement of a vendor to file a related Canadian tax return in instances where no Canadian tax liability exists in respect of the sale.

This measure will apply for determinations after 4 March 2010 of whether property owned by a taxpayer constitutes taxable Canadian property.

## Refunds under Regulation 105 and Section 116

Regulation 105 imposes a withholding tax requirement on payers on amounts paid to a non-resident of Canada who renders services in Canada. Section 116 imposes a withholding tax requirement on a purchaser of taxable Canadian property from a non-resident. In each case, the amounts are to be withheld and remitted to the CRA on account of a non-resident's potential Canadian tax liability. The responsibility of the payer to withhold and remit the subject taxes may exist notwithstanding that a non-resident is exempt from tax in Canada due to a tax treaty.

The ability of the non-resident to file a Canadian income tax return and claim a refund of any such excess amount is subject to certain time limits. The Budget proposes to correct a technical anomaly that otherwise prevents a non-resident from recovering any such excess amount withheld and remitted to the CRA. It is proposed that the tax return, giving rise to the refund, is required to be filed within two years of the assessment of the withholding tax.

## Foreign Investment Entities and Non-Resident Trusts

The Budget contains new proposals to replace previous draft proposals pertaining to Foreign Investment Entities and Non-Resident Trusts. Taxpayers who voluntarily complied with the previous draft proposals for Foreign Investment Entities may choose either to have applicable previous years reassessed or may claim a deduction in respect of any excess income previously reported in its current year.

## Measures for Charities

### Charities – Disbursement Quota

Currently, registered charities are required to spend a certain amount of their accumulated capital (“disbursement quota”) to ensure that a significant proportion of the charity’s resources are devoted to charitable purposes. For fiscal years ending on or after 4 March 2010, the Budget eases these requirements by:

- Eliminating the charitable expenditure rule that requires charities to expend 80% of their previous-year’s receipted donations and certain other amounts.
- Modifying the capital accumulation rule whereby 3.5% of all assets not used in charitable programs or administration must be spent annually. The exemption threshold for accumulated capital not used in charitable programs or administration is increased to \$100,000 of assets for charitable organisations (remains at \$25,000 for charitable foundations).
- Introducing anti-avoidance rules to situations where it can reasonably be considered that a transaction’s purpose was to delay or unduly avoid application of the disbursement quota and to ensure that amounts transferred between non-arm’s length charities are used to satisfy the disbursement quota of only one charity. Penalties of 110% of the expenditure avoided or delayed can be imposed on both charities on a joint and several basis.

### Information Reporting Regime for Aggressive Tax Planning

The Budget announces that the government will release proposals for public consultation on a formal reporting process for identifying aggressive tax planning transactions that may be considered abusive tax-avoidance plans (existing General Anti-Avoidance Rule (GAAR) regime). The federal regime will define a reportable transaction as a tax avoidance transaction that contains at least two of three “hallmarks” that commonly exist when taxpayers enter into avoidance transactions.

These hallmarks would include:

- Circumstances in which a promoter or tax advisor is entitled to fees to the extent they are attributable to the amount of the tax benefit or contingent on obtaining a tax benefit
- Where the promoter or tax advisor requires “confidential protection” related to the transactions
- Where the taxpayer or the person who entered into the transaction for the benefit of the taxpayer obtains “contractual protection” in respect of the transaction.

Tax shelters and flow-through share arrangements will be exempted as they have existing reporting mechanisms.

The new regime, as modified through consultations, would take effect after 2010.

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# CYPRUS

## Tax amendments update

Amendments to the Income Tax and Special Defence Contribution Laws

The Cyprus Parliament passed amendments to the Income Tax and Special Defence Contribution (SDC) Law on 22 October 2009 that makes Cyprus even more attractive to potential foreign investors. The amendments came into force with retroactive effect to 1 January 2009.

### Main changes:

- Dividend income received by a Cypriot tax resident company from abroad was subject to a 15% SDC if a minimum 1% holding in the payer company was not maintained. The 1% minimum holding requirement was abolished.
- Interest income earned by a company was subject to Corporation / Income Tax at 5% (exemption 50% of 10% corporation tax) and Special Defence Contribution at 10%. Now the whole amount of interest income is tax exempted from Corporation / Income Tax.

## Decrease of Public Interest Rate

The interest rate applicable with respect to overdue tax has been decreased from 8% per annum to 5.35% per annum as from 1 January 2010.

## Tax Treaty with Qatar

The tax treaty between Cyprus and Qatar which was signed on 11 November 2008 and ratified in 20 March 2009 has come into force as from 1 January 2010.

## Tax Treaty with Czech Republic

A new treaty between Cyprus and the Czech Republic was signed on 28 April 2009 and was ratified on 26 November 2009. This treaty replaces the previous 1980 treaty with Czechoslovakia.

### Main changes:

- Elimination of withholding tax on dividends (where holdings are 10% or more).
- Elimination of withholding tax on interest.

- Withholding tax on royalty payments will increase from 5% to 10%. However, as from 1 January 2011, royalties paid to Cypriot companies will be exempt from Czech withholding tax where the conditions of the EC Interest and Royalties Directive are satisfied.
- The treaty came into force as from 1 January 2010.

## Germany new protocol of tax treaty

The new Protocol replaces Article 26 of the existing Treaty on Exchange of Information which adopts the wording of the 2008 OECD Model Convention with only one exception of scope. The contracting States are allowed to use information received for non-tax purposes in those cases whereas the domestic laws of both States allow for this kind of use and that the supplying States authorises such use by the State that receives it.

There is also a provision for a comprehensive list of information to be provided by a Contracting State when making a request which follows Cyprus's domestic law requirements for providing information and includes provisions for the protection of personal data.

The new Protocol is expected to come into force immediately upon ratification by both States Parliaments.

## Cyprus – Russia New Protocol of Tax Treaty

After many discussions between the two countries, a protocol was signed on 16 April 2009. The protocol will be ratified in 2010 and includes the following:

### Main Points:

- Withholding tax on interest and dividends remain unchanged.
- Withholding tax on dividends 5% or 10% remain unchanged with the difference that those who are eligible for the 5% rate instead of the minimum USD 100,000 investment in the capital of the company where the shares are held, the minimum investment is EUR 100,000.
- Gains on the sale of shares in real estate property companies will be taxable in the country where the real estate is situated. This is in line with the OECD Model Treaty. This amendment will take effect as from the year following the expiration of a four year period from the date that the protocol enters into force.

- The Limitation of Benefits Article 29 has been incorporated in the Protocol in order to prevent any enterprise non-resident of the Contracting States involved from taking advantage of the benefits of the treaty.
- Adoption of Article 26 – Exchange of Information – adopts the wording of the 2008 OECD Model Convention.
- Where the place of effective management of a person cannot be determined, the Cypriot and Russian tax authorities shall determine this by mutual agreement.

## Tax General

The results of the amendments that took place during the previous year to the Income Tax Law (i.e exchange of information etc) were the inclusion of Cyprus to the White List of the G20 and the OECD.

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# HUNGARY

## New double taxation treaty with the USA and other recent tax changes

### Double Taxation Treaty with the USA

The United States of America and Hungary has signed the new convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. The new Treaty is expected to become effective on 1 January 2011.

A new feature is the introduction of a "limitation" to the scope of the Treaty. Companies resident in either of the countries can only benefit from the Treaty if their owners reside in Hungary, the USA or an EU member state, and they conduct actual business activity.

The highest rate of withholding tax on dividends is 15%. There is a discount maximum rate of 5% in case the owner has at least a 10% share in the company paying the dividend. As there is no withholding tax on dividend in Hungary, this measure only applies if the dividend is received from the USA.

The highest rate of withholding tax on interest will be increased to 15% from the previous 0%.

When determining the residence of a private individual, the 183-day-rule should no longer be applied to each tax year but to any period of 12 months that begin or end in the tax year.

The sale of shares of companies that own Hungarian properties will be taxed in Hungary, similarly to the sale of Hungarian property. The new Treaty allows the deduction of costs from the profit on the sale of property.

### Property tax act repealed

The Property tax act has been repealed after the decision of the Hungarian Constitutional Court.

The Court explained that the definition of 'market value' in the Act was unclear and the Tax office was given a broad authority to impose penalties. The Act has therefore created legal uncertainty for taxpayers.

### Income received from foreign companies

According to the Corporate Income Tax Act effective from 2010, interest income received from abroad is excluded when calculating the CIT base in order to avoid double taxation.

Interest income is 75% of the interest received from abroad, less the costs incurred related to the interest, and adjusted for other items in connection with the interest prescribed by the Act.

### Changes in the regulations for transfer pricing policies

The Minister of Finance Decree No 22/2009 changes the requirements related to the preparation of transfer pricing policies.

The transfer pricing documentation may be prepared in any language. The former legislation required a certified translation if the policy was prepared in a language other than Hungarian but, from the tax year 2009, a professional translation is also accepted (so the translation does not need to be certified). Another change already affecting 2009 is that the 50 million HUF threshold applicable to simplified documentation is also available in case the contracts are concluded for an indefinite period of time.

The new Decree provides a choice for the companies regarding the type of the documentation. The policies prepared according to the former legislation will be referred to as a "**single documentation**". The requirements of this type will not change significantly.

The new type introduced from 2010 will be called "**joint documentation**". This consists of two parts. The master-file contains common standardised information about all group companies resident in the EU. (Compulsory elements of the master-file will include the description of the corporate group and its business strategy, the presentation of the changes compared to the previous years and the documentation of the controlled transactions.)

