



BDO International

# BDO World Wide Tax News

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**BDO World Wide Tax News****Issue No. 1 / 09 - April 2009**

Welcome to Issue 2009 No. 1 of *BDO World Wide Tax News*. This newsletter summarises important recent tax developments of international interest across the world. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *BDO World Wide Tax News* is published quarterly by BDO Global Coordination BV in Brussels. If you have any comments or suggestions concerning *BDO World Wide Tax News*, please contact the editor, Zigurds Kronbergs, by e-mail at [zkronbergs@bdoglobal.com](mailto:zkronbergs@bdoglobal.com) or by telephone on +32 (0)2 778 0141.

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## United States of America

# Tax cuts in Recovery and Reinvestment Act

Over USD 300 000 million of tax cuts are included in the American Recovery and Reinvestment Tax Act 2009, signed by President Obama on 17 February. The Act is one of the first steps taken by the Administration and Congress to revive the US economy.

For businesses, the tax measures include the following.

**Bonus depreciation**

The Act extends the availability of 50% bonus (additional) depreciation on qualifying property to the end of 2009, and in certain cases also for the whole of 2010. In general, bonus depreciation is available for assets with a useful life of no more than 20 years, the first use of which must be by the taxpayer. The assets may be either acquired or manufactured. For the bonus depreciation to be available in 2009, the asset must be placed in service before 1 January 2010.

Taxpayers with newly constructed properties should undertake cost-segregation analysis, to identify assets that qualify as five-year, seven-year or 15-year property (i.e. assets deemed to have a useful life – and hence depreciation period – of five, seven or 15 years, as distinct from the building of which they form part, which will have a useful life of 27½ years (in the case of residential rental property) or 39 years (in the case of non-residential real property). In most types of building, the benefits of cost segregation can be significant; an immediate deduction of 50% of an asset's base cost, coupled with a shorter life (depreciation period) for the remainder, can provide increased cash-flow benefits in the first year as well as net-present-value benefits over the life of the asset.

**Refundable credits**

In addition to the benefits of accelerated depreciation, there is another advantage arising from the one-year extension of bonus depreciation. The Act extends to the end of 2009 a provision that permits corporations to encash some of their older unused AMT (alternative minimum tax) and research and development credits. Under this provision, a corporation that is eligible for bonus depreciation may elect instead to claim additional refundable AMT or R&D credits. The credits are increased by 20% of

the difference between depreciation claimed on eligible assets with and without bonus depreciation. The amount is limited to the smaller of 6% of the accumulated credits and USD 30 million. The one-year extension of bonus depreciation gives taxpayers an opportunity to use cost-segregation studies to increase the amount of otherwise available bonus depreciation, which they can then forgo in order to increase their refundable credits.

### Losses carried back

The Internal Revenue Code (IRC) normally allows businesses to carry back losses ('net operating losses') for a maximum of two years. The Act extends the carry-back period for losses incurred in 2008 by 'small' businesses to three to five years. A 'small' business is one with an average annual gross turnover of less than USD 15 million (equivalent to EUR 11.35 million), taking into account the gross receipts of certain related taxpayers.

### S-Corporation built-in gains

When a 'C corporation' (a normal corporation, recognised for tax purposes as a separate legal entity distinct from its owners) converts to an 'S corporation' (a corporation treated for tax purposes as a look-through entity), certain of its unrealised gains become subject to tax if the underlying assets are disposed of within ten years. The Act reduces the clawback period to seven years in tax years beginning in 2009 or 2010. This will primarily benefit S corporations that converted from C corporations in the years 2000-2003.

### Bank losses and other bad debts

The last issue of *BDO World Wide Tax News* (2008/09, Issue 4) reported that the Internal Revenue Service (IRS) had issued Notice 2008-83, relieving banks and other financial institutions from the application of certain aspects of IRC section 382, which restricts the use of built-in losses following an ownership change. The Act withdraws the application of the Notice for transactions taking place after 16 January 2009 (subject to transitional provisions), in language that suggests lawmakers considered that the IRS and the Treasury had exceeded their authority in issuing the Notice.



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## North America and the Caribbean Canada

### Taxpayer wins again in Prévost case

The Canada Revenue Agency (CRA) has lost its appeal on an April 2008 decision of the Tax Court that a Netherlands holding company interposed between a Canadian subsidiary and its Swedish and UK shareholders was the 'beneficial owner' of dividends paid from Canada, and hence entitled to beneficial rates of withholding tax under the Canada–Netherlands double tax treaty.