The master-file will be followed by the country-specific documentation, whose requirements are largely the same as those of the single documentation. (It should include presentation of the company and its business strategy, description of the contract, determination of comparable prices, etc.)

Similarly to the current legislation, the transfer pricing policies will not need to be submitted to the Tax office or the Registry Court but taxpayers will need to declare in their corporate income tax returns whether they choose to prepare a single or a joint documentation.

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# INDIA

## Important Changes/ Notifications

- **Remittance of Consular receipts to non-residents:**

Circular No. 4/2009, dated 29 June 2009, prescribed the revised procedure for furnishing information regarding remittances being made to non-residents with effect from 1 July 2009. As per Article 28 of Schedule to section 2 of the Diplomatic Relations (Vienna Convention) Act 1972, the fees and charges levied by a diplomatic mission in the course of its official duties shall be exempt from all dues and taxes.

In view of the above, while remitting consular receipts abroad, diplomatic missions in India will be required to submit only a self-certified undertaking in Form No. 15CA to the remitter bank. They are not required to obtain a certificate from an accountant/certificate of Assessing Officer (Form 15CB). For detailed procedures for furnishing information regarding remittances of Consular receipts by diplomatic missions in India, please refer to the Circular.

**Circular No. 9/2009 [f. no. 142/19/2007-tp], 30-11-2009.**

- **Revised DTAA with Finland:**

Government of India has signed a revised DTAA with Finland. The revised DTAA would come into force after completion of internal processes in both the countries. Some of the important features of the revised agreement are:

1. Withholding tax rates have been reduced on dividend from 15% to 10%; and on royalties and fee for technical services from 15% or 10% to a uniform rate of 10%.
2. Provisions regarding service PE have been included in the Article concerning PE.
3. New Article on assistance in collection of taxes has been added to ensure assistance in collection of taxes when such taxes are due under the domestic laws and regulation.
4. Time test for Independent Personal Service has been extended from 90 days or more in the relevant fiscal year to 183 days or more in any period of 12 months commencing or ending in the fiscal year concerned.

## Important Judgments

### Court case

- **Payer's obligation to deduct TDS u/s 195 is unavoidable even if the payment received is non-taxable in the hands of the recipient:**

In the case of Samsung Electronics Co Ltd v. CIT, a very interesting decision was given by the Karnataka High Court which may have a wide-ranging impact. The High Court opined that when a resident makes a payment to a non-resident which is in the nature of an income receipt in hands of the non-resident, then the resident payer has to deduct the TDS u/s 195. It cannot contend that TDS need not be deducted because the payment would not result in taxable income in the hands of the non-resident or because the non-resident could have avoided tax liability under different provisions of the Act or the DTAA.

In the present case, the assessee purchased software also named as 'shrink wrapped, ready to sell, software' from the non-resident, and did not deduct TDS on the payment, under the bona fide belief that it was not taxable as 'royalty'. It was argued by the assessee that it had purchased only a copyrighted article (the software) not the copyright itself, therefore payment is not in the nature of royalty, and so it was not needed to deduct TDS. The assessing officer did not accept the contention of the assessee and held that receipt is to be treated as royalty as per section 9(1) of the Income tax act. The appeal made by the assessee against this order was dismissed by the Commissioner. In further appeal to the Tribunal, it was held that in this case the assessee had acquired only a copyrighted article, while the copyright remained with the non-resident. Therefore as per the definition mentioned in the DTAA, the payment made was not royalty and hence not taxable in India in the hands of the non-resident. Consequently, no liability of TDS deduction had arisen to the assessee u/s 195(1) of the Income Tax Act.

On further appeal by the Revenue, the Karnataka High Court ruled that:

- The obligation of the resident payer to deduct TDS u/s 195(1) comes into action the moment there is a payment to the non-resident which is in the nature of income in the hands of the non-resident.
- In all these appeals there was no dispute that payment made by the resident, whether it was for buying software or for royalty, resulted in some possible income in the hands of the non-resident.

- If the payment bears the character of an income receipt in the hands of a non-resident recipient, then the obligation on the part of the resident payer to deduct TDS u/s 195(1) is unavoidable. It is a different matter that when the non-resident recipient files its returns, it may claim non-taxability of such a receipt under the Act or DTAA.
- The only limited way to avoid or reduce TDS deduction u/s 195(1) is by invoking the provisions of sec 195(2), wherein it needs to be established that there was a computational error in determining the income of the non-resident arising from this payment. Even then the TDS obligation would be reduced only proportionately and may not be eliminated altogether.
- Therefore High Court set aside the order of the Tribunal and restored the order of the assessing officer, thereby directing the assessee to deposit TDS in the account of the Revenue, along with interest.

Questions arising from High Court judgment: This judgment has given rise to the following questions and practical difficulties:

- The High Court does not seem to have considered the recent (July 2009) procedure prescribed by CBDT for remittance to non-residents on the basis of a Chartered Accountant's certificate. As per this prescription, if, before a remittance is made, a CA certifies that the payment would not result in taxable income in the hands of the non-resident recipient, then there is no need to deduct TDS. This inconsistency between the HC decision and CBDT prescription may lead to implications for the remitter who otherwise had acted on a bona fide belief in complying with the new procedure.
- As a result of this decision, Revenue may get tempted to scrutinise cross-border transactions between two non-residents, who prima-facie may not be liable to tax in India, leading to issues pertaining to extra-territoriality of tax obligation.
- The High Court decision is binding only in the jurisdiction of the state, i.e., Karnataka, in this case, and may carry at best only persuasion value in other states, while the CBDT prescription is valid for the entire country. However, High Court decision being in Revenue's favour, there would be temptation on part of Revenue to apply the High Court judgment in all states, which may lead to increased litigation in the coming months.

## Rulings of the Advance Rulings Authority

- **Taxability of services acting as a facilitator and technical consultant:**

The applicant, Federation of Indian Chambers of Commerce and Industry (FICCI), was a non-profit company that entered into a MOU with Defence Research Development Organisation (DRDO) for identification and business development of competitive global technologies in DRDO's inventory for existing defence related innovations. To implement the MOU, applicant and DRDO jointly initiated a programme called ATAC, and applicant entered into an agreement with University of Texas (UT) to perform certain work and services for this project.

FICCI agreed to provide facilities and assistance for this project. UT was engaged in research to enhance solving of problems related to market economics and commercialisation of technological innovation. It was agreed that DRDO would pay consultancy fees to FICCI and applicant will pay fee to UT. ATAC programme was divided into three major areas: (i) awareness of ATAC programme; (ii) technology assessment; (iii) business development. Some of the functions were to be performed in India and some in USA. The issue was whether amount received by UT liable to be taxable in India and was FICCI liable to deduct TDS u/s 195 of the Income Tax Act.

The ruling was given as follows:

- As per the provisions of the Act, the expression "fees for technical services" means any consideration for rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel). According to this definition UT's services may fall under this category but if UT is covered under any specific provision of DTAA, then it will prevail over the provision of domestic law.
- To examine whether services provided by the UT would fall under the scope of "fees for included services" under article 12 of DTAA between India and USA, it is to be seen whether the services rendered by UT, make available "technical knowledge, experience, skill etc." or not. The nature of services provided by UT with FICCI are not essentially teaching activities but they are in nature of services and assistance extended to DRDO for identification, assessment and business development of competitive technologies in field of defence related innovations.

- None of the services as mentioned in ATAC undertaken by UT, would amount to make available the technical knowledge, experience, skill, know how or processes possessed by UT. UT was acting as a facilitator and technical consultant for the purpose of commercialisation of identified technologies, screening and assessment of technologies by deploying the expertise and resources and preparing technical reports including market analysis, it would not fall under the purview of para 4(b) of Article 12 of DTAA between India and USA.
- Therefore the payments received under the Agreement are not liable to be taxed as fees for technical services under the domestic law.
- Also the payments cannot be subjected to tax as business profits in view of the undeniable fact that UT has no permanent establishment in India.

## Tribunal case

- **Transfer Pricing:**

The assessee, Gharda Chemicals Ltd, entered into an international transaction for sale of Dicamba (medicine) to Gharda USA Inc (AE), a wholly owned subsidiary of the assessee. Assessee sold Dicamba to unrelated parties in various other countries at significantly higher rates as compared to the rate offered to its AE. The assessee had determined the 'ALP' by comparable uncontrolled price (CUP) method. The transfer pricing officer rejected the CUP method as well as the assessee's alternative submission for adoption of "resale price method" for calculating ALP. The Additional Commissioner of Tax passed an order u/s 92CA, requiring an adjustment in total income.

The Assessee submitted that:

- Provisions of section 92CA were not applicable in this case as there was no reduction in tax liability of the assessee. Assessee exported Dicamba to other countries and because direct export to USA was not permissible, assessee opened an AE in the name of Gharda USA Inc.
- Gharda USA was operating under high losses and did not pay tax. Sale of Dicamba to AE at a lower rate did not result in lowering of tax incidence. It did not have any ultimate effect on tax liability of the assessee when considered in totality.

The Tribunal held that:

- To determine correct tax liability in hands of an Indian enterprise, it is not relevant how much tax was paid by the foreign AE. Correct amount of tax payable in India should not suffer due to adjustment of price for goods or services between the related enterprises.
- In the present case, the choice is between CUP method or resale price method. Resale price method is not applicable as this method is applicable in case there is a purchase of property or services obtained by enterprise from its AE which is then resold or provided to unrelated party.
- The essence of determining ALP under CUP method is to ensure that the price charged from unrelated parties is same under similar circumstances. Two types of CUP methods- Internal and external CUP methods – were discussed in this case.
- Internal CUP method is not suitable in this case as price varies from one country to another due to many factors. Therefore no comparison can be made between the price charged from other countries with that from USA, more particularly when the quantity exported to USA is on wholesale basis with that to other countries in small lots on retail basis.
- External CUP method is the most suitable method for the present case, as this method compares the price charged by the assessee from its AE, with the average price at which the goods were available in the open market in that country from transactions between unrelated third parties.
- **Agent of a non-resident:**  
In case of *Pride Foramer S.A.S. v ACIT*, it was held that a live connection between employer and expatriate personnel must be proved to consider them as agent of the non-resident.

The assessee – Pride Foramer (a French company) – entered into a contract with ONGC to carry out drilling services. For this, it employed its own personnel as well as personnel of its associate company – M/s Pride Forasol (a Foreign company), with which assessee entered into a contract for providing technical assistance on payment of technical fees. According to the agreement, Pride Forasol was to remain the employer of expatriates deployed to the assessee.

The Assessing officer wanted to treat the assessee as an agent of the expatriate personnel.

The Assessee contended that, firstly, there was no connection between assessee and the personnel; neither did it make any payment to them. Secondly, as per DTAA between India and France, if stay of personnel did not exceed 183 days in India then they were exempt from payment of tax. Hence, provisions related to agent of a non-resident in the IT Act were not attracted.

The Assessing officer and Commissioner Appeals did not agree to this contention. As per the Commissioner Appeals, the Assessing officer had the option of either treating Pride Foramer or assessee as the agent of the expatriates, or to treat Pride Forasol as the agent of the expatriates. The second option was not practical as Pride Forasol had no permanent establishment in India. The first option was found suitable as expatriates were working under direct supervision of the assessee and assessee was making a payment of technical fee to Pride Forasol and, in case of any tax liability, it could deduct it from the payment to be made to Pride Forasol.

**Tribunal held the following view on the matter:**

- As per section 163(1)(c) of the Indian Income Tax, 'agent' includes any person in India from or through whom the non-resident is in receipt of any income whether directly or indirectly. As the expatriates did not receive any income from the assessee therefore no live connection existed between assessee and the expatriates. Hence sec.163 did not come into picture.
- The fact that personnel of Pride Forasol provided technical services on the arrangements made by assessee did not establish a business connection.

- The fact that Pride Forasol charged technical fees for providing technical assistance through its personnel, did not bring it under the ambit of indirect payment of salary to expatriates by the assessee, as there was no proof of direct connection between assessee and expatriates.

In view of the above, it was held by the Tribunal that assessee could not be treated as an agent of the expatriates.

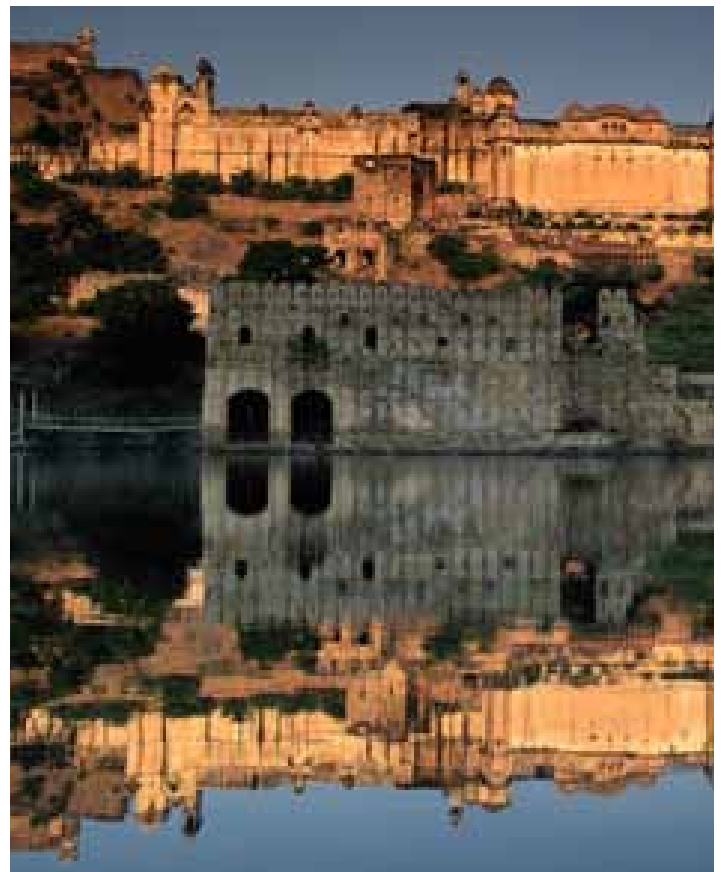
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# JORDAN

## Tax update

Jordan has proven to be very serious and responsible and has shocked everybody with what it has managed to do by joining the World Trade Organization (WTO) in 11 months; an extraordinary feat which people doubted could be accomplished. Jordan's success has caused the international community to be very responsive. As a result, Jordan has had many foreign investors. It has free trade with the European Union and with many Arab countries. Jordan has Qualifying Industrial Zones (QIZ) that allow free trade into the United States. This creates tremendous opportunities for investing in Jordan. It has taken very important steps towards building its economy and continues to advance. Jordan is very eager to establish good relations with everybody which was initiated by King Hussein and which King Abdullah plans to continue.

## Investor-friendly Jordan

Jordan has recognised the need to establish business-friendly structures with strong emphasis on supporting entrepreneurial initiative. His Majesty King Abdullah has identified national goals such as increasing foreign and domestic direct investments. His Majesty is the surest catalyst for creating sustainable economic growth.

With the establishment of the Investment Promotion Law in 1995, and with other subsequent actions designed to enhance the investment environment, Jordan has opened its economy to the wealth and prosperity business and investment should bring.

The Investment Promotion Law grants generous and attractive incentives to domestic as well as international investors in terms of: freedom from customs duties, tax holidays, income tax exemptions and unrestricted transfer of capital and profits. The implementation of this law is vested in the Jordan Investment Board which is the only national entity responsible for promoting and facilitating investment in Jordan. The law irrevocably affirms that both Jordanian and non-Jordanian investors are treated equally.

Jordan provides an attractive investment climate where the investor can enjoy total customs exemptions on imported fixed assets, ease of licensing and registration procedures. Export industries are not subject to customs duties on imported raw materials, free repatriation of capital, profits and salaries. Moreover, projects approved by the Investment Committee enjoy a ten year exemption from income and social services taxes at the following rates depending on the sector and the area in which the project is located.

Some more advantages can also be enjoyed like Jordan's strategic location near Asia, Africa and Europe; future regional markets; abundance of space and lands; access to foreign markets; competitive qualified labour; conducive investment climate; and the fact that Jordan is part of the MENA region which provides a vital economic power.

## Free Zones

Jordan's Free Zones were established to promote export-oriented industries and transit trade; to attract domestic and foreign direct investment; and to spur economic growth and job creation. Free Zones accommodate processing industries in addition to trading, warehousing, and other activities. Commodities and goods of various origins are deposited in the Free Zone areas for storage and manufacturing, without payment of the usual excise fees and taxes.

Free Zones accommodate enterprises that introduce new industries, utilise modern technology, complement domestic industries, use local raw materials or manufacturing parts, upgrade the skills of local workers, and produce goods with limited availability in the domestic market.

Incentives offered by Free Zones include:

- Exemption from income taxes for exported goods, goods in transit trade, as well as profits gained from the sale or transfer of goods inside the Free Zone.
- Exemption from income and social services taxes on salaries and allowances of non- Jordanian employees involved in projects established in the Free Zones.
- Exemption from custom duties, taxes, and other fees on imported goods, or on those goods which have been exported (with the exception of services and rent charges).
- Exemption from licensing fees and taxes on land and buildings, and other construction setups in the Free Zones.
- Full repatriation of capital and profits generated from operations in the Free Zones.

## Industrial Estates

The Jordan Industrial Estates Corporation (JIEC) is a semi-governmental corporation established in 1984 with both public and private ownership. Its catalytic role is to contribute to the development of small and medium-sized industries (SMIs) by providing comprehensive and integrated industrial estates. In 1996, the JIEC inaugurated its Centre of Excellence which functions as an incubator for new enterprises and as a catalyst for the interaction between industry and academia. Three of the operating public industrial estates also hold QIZ status, which allows exporters of goods manufactured in these zones to benefit from duty-free and quota-free access to the US market. Industrial estates offer the following incentives to investors:

- 100% exemptions for two years of income and social services tax for industrial projects located within industrial estates owned and managed by JIEC.
- Total exemption from buildings and land tax.
- Exemption or reduction on most municipal fees.
- 100% exemption of taxes and fees on fixed assets for the project, fixed assets for expansion or modernization, and on spare parts.

## Corporate Income Tax

In case the investor(s) decided to do business in Jordan and was not subject to any tax exemption, then the investor will be subject to one of the following Corporate Income Tax Rates (per sector):

- 14% of the taxable income for all companies and juristic persons except the below mentioned.
- 24% of the taxable income for all basic telecommunication companies, insurance companies, intermediation companies, and financial companies including exchange companies and capital leasing companies.