As reported in *BDO World Wide Tax News* at the time (2008 Issue No 2), Prévost Car Inc was a manufacturing subsidiary, 51% of which was owned by Volvo and 49% by an unrelated UK company, Henlys. This ownership was held via a Netherlands holding company ('Holdco') owned in that proportion by the two shareholders; the holding company in turn owned 100% of Prévost. There was also a shareholders' agreement between Volvo and Henlys, which provided that 80% of the profits of Prévost and Holdco was to be distributed as dividend to the two shareholders. Holdco had no office, employees or significant other assets.

When paying dividends to Holdco, Prévost applied the reduced 5% withholding tax provided under the Canada–Netherlands treaty. Had the dividends been paid directly to Henlys and Volvo, the relevant withholding-tax rates would have been 10% for the dividend to Henlys and 6% for the dividend to Volvo (under the respective treaties with the United Kingdom and Sweden). It was these rates that the CRA maintained should have applied, and assessed Prévost for the difference, on the grounds that Holdco was merely a conduit, and not the 'beneficial owner' of the dividends.

In the lower court, the judge, having made extensive reference to dictionaries, civil law, common law and the OECD Model double tax Treaty and Commentaries, and having heard expert evidence, concluded that Holdco was indeed the beneficial owner of the dividend. It was not a mere conduit, but had discretion as to how it applied its funds. It was not bound by the shareholders' agreement, although the shareholders together controlled the company, since it was not a party to that agreement.



The Federal Court of Appeal has now upheld that decision. It ruled that the determination of the beneficial owner was a question of fact, and that the judge in the Tax Court had made no palpable or overriding error in his decision.

The result of this case, together with the earlier case of *MIL (Investments) SA*, gives important judicial support for the proposition that, as far as Canada is concerned, a foreign entity in receipt of dividends, interest, royalties or indeed other similar types of income, will be considered the beneficial owner for treaty purposes of that income as long as it has discretion in the way that it applies those amounts.

However, the Appeal Court judges made other observations that are potentially of less comfort to taxpayers. Accepting that the OECD Commentaries are a widely accepted guide to the interpretation of double tax treaties, the judges appeared to give support to consideration of new or revised Commentaries issued subsequent to the date on which the treaty in question was entered into (and which could not thus have been in the minds of the signatories at the time), provided that they are not inconsistent with the wording in existence when the treaty was concluded.

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## United States of America

### **Tax cuts in Recovery and Reinvestment Act**

See page 1.

## Europe and the Mediterranean European Union

### **Belgian participation-exemption rules unlawful**

See under Belgium

### **Belgian notional-interest rules challenged**

See under Belgium

## Austria

# Participation exemption may be extended

Austria is intending to increase its participation exemption for dividends to small (portfolio) holdings. Currently, the exemption from corporate tax for dividends received from abroad applies solely to significant shareholdings (i.e. those amounting to 10% or more).

The exemption for portfolio holdings would extend only to dividends from EEA countries, however, but would require no minimum holding period. A further condition applying to the exemption in the case of dividends from EEA but non-EU countries (i.e. Iceland, Liechtenstein and Norway) is that the country

concerned have a mutual assistance agreement with Austria providing for recovery of tax. At the present time, only Norway has such an agreement.

For portfolio dividends from 'low-tax' countries within the EEA (where the rate of corporate tax is less than 15%, e.g. Cyprus), there would be no exemption, but credit for foreign tax would be available. Portfolio dividends from countries outside the EEA would remain fully subject to corporate tax of 25%.

## Withholding rebates on outbound EU dividends

The draft Bill including the changes to the treatment of inbound dividends also contains provision for a refund of withholding tax charged on outbound dividends from Austrian companies to portfolio corporate shareholders in other EU Member States and Norway, where the respective tax treaty between Austria and the country of residence of the portfolio shareholder does not provide for a credit for the Austrian withholding tax.

In order to qualify for the refund, the foreign company will have to provide evidence (e.g. a tax assessment) that there is no possibility of receiving a foreign tax credit for the Austrian tax. It is expected that withholding taxes charged in the last five years will be refundable.

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## Belgium

# Participation exemption falls foul of Europe

Belgium's rules for allowing exemption (to the extent of 95%) for EU-source dividends under the EC Parent-Subsidiary Directive has been held to be unlawful by the European Court of Justice (ECJ).

Under the Directive (90/435/EEC), Member States are obliged either to exempt from corporate tax qualifying dividends received by their companies from associated companies resident in other Member States or to tax them with full credit for the tax paid in the home country.