- 30% of the taxable income for banks and external branches.
- 30% of the taxable income which was specified at the rate of 20% of the total net income, after deducting the foreign income tax, of the Jordanian companies' branches operating outside the Kingdom as declared in their final accounts which are certified by an external auditor.

Accordingly, the net tax charged on the external branches equals to 6% (30% x 20%).

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# MALAYSIA

## Recent Developments

There have been some interesting tax developments both domestically and internationally over the last few months which are summarised below.

### Goods and Services Tax (GST)

#### GST Tabled

For the very first time, the GST bill was tabled on 16 December 2009. It is proposed that in the middle of year 2011 a 4% tax will be implemented on companies with a threshold of RM500,000 in revenue. As per scheduled the second reading will be tabled in March 2010.

#### Real Property Gains Tax (RPGT)

With effect from 1 Jan 2010, chargeable gains from the disposal of real properties which are held more than five years will be exempted from real property gains tax (RPGT) of 5%. However, any gains from the disposal of real properties in which holding period is within five years from the date of acquisition of the real properties will still be subjected to RPGT at the rate of 5%. This exemption is applicable on gains from all types of real property

including shares in real property companies disposed by all categories of property owners who are individual (citizens, permanent residents, non-citizen and non-permanent resident of Malaysia), companies as well as other property owner.

### Double Tax Agreement (DTA)

#### Malaysia – Venezuela

The DTA between Venezuela and Malaysia was ratified on 8 January 2008. According to the information provided in the Inland Revenue Boards website, the effective dates in Malaysia are as follows:

Type of tax	Dates
Income tax and withholding tax	1 January 2009
Petroleum income tax	1 January 2009

Interest	–	15%
Royalties	–	10%
Technical fees	–	10%



## Implementation of three Free Trade Area Agreements effective 2010

Malaysia has implemented the following three Free Trade Agreements within ASEAN region effective 1 January 2010.

- Full implementation of ASEAN Free Trade Area (AFTA) comprising Malaysia, Brunei, Indonesia, Philippines, Singapore and Thailand.
- ASEAN – Australia – New Zealand Free Trade Area – AANZFTA
- ASEAN – India Trade in Goods Agreement.

The enactment of legislation for the implementation of the three regional Free Trade Agreements has been finalised. It is hoped that the implementation of the above three regional Free Trade Agreement will further strengthen trade ties between ASEAN member countries as well as trading partners from Australia, New Zealand and India. This will directly open windows of opportunities to the business community in Malaysia to expand their business and products and services market to those countries.

Some salient points on the three regional Free Trade Area Agreements are as follows:

AFTA	<p>The ASEAN member countries will abolish or reduce tariffs on all goods except for some "sensitive" agricultural products.</p> <p>Malaysia has committed to abolish duties on 1,943 tariffs lines. Thus, import duties on intra-ASEAN trade is no longer a barrier to trade.</p>
AANZFTA	<p>This is the first comprehensive Free Trade Area Agreement for ASEAN.</p> <p>The deal for the goods sector involves the complete but progressive abolition of tariff by Australia and New Zealand within a period of three to 10 years.</p> <p>By 2020, export of goods by Malaysian exporters to Australia and New Zealand will not be subject to import duties.</p> <p>In return, Malaysia will abolish or reduce tariff on 99% or 10,502 of its tariff lines.</p>
ASEAN-India	<p>Involves the abolition and reduction of goods tariff on products offered by ASEAN member countries and India.</p> <p>Import duties on goods will be abolished progressively within a period of 3 to 8 years commencing 1 January 2010.</p> <p>The pact between Malaysia and India involves the abolition and reduction of import duties progressively on more than 10,000 tariff lines.</p>

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# MEXICO

## Mexico – Income Tax Law

### Temporary adjustment to rates for individuals and legal persons

One of the main reforms is the temporary increase in Income Tax Law, applying the maximum marginal rate of 30% during the years 2010 to 2012, 29% for 2013 and returning to the rate of 28% in 2014.

### Cash Deposit Tax

As a measure to strengthen the fight against tax evasion and stimulate entry into the formal economy by the persons who are not part of the tax base, there are two significant amendments to the Cash Deposit Tax Law:

#### **Increase the tax rate**

According to the reform approved in 2010, the tax rate increases from 2% to 3%. It reduces the amount subject to exemption.

After 2010 the amount of cash deposits is free of \$5,000.00 instead of \$25,000.00 that the Cash Deposit Tax Law (LIDE) expected for 2009.

#### **Value Added Tax**

The amendment to the general rate of this tax is one of the main changes for 2010.

The general tax rate is raised from 15% to 16% and in border areas has been raised from 10% to 11%.

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# NETHERLANDS

## Corporate income tax rates

The corporate income tax brackets for 2010 and 2011 are as follows:

Taxable Amount		Percentages	
From:	Up to:	2010	2011
€ 0	€ 40,000	20%	20%
€ 40,000	€ 200,000	20%	23%
€ 200,000		25.5%	25.5%

## Rules regarding the participation exemption

From 1 January 2010 a relaxation of the requirements of the participation exemption has been enacted. As of 1 January 2010, the principal rule is that the participation exemption applies to a subsidiary in which the Dutch parent company holds a minimum interest of 5%, unless the subsidiary itself is held as a portfolio investment. A subsidiary will be held as a portfolio investment if the Dutch parent company only aims at deriving a return that can be placed on a par with a return that can be expected from normal, active portfolio asset management. In view of the portfolio investment criterion, in the past, the Dutch Tax Authorities have accepted that a Dutch holding company does not hold the shares as portfolio investment if it played an important role within the group in terms of management, strategy or finance. With respect to Dutch intermediate holding companies, the participation exemption would normally be available if it acts as a link between the ultimate parent company and the operating subsidiaries.

It should be noted that the law contains specific rules pursuant to which certain subsidiaries, by fiction of law, will be deemed to be held as portfolio investment, such as for instance intra-group financing companies.

The rules applicable from 1 January 2010 also contain a safe harbour rule in the event the subsidiary would be held as a portfolio investment, the participation exemption would still apply if one of the following conditions would be satisfied:

Less than 50% of the assets, directly and indirectly held, consist of low taxed portfolio investments. Real estate and assets used in an active leasing business are not regarded as portfolio investments.

The subsidiary is subject to a realistic levy of taxes in its residency state. Indicated in legislative history is that an effective tax rate of at least 10% would be sufficient to pass this test based on domestic rules as long as these domestic rules are more or less equivalent to Dutch tax rules. Rules that are not equivalent to Dutch tax rules include for instance, deductible dividends, tax sparing credits in situations where the Netherlands would not grant such credits, and local tax holidays.

## Dividend withholding tax exemption

An exemption from the Dutch dividend withholding tax currently applies to dividends distributed by a Dutch company to companies resident in one of the EU countries which (i) own 5% or more of the shares – or voting rights under very specific circumstances – of the Dutch company distributing the dividends, (ii) have the corporate form as listed in the EU Parent Subsidiary Directive and (iii) are subject to profit tax as is mentioned in that directive.

As of 2010, the requirement regarding corporate form (see (ii) paragraph above) will be cancelled. The subject to tax requirement (see (iii)) will be replaced by an exclusion of the exemption to shareholders that are subject to a tax regime which is comparable to the regime applicable to the Dutch fiscal investment institution or the Dutch tax exempt investment institution. Furthermore, the same exemption will be available for companies resident in Norway and Iceland.

## Changes to the patent box

The 'patent box' was introduced in 2007 allowing optional taxation against a lower tax rate of 10% on income from patents and income from certain research and development assets. The lower rate applied to income that exceeds the investment cost of such assets and the box was capped at four times the investment costs in such assets. As of 2010, the patent box is renamed to the 'innovation box' and contains the following improvements:

- the tax rate for income included in the innovation box has been lowered from 10% to 5%
- the total net proceeds taxable at 5% will no longer be capped
- losses incurred in connection with the innovation box can be offset against other "normal" income (although a recapture of later innovation box profits will apply against the regular tax rate).

## Extension accelerated depreciation

In 2009, the Dutch government decided to stimulate investments and to introduce a temporary opportunity to allow accelerated depreciation on business assets acquired in 2009. This measure allows depreciation on such business assets for a maximum of 50% in 2009 and 50% in 2010. This temporary measure has been extended with one year to include investments made in 2010. Consequently, business assets acquired in 2010 can be depreciated for 50% in 2010 and for 50% in 2011. The accelerated depreciation is available for most business assets with the exception of real property, intangible assets and business assets which are put at the disposal of a third party, amongst others.

## Optional extension of period for carry back of losses

Corporate tax payers are temporarily allowed to opt to carry back losses originating in 2009 and 2010 for three years (instead of the current one year carry back period). If opted therefore, the carry forward period of these losses will be six years instead of nine. The additional carry back is limited to €10 million per year.

## Implementation of 2010 EU VAT package

Until 31 December 2009, the main rule dictated that services are (deemed to be) performed where the supplier of the service is established. From 1 January 2010, based on the EU 2010 VAT Package, this principal rule has changed for the supply of business to business services. Under the new rule all services performed to an entity or individual qualifying as an entrepreneur for VAT purposes are deemed to be supplied where the customer is established. This means that EU entrepreneurs should render these services without charging their local VAT and that the EU customer has to report VAT on these provided services in its own VAT return under the so-called 'reverse-charge mechanism'. A further important change to the VAT system is that the suppliers of services, equally as the suppliers of goods within the EU, as of 1 January 2010, also have to include the names and VAT registration numbers of EU customers in lists. These lists will then be filed with the tax authorities together with the VAT return.