Belgium chose the exemption method, reserving the right granted under the Directive, to tax 5% of the dividend received by way of management costs. The particular mechanism adopted by Belgium was to include the whole of the dividend received in taxable income and then to deduct 95%. However, the right to deduct was made subject to the proviso that there was sufficient taxable profit to absorb the deduction. Any amount that could not be deducted as a result of insufficiency was lost and could not be carried forward.

This rule was challenged by a Belgian company, Cobelfret NV, which had had its dividend deductions in respect of dividends from its qualifying UK subsidiary restricted in this way. The ECJ agreed with Cobelfret (Case C-138/07) that the Directive did not permit Member States unilaterally to introduce restrictions on the application of the exemption method so as to make it subject to conditions not envisaged in the Directive. It was of no consequence in this instance that the same rule applied also to dividends received by Belgian companies from other Belgian companies.

The ECJ also refused to concede a temporal limitation on the effect of its decision, as the Belgian government had not demonstrated that an adverse judgment would have significant adverse economic repercussions.



# Europe moves against notional-interest rules

The European Commission has initiated infringement procedures against Belgium for certain aspects of its notional-interest régime. It is important to note, however, that the Commission is raising no objection to the régime itself and its compliance with the state-aid rules is not in doubt.

Under the régime, Belgian companies and foreign companies' permanent establishments (branches) in Belgium may claim a deduction from profits subject to corporate tax for a fixed percentage of their net equity. In computing eligible net equity, the net book value of permanent establishments and real property situated abroad (in jurisdictions having a tax treaty with Belgium) must be deducted.

It is this last aspect of the rules that the European Commission is challenging. It maintains that the exclusion from the deduction base for notional interest of branches and property situated abroad is in breach of the EC Treaty guarantees for free movement of capital and freedom of establishment. The right to freedom of establishment applies only within the European Union but the right to free movement of capital also applies vis-à-vis third countries.

Should the matter eventually proceed to the European Court, and a judgment be delivered in support of the Commission's view, or should Belgium amend its rules to comply with the Commission's opinion in the meantime, there would be no retroactive effect, but the opportunity would be open for increased notional-interest deductions in future.

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## Denmark

# Tax-reform proposals published

The Danish government has published its tax-reform proposals for both corporate and personal taxes, in response to the recent report of the Tax Commission on reforms, which was published in February. The proposals take the form of exposure drafts, which the government, after taking account of comments, will then introduce in a Bill, expected towards the end of April.

On the corporate tax side, the government proposes to leave unchanged the corporate rate of 25%, but among the measures it does intend to make are the following:

## Harmonising taxation of participations

Currently, a company with a portfolio (under 10%) holding in another company is required to bring into account for tax only 66% of the dividends received from the shares. In future, it would be required to bring the whole of the dividend into tax and also be taxed on the whole of any capital gain from disposal of portfolio shares, however short or long the period of ownership. However, it is also proposed that portfolio holdings, bonds and holdings in investment funds should be subject to tax each year by reference to their market value at the balance-sheet date, instead of only when realised. On the other hand, the government is proposing that dividends and gains relating to 'subsidiary' shares and 'group' shares be exempt from corporate tax, whatever the holding period. 'Subsidiary' shares are shares belonging to a direct holding of at least 10% in the investee company if that company is Danish. For foreign holdings, the definition covers qualifying holdings under the EC Parent-Subsidiary Directive or equivalent holdings in a company resident in a treaty-partner jurisdiction. 'Group' shares are shares in a company included in mandatory tax consolidation with the investor company, or included or includible in a voluntary international tax consolidation.

## Phasing-in of tightened interest restriction

Under Denmark's rules for restricting the deduction of related-party interest payments, a Danish company may not deduct net financing expenses to the extent that they exceed either:

- 80% of EBIT (earnings before interest and tax) or
- 6.5% (2009 value) of qualifying assets

Net financing expenses of less than DMK 21.3 million (2009 value; EUR 2.86 million; USD 3.78 million) may be deducted in any case. Included in qualifying assets is 20% of the acquisition cost of direct holdings in foreign subsidiaries.

The government is proposing to reduce the 20% to zero, over a period of seven years, beginning in 2010.

## Dividend withholding tax

It is proposed to reduce the standard rate of withholding tax on dividends from 28% to 27%, and to remove the one-year minimum holding period for exemption from withholding tax for holdings of at least 10% in a Danish company. Currently, there is no withholding tax on dividends paid by a Danish company to a foreign company that holds at least 10% of the shares in the Danish company, provided that the foreign company has held the shares for an uninterrupted period of at least one year and the foreign company is either one to which the EC Parent-Subsidiary Directive applies with respect to the Danish company or one resident in a treaty-partner jurisdiction and qualifying for treaty benefits.

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## Ireland

# Relief for IP expenditure announced

In the Supplementary Budget speech given by Finance Minister Brian Lenihan on 7 April, the Minister announced the introduction of a new tax relief by way of capital allowances for expenditure on the acquisition of most forms of intellectual property (expected to include brands and goodwill). Details will be contained in the Finance Bill, to be published in May. The Minister also confirmed that the 12.5% rate of corporation tax for trading companies would remain unchanged, as a key means of attracting and retaining foreign investment in Ireland. However, the special 20% rate on

trading profits from dealing in or developing residential development land is to be abolished, and such profits will in future be charged at the 25% rate applicable to non-trading income generally.

On the tax-raising side, a number of measures were announced. These include an increase in the rate of capital gains tax from 22% to 25%, an increase in the deposit-interest retention tax on standard deposit accounts from 23% to 25%, an increase in the rate of capital acquisitions tax from 22% to 25%, and increases in social security contributions.



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## Italy

# Opportunity to step up real property

Under a recently enacted new law, companies that have not adopted IAS have the opportunity to step up the value of their real property owned at the end of the 2007 financial year.

The step-up must be made in the financial statements for the period immediately following that in which 31 December 2007 falls and applies to all real property belonging to the same group. For this purpose, amortisable and non-amortisable real property must be treated separately.

The amount of the revaluation has to be recorded in a special net-equity reserve, taxable in the event of distribution.

For the step-up also to have effect for tax, the company would have to pay a substitute capital gains tax in lieu of both corporate income tax (IRES) and the regional productive activities tax (IRAP) at the following rate:

- 3% for amortisable real property
- 1.5% for non-amortisable real property

on the increase in value, payable immediately or in three annual instalments subject to interest of 3% per annum. It is also possible to pay a 10% substitute tax to exempt the special reserve from any further tax.

For the purposes of tax amortisation, the fiscal effects of the step-up of the real estate will be taken into account starting from the fifth tax period subsequent to that in which the step-up is made, and for sale purposes starting from the sixth period subsequent to that in which the step-up is made.



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## Netherlands

# Protective assessment remains valid

The Netherlands Supreme Court has held that the principle of raising a protective assessment on emigrating nationals in respect of unrealised gains is valid, following the European Court's decision in the N case (Case C-470/04).

When Netherlands nationals emigrate, they are deemed to realise certain assets, and a protective (*conserverende*) assessment is raised in respect of the deemed (unrealised) gains. Under the law as it stood at the time of the facts in the case, payment of the assessment could be deferred if the emigrant provided a guarantee. If the assets were not realised in the ten years following emigration, the assessment lapsed. If they were realised, no account was taken of any fall in value of the assets following emigration.

Following its own decision in the French case of *de Lasteyrie du Saillant* (Case C-9/02), the European Court held that while the principle of the protective assessment was acceptable, the rules went beyond what was proportionate, because of the requirement of a guarantee and the non-recognition of subsequent losses.

After this judgment in the European Court, the Netherlands government repaid N the guarantee, but he appealed against the principle of the assessment. A lower Netherlands court annulled the assessment on unrealised gains. On appeal to the Supreme Court, this decision was overturned, and the assessment allowed to stand, as it was not incompatible with Community law. The taxpayer was, however, entitled to be compensated for the expenses he had incurred in providing the guarantee, and the Netherlands was obliged to take any subsequent fall in value of the assets

into account if tax became payable. The Supreme Court also held on a subsidiary issue that the United Kingdom – Netherlands treaty (N had emigrated to the United Kingdom) did not preclude the protective assessment.

The law as it now stands in the Netherlands grants automatic deferment of the tax on a protective assessment without the need for a guarantee where the taxpayer emigrates to another EU Member State, and takes losses into account in certain cases if the assets are realised within 10 years of emigration.

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## Sweden

# Cross-border group contributions deductible

The Supreme Administrative Court of Sweden (*Regeringsrätten*) has held that a Swedish parent company must be allowed to claim a tax deduction for a 'group contribution' to a foreign subsidiary, if that subsidiary has exhausted the possibility of loss relief in its own country as a result of liquidation.

The group-contribution system is the method of intra-group loss transfer applied in Sweden. A profitable company in a group may transfer some of its profits (make a 'group contribution') to a loss-making fellow group member. The group contribution is deductible by the transferor company and taxable in the hands of the transferee company. However, one of the conditions of the régime is that both the transferor and transferee companies be subject to corporate tax in Sweden.