## Cross-border employment

The Dutch Ministry of Finance recently issued a regulation with respect to intercompany assignments of employees to The Netherlands (DGB2010/267M). According to this regulation, foreign employees who are assigned to The Netherlands and who work for an international group are exempt from Dutch

tax on their employment income and there is no obligation to withhold Dutch wage tax on the Dutch employment income provided that the assigned employee work for a maximum of 60 days in the Netherlands in a 12 month period. This new, practical, approach reduces the administrative burden.

## Tax treaties

The Netherlands has entered into income tax treaties with Bahrain and Qatar which entered into force and become effective 1 January 2010. Both treaties aim at the avoidance of double taxation and contain provisions regarding the exchange of information. Withholding taxes in both tax treaties are substantially reduced or even eliminated. The treaty with Bahrain provides for no withholding on income from debt claims and royalty payments. This equally applies to dividends provided that the shareholder is the beneficial owner of at least 10% of the shares in the company paying the dividends and some other (anti-treaty shopping) conditions are satisfied.

The withholding tax rates as laid down in the treaty with Qatar are as follows:

- no withholding tax on interest
- 5% on royalties and
- no (withholding) taxes on dividends will generally be available if the shareholder is the beneficial owner of at least 7.5% of the shares in the shares in the company paying the dividends and some other (anti-treaty shopping) conditions are satisfied.

The Netherlands has concluded a new protocol with Azerbaijan which came into force on 19 December 2009. In relation to (withholding) tax, the rate is 5% on dividends paid to a shareholder who is the beneficial owner who holds at least 25% (and minimal investment of €200,000). In other cases, the tax rate is 10%. The rate of 10% generally also applies to interest payments, except for certain specific interest payments. Finally, withholding tax on royalties is either 5% or 10% depending on the underlying intangible.

The Netherlands and Mexico have concluded a new protocol to the existing tax treaty which came into force on 31 December 2009. Pursuant to the new treaty, withholding tax on interest is generally 10% (former treaty 15%) and 5% for interest paid on loans granted by banks, other financial institutions or insurance companies and interest paid on bonds and other debentures (“waardepapieren”) which are traded, subject to certain conditions, on a recognised stock exchange. Withholding tax on royalties is generally 10%. Under the former treaty, it was also 10% subject to certain conditions which no longer apply.

The taxation regarding the sale of shares is modified. At Mexico’s request, the new treaty contains anti-abuse rules regarding:

- (i) the determination of the place of effective management and
- (i) (ii) the sale of shares in a company.

According to the new treaty such sale is only taxable in the state where the seller is resident in the following situations:

- (a) a sale of at least 80% of the shares of a company within a group subject to certain conditions
- (b) the sale of shares by an insurance company or pension fund and
- (c) a sale via a recognised stock exchange.

In the event the source state – i.e. the state in which the company whose shares are sold is resident – would be entitled to tax the capital gain made upon the sale of shares, the tax is maximum 10% of the taxable benefit (under the former treaty, it was 20%).

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# ROMANIA

## New fiscal and accounting modifications starting 2010

### New accountable regulations according with the European Directive

Starting in 2010 the new accounting regulations according to the Directive IV of the European Economic Communities were approved by Order no. 3.055/ 2009 and entered into force. They have been officially published in the Official Gazette no. 766 from 10 November 2009.

### Certification of annual tax returns of corporate taxpayers by a tax consultant

Starting in 2010, the new rules regarding the certification of the annual tax returns (tax on profit declarations) of the corporate taxpayers came into force with the exception of those for whom an audit is compulsory. The certification of the fiscal declarations is made by a fiscal consultant and represents the verification of the accuracy and reliability of the data submitted in the tax returns, on the basis of the documents and accounting such as financial and fiscal information requested by a tax consultant and provided by the company according to the dates which are stipulated in the accounting registers.

The results of the certification will be reported in a certification report. The fiscal consultant will also issue a note of certification to accompany the annual profit tax return. In order to certify the fiscal declarations, the fiscal consultant must take into consideration the materiality level which will be based on professional reasoning and also on the analytical procedures and understanding of the company and economic environment in which the company operates.

### Law on the state budget for 2010 and Law on the social security state budget for 2010

According to the Law on the state budget, the following rates for social health insurance are applicable for income from 1 January 2010:

a 5.5% rate payable by employees and a 5.2% rate payable by employers.

The Law on the state social security budget for 2010 states the following:

The average gross salary used for calculations under the state social security budget for 2010 is EUR 450. The following social security insurance rates for 2010 are applicable for income from 1 January 2010:

- 31.3% for normal working conditions, out of which 10.5% is payable by employees and 20.8% by employers
- 36.3% for difficult working conditions, out of which 10.5% is payable by employees and 25.8% by employers
- 41.3% for special working conditions, out of which 10.5% is payable by employees and 30.8% by employers.

The social security contribution rate mentioned above for employees includes the 2.5% compulsory contribution to private pension funds.

Law 11 regarding the state budget for 2010 published in the Official Gazette no. 60/2010 stipulates all the information about the contribution rates for unemployment insurance budget and the contribution rates paid by the employer depending on the risk class for insuring for accidents at work and professional illnesses.

### Tax exemption for “technical unemployment”

The Emergency Ordinance no. 4/2010 on social protection measures was published in Official Gazette no. 93 on 10 February 2010. This Emergency Ordinance aims to support employers affected by the current economic environment, and its provisions are similar to legislation introduced in 2009. These measures take effect during the period starting with 1 February 2010 to 31 December 2010. The document stipulates the exoneration of payment of tax on income and social contributions (also for the employee and for the employer), and of the allowances for employee benefits during the period of temporary interruption of the employer’s activity. These indemnity represents 75% from the base salary and can be allowed for a maximum period of 90 days.

## New regulations of certain measures in order to create new jobs and to reduce the unemployment figures

There is a payment exemption for tax contributions for six months for employers who hire unemployed persons during 2010 for newly created jobs for a period of at least one year.

## Legal modifications regarding the VAT

A series of modifications regarding the VAT regime came into force in 2010:

- The Procedure regarding the approval of the fiscal period for the persons registered for VAT purposes is as follows: the fiscal authority can approve the utilisation of a fiscal period other than the month or the quarter on the request of the taxable person registered for VAT purposes. The Russian calendar can be used if the taxable person makes taxable operations for a maximum of three calendar months in a semester. The calendar year can only be used where the taxable person makes taxable operations only for six months from a period from a calendar year.
- The implementing measures of the simplifying measures regarding VAT for the multiparty operations from European Community connected with works on the movable assets and implementation measures of the simplifying measures regarding the VAT of the returns of goods in the communitarian territory and the fiscal treatment of the repairs made in the guarantee period and also on the post guarantee period.
- The rules for applying VAT exemption for the international traffic of goods are set out in art. 144, alin. (1) of the Fiscal Code, where the documents necessary for the exemption of the VAT in case of goods transportation are explained. There are also modifications to the VAT exemptions relating to the delivery of goods which are to be stored in a warehouse.
- The modification and fulfillment of the implementing measures of the VAT exemption for certain operations stipulated in art. 143 and 144 from the Fiscal Code were approved.

## Effect of economic financial crisis: deferred payment of outstanding tax obligations on time

The Public Finance Ministry Order no. 99/ 22.01.2010 modifies the methodology for Rules regarding the approval procedure of payment deferred of the tax obligation which remain unpaid. Administered by NAFA, one of the “cumulative” conditions which must be fulfilled by the taxpayers is that all the fiscal declarations according to law until the date of submitting the request for deferred payment must be filed. Within 15 days of communicating the decision of payment deferred, taxpayers will provide guarantees as bank letters and/or will offer free goods of any kind regarding the implementation of security measures.

The Order brings clarification regarding the implementation of the different payment for fiscal obligations not paid due to the effects of the financial economic crisis. The interest owed during the period of deferred payment has been established to the level of 0.05% for each day of the period of deferred payment, starting with the date of issue of the decision.

The Order clarifies the implementation of postponement of the payment of unpaid tax obligations as a consequence of the global crisis.

## Inflation index for advance payments in 2010

For 2010 the inflation index used for the update of the advance payments in the account of annual tax on profit is 3.5%.



## Modification of automatic fiscal vector for the taxpayers were registered as payers on the microenterprises income from 31 December 2009

According to the new modification, starting from 1 February 2010, the competent fiscal authority will proceed to the modification of automatic fiscal vector of taxpayers who were registered as taxpayers on microenterprises income on 31 December. Thus, starting with the obligations related to January 2010, with the declaration term until 25 February 2010, the taxpayers mentioned previously are registered as taxpayers on profit tax.

Also, starting in January 2010, the taxpayers mentioned above will be obliged to declare and pay the taxes and contributions afferent for the incomes obtained from monthly salaries and not quarterly, thus the modification of the fiscal vector being changed automatically.

## The ad hoc mandate and introduction of the preventive arrangement

Starting from 14 January 2010, a new law entered into force, Law no. 381 from 10 December 2009, published in the Official Gazette no. 870/ 14 December 2009, regarding the introduction of the preventive arrangement and the ad hoc mandate which represents a concrete solution for the companies in financial difficulties.