In the case concerned, a Swedish parent company had loss-making subsidiaries in Italy and the Netherlands. The Swedish company made group contributions to both subsidiaries. The Italian subsidiary had exhausted the possibility of using its losses as a result of domestic tax rules, whereas the Netherlands subsidiary could no longer use its losses because it was undergoing liquidation. In neither case was the group contribution received taxable in the subsidiary's home country.

Although the proceedings in the case began before the *Marks & Spencer* decision of the European Court of Justice, the Swedish court's decision had to be compatible with that decision. Readers will recall that in *Marks & Spencer*, the European Court clearly established the principle that Member States in which some form of group relief is permissible had to allow relief for losses incurred by a foreign group member if all possibility for offsetting that loss was exhausted in the foreign company's home state.

The Supreme Court held that Sweden must allow a deduction for the group contribution to the Netherlands subsidiary, which, having been liquidated, had definitively no possibility of offsetting its loss. The amount deductible would be the smaller of the subsidiary's final loss in the year before liquidation computed under Swedish rules on the one hand and Netherlands rules on the other.

A deduction for the contribution to the Italian subsidiary was disallowed, however, on the grounds that the Italian subsidiary was not precluded from generating profits.

## Corporate tax rate cut

Sweden has reduced its rate of corporate tax from 28% to 26.3%, with effect from 1 January 2009, thus breaking ranks with its neighbours Norway and Finland, in which the corporate rate remains at 28%.

The reduction was made in the 2009 Budget Act, which also included reductions in social security

contributions and personal tax reliefs, but also restrictions on the deductibility of interest paid to related companies.

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## United Kingdom

# Foreign-currency losses not to be exposed to exchange risk

Legislation will be included in the 2009 Finance Bill (expected in late April or early May) to ensure that companies preparing their accounts in a currency other than sterling carry losses forward or back in the same currency rather than in the sterling-equivalent amount. This will prevent exposure for both the companies and the UK Exchequer to currency-market volatility.

Currently, a company preparing its accounts in a foreign currency and incurring a tax loss must translate that loss into sterling (normally at the rate for the balance-sheet date) before carrying back the loss to earlier periods or carrying it forward to subsequent periods. In either case, when the loss comes to be offset against profits, the exchange rate used to translate those profits into sterling will differ, possibly

markedly, from the rate used to translate the loss. As a result, either the company or the Exchequer may suffer a large and unintended revenue loss. For example, a tax loss of EUR 1 million translated into sterling at the 31 December 2008 rate will yield GBP 974 000. If carried back to profits of the previous year (to 31 December 2007, when the euro-sterling rate was 0.7379), that GBP 974 000 would offset original euro profits of as much as EUR 1.32 million.

The legislation will ensure that the rate used to translate the loss into sterling for the purpose of offsetting profits will be the same rate used to translate the profit.

## Stamp duty repayments may be due

Taxpayers may be in a position to make claims for substantial repayments of stamp duty reserve tax (SDRT) as the result of a case before the European Court of Justice. The Court's Advocate-General has released an Opinion in favour of the taxpayer. The Court is not bound to follow the Advocate-General's Opinion in any case, but normally does so.

SDRT is normally payable in the United Kingdom at a rate of 0.5% on share transfers. However, if the shares are entered into a clearance service (little used in the United Kingdom but prevalent in Continental Europe), SDRT must be paid at 1.5%, but subsequent transfers of shares within the service are free of further SDRT.

Alternatively, the clearance service may opt for an agreement with HMRC (the tax authorities) that SDRT at 0.5% will be paid on each share transfer within the service. In order to do so, the clearance service must have a subsidiary or agent in the United Kingdom and fulfil certain other requirements.

In the case concerned, the multinational banking group, HSBC, acquired a French bank in return for a cash payment or shares in itself. In order to make the shares more attractive, it agreed to place them in a French clearing service. As a result, it paid over GBP 27 million of SDRT at 1.5%. It subsequently applied for a repayment, which was refused. Its appeal was referred to the European Court of Justice (ECJ).

The questions before the ECJ are twofold: is the charge to SDRT unlawful under the EC Capital Duty Directive (69/335/EEC) and, irrespective of that, is the 1.5% charge in breach of the EC fundamental freedoms (free movement of capital, free provision of services, freedom of establishment)?

In his Opinion, Advocate-General Mengozzi considered that SDRT is a tax on the issue of shares which is not capital duty and, as such, unlawful under the Directive, which allows only capital duty to be charged on share issues. He dismissed the United Kingdom's argument that SDRT was an advance payment of a share-transfer

tax (which is permissible). On the second question, he found that the 1.5% charge on placements into a clearance service was an unjustified restriction on the free movement of capital.

If the Court follows the Advocate-General's Opinion, all share issuers who were charged 1.5% SDRT on the issue of shares into a clearance service will potentially be in a position to claim a refund of that tax.

## University not public body for reduced VAT

In the United Kingdom, a reduced 5% rate of VAT applies, among other things, to a supply of electricity for use by a charity 'otherwise than in the course or furtherance of a business'. The University of Cambridge, which is registered as a charity, had constructed a new building used for educational and research purposes. It sought the permission of HMRC to issue a certificate to its utility company in order that, as a charity, it could receive supplies of electricity at the reduced rate, as it was required to do. Whether or not such a certificate could be issued depended upon whether the university was acting in a non-economic capacity.

The university acknowledged that its supplies of higher education were a business activity but sought to disapply the normal rules by arguing that Article 13 of the EC VAT Directive (2006/112/EC) required non-taxation because it was a body governed by public law.

The High Court rejected the idea that whether a body was one governed by public law could be determined

by the law of a Member State. Reliance had to be had on Community law. The university quoted a number of Community judgments and in particular the last sentence of paragraph 107 of the Advocate-General's opinion in *T-Mobile Austria (C-284/04)* – "It is for the national court to examine whether this categorisation [part of the public administration] is correct under national law". The judge rejected this argument as paragraph 107 had already recognised the body in question as part of the public administration and the Advocate-General's comments had been referring, uncontroversially, to the Community-law concept. He also rejected the idea that within the United Kingdom universities were in general bodies apart from private traders. It would also offend fiscal neutrality for the ambit of an exemption to depend on the manner in which each Member State chose to interpret the public-body concept. Accordingly, the university's appeal was dismissed and VAT at the standard rate applied to its electricity costs.

# 1 April brings penalty and compliance changes

This year, not only does 1 April bring, as it always does, the start of a new financial (corporate tax) year, but several new systems for tax compliance and administration.

## New Tribunal system for first-instance appeals

The changes in administration see an end to the General and Special Commissioners, the first-instance appeal bodies for the direct taxes, whose origins go back to the introduction of income tax at the beginning of the 19th century. Taxpayers who were dissatisfied with a decision or assessment or penalty made or imposed by HMRC (the tax authorities) could appeal to the Commissioners, who were an independent appeals tribunal. The General Commissioners, largely lay people, generally heard simple appeals and the Special Commissioners more complex cases. The indirect taxes (VAT, excise duty etc) had their own Tribunal. Appeals against decisions of any of these bodies would be made (where a point of law was concerned) to the courts.

From 1 April, the separate tribunals are abolished. Instead, appeals relating to all taxes will be heard by the Tax Chamber of the First-Tier Tribunal or by the Upper Tier Tribunal, administered by the Ministry of Justice. Before resorting to the Tribunals, however, taxpayers may opt for an internal HMRC review of their case by specially trained HMRC officers not involved in the original decision. The review must be

completed within 45 days. If taxpayers are dissatisfied with the review decision, they may still appeal to the Tribunal. Appeals from the First-Tier Tribunal will normally be heard by the Finance and Tax Chamber of the Upper Tribunal, and hence to the High Court. In most cases, therefore, the new system introduces an extra appeal tier (so that the courts will hear mostly third-instance appeals rather than second-instance appeals as previously).

## New penalty régime for incorrect returns

The old and complex penalty régime for incorrect returns and declarations, which differed from tax to tax, is replaced by a new uniform penalty system, applying to income tax, capital gains tax, corporation tax, VAT and National Insurance (social security) contributions. From 1 April 2010, it will be extended to the remaining taxes (e.g. stamp-duty land tax, excise duty, insurance premium tax etc).