The law allows companies to contract with debtors to avoid the state of suspending the payments which could lead to insolvency. The proposal to come to an arrangement or an ad hoc mandate is initiated by the debtor and presented to the competent authority together with a recovery plan for the Court.

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# SINGAPORE

## Tax update

### Budget 2010

The Minister for Finance announced the Government's financial policy for 2010 on 22 February 2010. The key tax measures proposed in this Budget 2010 are outlined below:

#### a) Productivity and Innovation Credit

A key focus of the Budget 2010 is to improve overall productivity in the Singapore economy. In order to support and encourage businesses to innovate and to raise productivity, the Productivity and Innovation Credit will be given to businesses investing in the following activities:

##### 1. Research & Development

250% tax deduction for the first \$300,000 of qualifying expenditure on R&D done in Singapore per Year of Assessment (YA); 150% deduction for the balance expenditure.

With this enhancement of the tax incentive for R&D done in Singapore under the Productivity and Innovation Credit, the Government will phase out two existing R&D tax incentives – namely Research and Development Tax Allowance (RDA) and Research and Development Incentive for Start-up Enterprises (RISE) schemes.

##### 2. Registration of intellectual property

250% tax deduction for the first \$300,000 of qualifying costs of registering patents, trademarks, designs and plant varieties incurred per YA; 100% deduction for the balance expenditure.

##### 3. Acquisition of intellectual property

250% allowance for the first \$300,000 of qualifying costs from acquiring IP rights (The tax allowance for IP acquisition under the Productivity and Innovation Credit shall cover acquisition of patent, copyright, trademark, registered design, geographical indication, lay-out design of integrated circuits, trade secret or information that has commercial value, and plant varieties) incurred per YA; 100% allowance for the balance expenditure. The taxpayer must own the legal and economic rights of the IP.

##### 4. Design activities

250% tax deduction for the first \$300,000 of qualifying expenditure on eligible design activities done in Singapore per YA; 100% deduction for the balance of expenditure. This new tax incentive will be administered by Design Singapore Council. More details will be released by Design Singapore Council by May 2010.

##### 5. Automation through technology or software

250% allowance for the first \$300,000 of expenditure incurred on qualifying investments in automation per YA; 100% allowance for the balance expenditure.

##### 6. Training of employees

250% tax deduction for the first \$300,000 of qualifying training expenditure for external training and WDA-certified in-house training incurred per YA; 100% allowance for the balance expenditure.

The Inland Revenue Authority of Singapore (IRAS) will release further details on the scheme in June 2010.

#### b) Merger and Acquisition Allowance

A new Merger and Acquisition (M&A) Allowance will be introduced to encourage companies to consider M&A as a strategy for growth and internationalisation. Qualifying M&As executed from 1 April 2010 to 31 March 2015 (both dates inclusive) will be granted a tax allowance of 5% of the acquisition value. The total allowance granted is capped at \$5 million of allowance for all qualifying deals executed for each YA. The taxpayer can deduct the allowance against its taxable income equally over five years.

Stamp duty on the transfer of unlisted shares for qualifying M&A deals will also be remitted. This remission is capped at \$200,000 of stamp duty per year. IRAS will release further details on the M&A Allowance and stamp duty remission by June 2010.

#### c) Phase out of Industrial Building Allowance

The industrial building Allowance (IBA) will be phased out with immediate effect. Qualifying capital expenditures incurred by businesses on or before 22 February 2010 for the construction or purchase of industrial buildings or structures will continue to qualify for IBA, subject to existing IBA rules.

With the phase-out, IBA will not be allowed on capital expenditures for the construction or purchase of industrial buildings or structures which are incurred after 22 February 2010 except in specified scenarios. IRAS will release further details on the IBA phase out in April 2010.

#### **d) Land Intensification Allowance Incentive**

With the removal of the industrial building allowance, a new Land Intensification Allowance (LIA) incentive will be introduced from 1 July 2010 for a period of five years for the following nine industry sectors:

- i. Pharmaceuticals
- ii. Petrochemicals
- iii. Petroleum
- iv. Specialties
- v. Other Chemicals
- vi. Semiconductor-Wafer fabrication
- vii. Aerospace
- viii. Marine and Offshore Engineering
- ix. Solar Cell Manufacturing

Under the LIA incentive, qualifying businesses will be granted an initial allowance of 25% and an annual allowance of 5% on the qualifying capital expenditures incurred on the construction of a qualifying building or structure. Details on the incentive will be announced separately by Economic Development Board (EDB)/ JTC by June 2010.

#### **e) Ship Broking and Forward Freight Agreement (FFA) Trading Incentive**

The Minister introduced a new ship broking and FFA trading tax incentive to further promote Singapore as an International Maritime Centre and to grow such activities in Singapore. The incentive recipient will enjoy a concessionary tax rate of 10% on the qualifying income for an award period of five years. The Maritime and Port Authority of Singapore will release the implementation details by end March 2010.

#### **f) International Legal Services Tax Incentive**

Legal practices providing international legal services can apply for the Development and Expansion Incentive (DEI) scheme from 1 April 2010 to 31 March 2015 (both dates inclusive). These practices must be registered in Singapore as a company or a branch of a foreign company. Approval applicants will enjoy a 10% concessionary tax rate on incremental income from qualifying international legal services for five years. The Ministry of Law and EDB will release further details in March 2010.

#### **g) Import GST Deferment Scheme (IGDS)**

Currently, import Goods and Services Tax (GST) is payable on all goods brought into Singapore at the point of entry, unless import GST relief has been granted or the goods are imported under import GST suspension schemes such as the Major Exporter Scheme.

IGDS is being introduced to allow approved GST-registered businesses to ease their operating cash flow through the deferral of import GST from 1 October 2010. The import GST will be deferred for at least one month and will be declared as a payable amount in the corresponding GST return. Approval will be accorded to GST-registered businesses that meet all qualifying conditions including good compliance records and subscription to monthly GST filing.

#### **h) Reduce withholding tax rate for non-resident public entertainers**

A non-resident public entertainer (NRPE) is subject to withholding tax on his gross income derived in respect of services performed in Singapore. As a concession to help local organisers attract high quality performances to Singapore, the withholding tax rate of 15% will be reduced to 10% on sums payable from 22 February 2010 to 31 March 2015.

### **New Agreement for the Avoidance of Double Taxation (DTA)**

Singapore signed a new DTA with Georgia on 17 November 2009. This new DTA will be effective only after ratification by the respective governments.

The withholding tax rates applicable in the DTA are as follows:

- Dividends – 0%
- Interest – 0%
- Royalties – 0%

## Tax Framework for Corporate Amalgamations

Since January 2006, companies have been able to carry out voluntary amalgamations (referred to as statutory voluntary amalgamations) without first obtaining court approval. However, the amalgamation process was not a tax-free process. Amalgamating companies were treated as having ceased business and disposed of their assets and liabilities. The amalgamated company (i.e. the surviving entity) was treated as having acquired or commenced a new business. This resulted in both temporary and permanent tax consequences for the amalgamating entities. For instance, tax losses and unabsorbed capital allowances could not be transferred from the amalgamating companies to the amalgamated company, resulting in the permanent loss of the tax losses.

The Inland Revenue Authority of Singapore (IRAS) introduced the Tax Framework for Corporate Amalgamation on 20 January 2010. Under this framework, the businesses of the amalgamating companies are considered as ongoing and continuing in the amalgamated company. As such, the tax treatment of the items (e.g. provisions, receivables, payables, accruals, etc) transferred under the amalgamation remain the same as if they were held by the amalgamating companies. In addition, tax losses and unabsorbed capital allowances can now be transferred to the amalgamated company subject to certain conditions.

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# TANZANIA

## Tax update

### Corporation Tax

The Tanzanian Government has made recent changes seeking to encourage more listing in Dar es Salaam stock exchange as the result Companies listed on the Dar es Salaam Stock Exchange (DSE) and issuing at least 30% of their share capital to the public shall have the benefit of a lower corporate income tax rate of 25%, the normal corporate income tax rate in Tanzania is 30%.

### Value Added Tax

There is a reason to celebrate – the VAT rate has been reduced from 20% to 18%.

Furthermore, VAT special relief granted to mining companies in Tanzania is now restricted on importation and supply of goods for use in exploration or prospecting stages. That is to say that mining companies already at the production stage will no longer enjoy VAT special relief as they previously did.

### Customs Duty

The importation of heavy trucks of carrying capacity of at least 20 tons is now exempt from import duty. Previously such importation was charged at the rate of 25% import duty.

There is good news for investors in tourism because four wheel drive vehicles specially designed for tourism activities are now exempt from import duty and Visa fees have now been standardised at US\$ 50.

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# THAILAND

## Tax update

### New tax incentives approved by the Cabinet

On 22 December 2009 the Cabinet approved the following tax incentives which will be effective following their publication in the Government Gazette later this year:

#### 1. Further tax exemptions on receipts from provident funds

In general, receipts from a provident fund are exempted from personal income tax in the following cases:

- retirement
- disability or
- death.

It should be noted that there are specific conditions attached to each of the above cases. The Cabinet has approved that, in the case of an employee's resignation, there will also be an exemption from tax with respect to the following situations:

- a lump sum amount either immediately or after resignation; or
- an instalment payment and transfer of the provident fund from the previous fund to another fund.

There is however some uncertainty as to what constitutes "resignation" and, for example, whether employee redundancy would also be covered.

#### 2. Income tax exemption on donations to the Persons with Disabilities Empowerment Fund

Individuals, companies or partnerships that make donations to the Persons with Disabilities Empowerment Fund will be eligible to receive tax allowances:

not exceeding 10% of the assessable income of an individual after deducting allowances and deductions

not exceeding 2% of the net profit of the company or partnership before deducting the expense for charitable purposes which includes other charitable expenses.

#### 3. Double allowances in relation to disabled persons

When calculating corporate income tax, the deductible expense of a salary paid to a person holding a disabled ID card is allowed at a special rate of 200%.

A company, individual or juristic person that provides equipment or services to buildings, transportation or other public services to the disabled under the law governing Persons with Disabilities Empowerment is allowed to deduct the expense when calculating corporate income tax at a special rate of 200%.

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# UK

## Tax update

### Proposals for CFC reform

The UK Government is increasing its efforts to make the UK corporation tax regime attractive to international companies. The most recent example is a consultation document published by HM Treasury on 26 January 2010 containing proposals for the reform of the controlled foreign companies (CFC) legislation. The rules seek to tax UK parent companies on the profits of overseas subsidiaries where UK tax avoidance is suspected.

Based on the proposals in the consultation document, it appears that the new CFC rules are likely to operate in broadly the same way as they currently do, but with some simplifications to make them easier for UK parent companies to apply.

For example, significant emphasis would be placed on a redesigned exempt activities test which is intended to exempt genuine trading activities from the rules where there is little or no risk of erosion of the UK tax base. Whilst it is intended that the profits of such companies would be exempt from a CFC charge, a charge may apply to 'passive' income earned by such companies where this is not incidental or ancillary to the company's main activities.

It is anticipated that there will be separate rules for finance and treasury companies, reinsurance and property subsidiaries and those holding group intellectual property outside the UK. In each case, specific rules have been proposed to help determine to what extent overseas profits from these functions are attributable to the UK.

Going forward, there will no longer be an assumption that activities are being carried on offshore for the purpose of avoiding UK tax. Indeed, it has been stated that the Government intends to take a pragmatic approach to ensure that the new regime is no more restrictive than the current one.

Many of the existing exemptions from the CFC rules may also be simplified. For example, the current rules only apply where the overseas company concerned suffers a 'lower level of tax'. This is determined by comparing the actual tax liability in the territory in which the company is resident with the tax it would have suffered in the UK, having recomputed profits under UK tax

law principles. A proposed new exemption would instead involve a comparison of the tax rates and rules in the UK and the host territory. It has been indicated that this new test could also allow the 'excluded countries list' to be repealed.

The new rules are expected to be included in Finance Bill 2011.



## Updated guidance for companies claiming non-UK residence

HM Revenue & Customs (HMRC) has recently updated the guidance set out in its International Manual relating to companies claiming non-residence in the UK. The updated guidance provides a useful reminder of the approach that companies and HMRC must take in respect of such claims.

Claims for non-UK residence often arise where both the UK and another country both claim that the company concerned is resident in their territory. In order to resolve this conflict, double tax agreements (DTAs) often include a tie-breaker clause which determines in which territory a company is to be considered resident. The newly updated manual includes a list of DTAs (up to date as at 1 December 2009) signed by the UK which have a residence tie-breaker clause.

Where the tie-breaker refers to the company's place of effective management and the UK and overseas tax authorities disagree over the application of this concept, the company may face double taxation and must then seek a resolution under the mutual agreement article of the relevant treaty. In the meantime, the company must continue to self-assess its position. If it is confident that it is not UK resident then it may choose not to file tax returns during the mutual agreement procedure. However, if the company is eventually found to be UK resident it may then be liable to back-dated tax, interest and penalties.

Where a company claims non-UK tax residence HMRC will, as a matter of course, request a copy of a certificate of residence from the overseas tax authority. The Tax Inspector must satisfy him or herself that the company should be regarded as resident overseas under the tie-breaker clause in the relevant DTA. The Inspector should also establish where the business of the company is carried on. If this is in the same territory in which the company has claimed residence, he or she will usually allow the claim. Where the Inspector finds that the business is carried on in a third country, he or she will investigate where the place of effective management of the company is. If the Inspector cannot satisfy him or herself that the place of effective management is in the territory in which the company is claiming residence he or she may continue to treat the company as UK resident.

Where the company succeeds in demonstrating that it has migrated from the UK by virtue of transferring its place of effective management, the company must comply with the provisions of s130 FA 1988 to give notice of migration. This section requires the following information to be provided to HMRC:

- notice of the time that the company intends to cease residence in the UK.
- a statement of the amount of tax it believes is payable in respect of periods beginning before that time (including PAYE and income tax it is required to deduct at source), and
- details of the arrangements in place for payment of that tax.

HMRC may dispute the amount of tax outstanding and may refer the matter to the First-tier or Upper Tax Tribunals. Once the amount of tax outstanding has been agreed, the company must put arrangements in place to pay the tax and HMRC must approve those arrangements.



## UK VAT update

### 1 January 2010: UK standard rate of VAT reverts to 17.5%

After a temporary reduction to 15% for the 13 months to 31 December 2009, the standard rate of VAT in the UK has now reverted to 17.5%. Anti-avoidance measures were implemented to ensure that the 15% rate could not continue to be used into 2010. No assurances have been given by the UK Government that the standard rate will remain at 17.5%, and there is speculation that it may increase to 20% later this year.

### VAT returns to be filed online with effect from 1 April 2010

From 1 April, UK VAT registered businesses with an annual turnover exceeding £100,000, and all newly VAT registered businesses (irrespective of turnover) must file their VAT returns online. They will also be required to make payment of their VAT liability electronically, e.g. Direct Debit, BACS, CHAPS, etc

### VAT recovery on corporate finance deal costs

Despite making no public announcement of a policy change, the UK VAT authority, HMRC, has recently used a variety of different arguments to oppose the recovery of VAT incurred on corporate finance deal costs. The taxpayer has now fought back with victory in two important tribunal decisions covering this issue.

At the end of 2009, HMRC lost a VAT tribunal case brought by My Travel in respect of deal costs incurred on tripartite contracts with banks/investors. The professional advisers were instructed to assist the taxpayer with a corporate reconstruction. HMRC disallowed the recovery of VAT on the costs on the basis that the services were not used by Airtours but were supplied to its investors. The Tribunal did not agree, and decided that the taxpayer had received the benefit of the supply.

HMRC has now been defeated again in a case considering another aspect of corporate finance, this time brought by BAA Ltd, the company that operates most of the UK's airports.

BAA was taken over by Spanish transport infrastructure giant, Ferrovial which created a new company to act as a Special Purpose Vehicle (SPV) to acquire the shares in BAA. Once the deal was completed, the SPV was added to the BAA VAT group registration. BAA then attempted to recover VAT on legal fees and other costs associated with the deal. HMRC disallowed the claim, arguing that there was no firm link between the SPV's costs and the VATable activities of the BAA companies.

The Tribunal ruled that a VAT group, including an SPV and the company it has acquired, can treat corporate finance deal costs as overhead costs. Therefore, VAT on those costs can be recovered to the extent that the group's activities as a whole are subject to VAT.

More cases on this subject are expected to be heard in the UK VAT Tribunals soon, and appeals from HMRC are expected in the BAA and My Travel cases. This could become a hot issue in the UK's higher courts and possibly the European Court of Justice at some stage.

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# USA

## Tax court holds that guarantee fee is sourced to location of guarantor

The Tax Court's decision in *Container Corp. v. Comm'r* will have a significant impact on US corporations that guarantee loans to foreign subsidiaries. Although the case involved the guarantee by a foreign parent of US subsidiaries debt, the real import of the case will involve guarantees by US parents of foreign subsidiary debt. The case will have significant implication for transfer pricing issues and the source of income for purposes of determining the credibility of foreign taxes.

In *Container Corp. v. Comm'r*, a Mexican corporation guaranteed the debt of its US subsidiary. The US subsidiary paid a guarantee fee to the Mexican corporation and did not withhold US income tax from the guarantee fee, taking the position that the guarantee fee was foreign source income. The IRS argued that the guarantee fee was US source income, but the Tax Court held in favour of the taxpayer.

Sections 861 and 862 of the Internal Revenue Code provide source rules for certain types of income. If an income category is not addressed in the code, its source should be determined by the statutory rule that applies to the most similar type of income. Interest income is generally sourced to the residence of the borrower, and services income is generally sourced to the location where the services are performed.

The Tax Court concluded that the guarantee fee is not interest because the Mexican parent did not make a loan to the US subsidiary and that the guarantee fee is not compensation for services because the value of the guarantee stems from the promise made, not from an applied intellectual or manual skill. Because the guarantee fee is neither interest nor services, it had to be sourced using the rules for the type of income most analogous to a guarantee fee. The Tax Court concluded that a guarantee fee is most analogous to services income and therefore should be sourced to the location of the party that produced the guarantee – Mexico. It came to this conclusion because the business activities generating the guarantee fee took place at the location of the guarantor.

The Tax Court did not address whether the income to which a guarantee fee is most analogous is underwriting income, which is defined in the code as premiums earned on insurance contracts. The code provides that underwriting income is sourced to the location of the activity out of which the potential liability arises. Under this rules dealing with underwriting income the guarantee fee could have been considered US source income.