For the purposes of the new system, incorrect returns will be classified as arising from (a) carelessness (no intention to make an incorrect return); (b) deliberate intent, but with no attempt at concealment; or (c) deliberate intent and intent to conceal. Penalties will be tax-geared (i.e. imposed as a percentage of the extra tax due) and range between a minimum and a maximum for each category as follows:

Nature of error	Minimum penalty	Minimum penalty	Maximum penalty
	Unprompted disclosure	Prompted disclosure	
Careless	0%	15%	30%
Deliberate	20%	35%	70%
Deliberate and concealed	30%	50%	100%

No penalty will be imposed if the error has arisen despite the exercise of reasonable care by the taxpayer. The amount of any penalty will be reduced if the taxpayer alerts HMRC to the existence of errors without being prompted to do so, cooperates with HMRC in computing extra tax due or allows HMRC to check computations. As can be seen from the above table, if errors are disclosed only after prompting by HMRC, the minimum penalty in each default category is greater than for unprompted disclosure. In some cases, HMRC may agree to suspend a penalty for up to two years. At the end of the suspension period, the penalty will be waived if the taxpayer has met a series of conditions and has not made further errors. The right to appeal against any penalty remains.

### Compliance checks

New compliance requirements have been introduced across all taxes, with effect from 1 April 2009 in most cases. These consist of both:

- New inspection and information powers for HMRC and
- New record-keeping requirements

In addition to these changes, the time limits for assessments and claims have been standardised across the so-called 'core' taxes (income tax, capital gains tax, corporation tax, VAT and National Insurance (social security) contributions). There will be a four-year time limit for making claims and a six-year time limit for HMRC in which to raise assessments for additional tax where the taxpayer has failed to take reasonable care (reduced to four years in the case of VAT) and 20 years where tax has been lost as a result of a deliberate act of the taxpayer. The new time limits apply from 1 April 2010, except in the case of VAT, where they apply from 1 April this year.

The new inspection and information powers, also standardised across the 'core' taxes, are broadly based on the previous information powers for income tax, corporation tax and capital gains tax. HMRC has under the new dispensation the power to require a taxpayer to provide information and/or documents that are 'reasonably required' to check that taxpayer's tax liability. They do not require the prior opening of an enquiry or the delivery of a tax return. The power also extends to third-party notices and notices not specifying the name of the taxpayer(s), subject to additional safeguards.

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## Asia Pacific Australia

# Prior treaties do cover capital gains tax

The courts have again confirmed that those tax treaties concluded by Australia before the introduction of capital gains tax in 1985 do cover taxes on gains, and as a result gains made in Australia by non-residents benefiting from the treaties are not taxable there.

The case revolved around the definition for treaty purposes of the terms 'income taxes' and 'substantially similar taxes'. If capital gains tax could be said to fall within the definition of 'income taxes' in the treaties, those treaties gave Australia the right to tax only where the gains were made by an Australian permanent establishment of the non-resident taxpayer. In the absence of a permanent establishment, the gains were taxable solely in the taxpayer's state of residence.

In the present case, the taxpayers were a company resident in the Netherlands and one resident in the United Kingdom. Both had made substantial gains on the sale of shareholdings in Australian insurance companies. They argued that capital gains tax was included in the definition of 'income taxes' or 'substantially similar taxes'; as a consequence, the business profits article of the respective treaties conferred exclusive taxing rights on the home country (as there was no permanent establishment in Australia). The tax authorities maintained to the contrary and, in addition, that the business profits article of the treaty extended to revenue profits only, and not also to gains.

The Federal Court held (in *Undershaft (No 1) Ltd v Commissioner of Taxation*) that the term 'income taxes' did include taxes on capital gains. Both conceptually and historically, the meaning of income in this context

incorporated profits of a capital as well as of a revenue nature. Even if there were not the case, capital gains tax was a substantially similar tax to income tax, leading to the same conclusion in favour of the taxpayers.

In fact, the Court refused to distinguish its earlier decision in *Virgin Holdings SA* on the same issue. This judgment lends considerable judicial weight to the proposition that each of the 12 treaties that were concluded before the introduction of capital gains tax and which are still in force confers similar protection on taxpayers. In 2001, a ruling from the tax authorities (Taxation Ruling TR 2001/12) strongly maintains the contrary, and has not been withdrawn. However, the tax authorities have now withdrawn their appeal against the decision in *Virgin* and it remains to be seen whether they will appeal in the instant case.

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# People's Republic of China

## New withholding tax rules

The Chinese tax authorities (SAT) have issued regulations providing new procedures for collection and payment of withholding tax on payments of Chinese-source income (such as dividends, interest, rentals etc) to foreign (non-resident) entities.