Many US income tax treaties contain an „Other Income“ article under which guarantee fees paid by US corporations to foreign guarantors are not subject to US tax. The Mexican-US Income Tax Treaty is an exception to this general rule and would allow the US to tax income sourced in the US which is not dealt with in other provisions of the Treaty.<sup>1</sup>

Consequently, the primary impact of this case will be on guarantee fees received by US corporations from their foreign subsidiaries. If a US parent guarantees a loan to its foreign subsidiary and receives a guarantee fee in return, the guarantee fee will reduce the foreign source income of the subsidiary even though the guarantee fee is US source income under *Container*. The US parent therefore cannot offset the US tax on the guarantee income with foreign tax credits.

This case may have even wider significance if future guidance requires payment of guarantee fees. In the preamble to regulations under section 482, the IRS stated that it intends to issue future guidance regarding financial guarantees.

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<sup>1</sup>The Canada-US Tax Treaty would also allow the US to tax US source income not covered by the other provisions in the Treaty.

## IC – DISC – The last export incentive

The US tax law contains an important incentive for domestic manufacturers and certain service providers to defer and reduce taxes attributable to profits on export sales. These benefits can be achieved through an Interest Charge Domestic International Sales Corporation (IC-DISC). By utilising an IC-DISC, companies with export sales of goods and services with greater than 50% domestic content can eliminate corporate level taxes on part of the profits on those sales, and can allow for deferral of the shareholder level tax on dividend distributions of such profits. For S corporations and other pass-through entities, the IC-DISC has the effect of reducing the federal tax rate on such profits by as much as 20%. Earnings from manufactured goods, sales of architectural services for projects in foreign jurisdictions, entertainment products and software all qualify for these benefits through an IC-DISC. Earnings from consulting services generally do not qualify.

To utilise the IC-DISC, the US operating company (Supplier) or its owner incorporates a domestic corporation through which the earnings from the sales of qualifying property can be paid under the terms of the Supplier's Agreement. IC-DISC status must be elected by filing Form 4876-A. The shareholders of the IC-DISC are typically the same shareholders as the Supplier, or in certain cases the Supplier itself. The earnings of the IC-DISC are paid out (or deemed paid out in certain circumstances) to non-C corporation shareholders as a qualified dividend, currently taxed at the preferential capital gains rate of 15%. The IC-DISC dividend paid to a C corporation shareholder does not qualify for the dividends received deduction. An IC-DISC must pay an interest charge on profits not currently distributed as dividends.

There are three methods for calculating the profit of the IC-DISC:

1. 4% of the gross receipts from the sale of export property
2. 50% of the combined taxable income related to the export sales or
3. Arm's length pricing method.

The first two methods are safe harbour methods, which will yield a profit to the IC-DISC of the greater of either 4% of the total export sales or 50% of the combined export profit of the IC-DISC and related Supplier. An arm's length pricing method is generally only available to an IC-DISC that is an operating entity, and does not generally produce a more favourable result than the other available methods. The IC-DISC profit will then be deducted by the Supplier as a cost of sales and ultimately will be distributed

to the shareholders as a qualified dividend. Due to the increased depreciation allowances and other factors, for 2009, many businesses will recognise the greatest benefit by use of the 4% calculation.

In order to qualify as an IC-DISC, the corporation must have 95% of its gross receipts from Qualified Export Receipts and must hold assets referred to as Qualified Export Assets (QEA). Ninety five percent or more of the total assets of the IC-DISC must be QEA, measured at year end. QEA includes inventory, IC-DISC trade receivables, working capital, producer's loans and certain other assets. For non-operating IC-DISCs, the amount of working capital required for operations is negligible.

The use of an IC-DISC makes good sense for companies with as little as \$500,000 in export sales. The benefit is only available for prospective sales, so the IC-DISC should be established as early as possible in the year to maximise the benefits.

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## Uncertain Tax Positions

On 26 January 2010, the Commissioner of the Internal Revenue Service dropped a bomb on the tax and business community when he announced the Service is considering a new initiative whereby businesses will have to disclose uncertain tax positions (UTPs) on tax filings. The stated goals are to improve tax compliance and administration. In this regard, the Service is developing a schedule requiring certain business taxpayers with more than \$10 million in total assets to report such positions on their annual tax returns. The schedule will require a concise description of those positions and information about their magnitude. The proposal does not require the taxpayer to disclose the taxpayer's risk assessment, even though the Service can compel the production of this information through a summons.

The following is a summary of the information provided in IRS Announcement 2010-9:

### IRS Rationale

The United States federal income tax system relies on taxpayers to make a self-assessment of tax and to file the appropriate returns that show the facts upon which tax liability may be determined and assessed. To discharge its obligation to fairly and uniformly administer the tax laws, the Service must be able to identify quickly and efficiently significant issues. The Service believes that the current business returns do not require taxpayers to identify and explain UTPs. In response to potential criticisms of the increased burden on business, the Service stated that many taxpayers are already required to identify and quantify UTPs for financial statement purposes because of Financial Accounting Standards Board (FASB) Interpretation No. 48 Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (commonly referred to as FIN 48). Thus, by reference, the Service believes the burden in reporting UTPs is not significant.

### Proposed Schedule

The proposed schedule will require certain filers to provide information about their UTPs that affect their United States federal income tax liability. The schedule will require (i) a concise description of each UTP for which the taxpayer or a related entity has recorded a reserve in its financial statements and (ii) the maximum amount of potential federal tax liability attributable to each UTP.

In addition to those positions for which a tax reserve must be established under FIN 48 or other accounting standards, UTPs will include any position related to the determination of any United States federal income tax liability for which a taxpayer or a related entity has not recorded a tax reserve because (i) the taxpayer expects to litigate the position, or (ii) the taxpayer has determined that the Service has a general administrative practice not to examine the position.

The sufficiency of a description will depend on the taxpayer's particular facts and the nature of the underlying transaction. This description will include the rationale for the position and a concise general statement of the reasons for determining that the position is a UTP. To be sufficient, the description must contain:

The Internal Revenue Code Sections potentially implicated by the position

1. A description of the taxable year or years to which the position relates
2. A statement that the position involves an item of income, gain, loss, deduction, or credit against tax
3. A statement that the position involves a permanent inclusion or exclusion of any item, the timing of that item, or both
4. A statement whether the position involves a determination of the value of any property or right
5. A statement whether the position involves a computation of basis.

In addition, the schedule will require a taxpayer to specify for each UTP the entire amount of United States federal income tax that would be due if the position were disallowed in its entirety on audit. This amount is the maximum tax adjustment for the position reflecting all changes to items of income, gain, loss, deduction, or credit if the position is not sustained.

The Service is evaluating options for penalties or sanctions to be imposed when a taxpayer fails to make adequate disclosure of the required information regarding its UTPs. One option being considered is to seek legislation imposing a penalty for failure to file the schedule or to make adequate disclosure.

## Continuation of Policy of Restraint

As a general rule, the Service intends to retain the existing policy of restraint for requesting financial statement tax accrual workpapers during the course of examinations. This means the Service will not automatically and mandatorily request auditors' tax accrual workpapers at the onset of a tax examination. However, the Service will continue to review the policy and to consider additional modifications as appropriate or necessary to ensure it obtains complete and accurate information regarding a taxpayer's UTPs on a timely basis.

## Scope

The Service intends the new schedule to be filed by a business taxpayer with total assets in excess of \$10 million if the taxpayer has one or more UTPs of the type required to be reported on the new schedule. This includes a taxpayer who prepares financial statements, or is included in the financial statements of a related entity that prepares financial statements, if that taxpayer or related entity determines its United States federal income tax reserves under FIN 48, or other accounting standards relating to UTPs involving United States federal income tax.

## Comment Period

Given the importance of these issues to both the Service and taxpayers, the Service intends to publish the new schedule as quickly as possible and therefore invites the public to submit comments on the proposal described in this Announcement by 29 March 2010. The Service intends to mandate the new schedule for UTPs to be filed with returns filed after its release. A high ranking IRS official said: "A goal of the agency is to have the proposal become a reality in time for it to apply to 2010 returns filed in 2011".

It will be interesting to see if other jurisdictions around the world will follow suit and consider similar tax return disclosures.

## Update

### Announcement 2010-17

Since Announcement 2010-9, the Service has received a number of questions and comments on the proposal. Several informal comments asked whether taxpayers will be required to file the new schedule with returns relating to 2009 tax years and whether a draft schedule and instructions will be released. Other comments inquired about the scope and implementation of the proposal, such as its application to pass-through entities and tax-exempt entities, and potential duplication of reporting with disclosures made on other forms (such as the Form 8275, Disclosure Statement, and the Form 8275-R, Regulation Disclosure Statement). Some informal and written comments also asked for an extension of the comment period for up to 60 days to allow sufficient time to study the proposal and analyse its impact.

The Service response is that it continues to work on developing the schedule and implementing instructions. The Service's target date for releasing a draft schedule, is early April 2010 with a comment period ending on 1 June 2010. The Service expects the draft schedule and instructions will clarify some of the issues that have already been brought to the Service's attention, provide additional information and facilitate comment on the proposal.

The Service plans to require the filing of the new schedule for returns relating to the calendar year 2010 and for fiscal years that begin in 2010. The schedule will not be implemented for 2009 tax returns filed in 2010. To allow taxpayers and practitioners the opportunity to provide comprehensive comments both on the proposal and on the implementing schedule and instructions, the time for submitting comments in response to Announcement 2010-9 is extended to 1 June 2010.

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