Normally, the Chinese payer of the income must act as withholding agent on behalf of the foreign entity. SAT Circular *Guo Shui Fa* (2009) No 3 (Circular No 3) introduces new contract-filing and registration requirements for withholding agents, with effect from 1 January 2009. The key requirements are that:

- The withholding agent must file a designated contract registration form for withholding tax, a copy of the contract with the payee in respect of the income, and other relevant documents to the appropriate local SAT office within 30 days of concluding the contract with the foreign entity

- The withholding agent must withhold tax at the time the relevant payment is made or due to be made, and account for the tax within seven days of the withholding date

### Share transfers between foreign entities

Circular No 3 also contains procedures to be followed when the shares of a Chinese company are transferred between two non-resident entities. Should the transfer result in a capital gain for the transferor, the transferor enterprise must file an EIT (enterprise income tax) return with the relevant local SAT office, either itself or through an agent. If the transferor fails to comply with the filing and payment obligation, the Chinese authorities have the right to recover any EIT due from the enterprise's other Chinese-source income. In this respect, they have the power to collect the outstanding tax and any surcharges from the payers of this income. In addition, they may require the Chinese companies whose shares are the subject of the transfer to assist them to collect the tax due.



## Reduced treaty dividend rates

In order for a non-resident enterprise to benefit from the reduced rates of withholding tax on dividends provided by a tax treaty between China and its state of residence, the enterprise must:

- Be a company (corporate entity) and be resident in the treaty-partner jurisdiction
- Satisfy the prescribed direct-ownership thresholds by value and voting power
- Satisfy the direct-ownership thresholds at all times during the 12 consecutive months immediately preceding the receipt of the dividend

In Circular No 81 (*Guo Shui Han (2009) No 81*), SAT prescribes a number of documents that must be submitted with a claim for reduced treaty rates; namely documents:

- certifying the tax residence and tax status of the recipient, issued by or on behalf of the tax authority of the recipient's state of residence
- supporting the recipient's entitlement to the dividends from the Chinese company and
- proving the recipient's ownership of the shares in the Chinese company

## Anti-avoidance

Circular No 81 specifically provides that if the primary purpose of the transaction or arrangement concerned is to enjoy the benefits of the treaty, SAT may make appropriate tax adjustments.

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## Hong Kong

# Budget brings no change in tax rates

The 2009-10 Budget, delivered on 25 February, saw no change in corporate or personal tax rates, as the Financial Secretary foresaw a budget deficit in 2008-09. The standard corporate tax rate remains at 16.5% and the standard rate of salaries tax on individuals is unchanged at 15%. This coming year, there will again be a waiver of salaries tax and tax under personal assessment, but limited to 50% of the liability for 2008-09 and capped at HKD 6000 (EUR 585; USD 775) (compared to a 75% waiver capped at HKD 25 000 last year).

The Financial Secretary emphasised the need to expand Hong Kong's network of double tax treaties. Currently only five have been signed, of which four are in effect – those with Belgium, the People's Republic of China (of which Hong Kong is a Special Administrative Region, but with its own tax law and tax sovereignty), Luxembourg and Thailand. The treaty with Vietnam is yet to come into effect.

The Financial Secretary announced that Hong Kong would expand its treaty network by aligning its rules on the exchange of tax information with international standards, and that the necessary legislation would be tabled later in the year.

Hong Kong was not one of the three jurisdictions (Costa Rica, Malaysia (in respect of Labuan) and the Philippines) confirmed on 3 April by the OECD as failing to cooperate on exchange of information. All three countries have, incidentally, subsequently undertaken to cooperate with the OECD, as did Uruguay, which was originally named in error with the other three but then removed from the 'uncooperative' list.



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## Sub-Saharan Africa Namibia

### Withholding tax on interest

A withholding tax on interest received by persons (including a trust) and foreign companies has been introduced. This requires Namibian-registered banks and Namibian-registered unit-trust management companies to withhold a final tax at a flat rate of 10% from interest accruing to an individual, a trust or the estate of a deceased person, with effect from 1 March 2009. Interest paid to a Namibian company is specifically excluded from the withholding tax.

The tax withheld is a final tax as the interest on which it is paid cannot be added to any other income or set off against any other losses. As a result of the above withholding tax provisions, the interest exemption of NAD 500 (EUR 40; USD 55) applicable to natural persons will be removed.

The withholding tax must be deducted or withheld by the respective bank or unit trust and must be paid by such institution to the Namibian tax authorities within 20 days of the end of the month in which the interest accrued or was received by the person or foreign company.

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## Zambia

### Help for mining sector in Budget

Tax reliefs for mining companies featured strongly in the 2009 Budget for Zambia, as a response to the fall in commodity prices and the world financial crisis.

The mining sector will benefit from abolition of the windfall tax introduced in 2008 and an increase from 25% to 100% in capital allowances. Further, foreign-currency hedging as a risk-management tool will no longer be regarded as a separate activity from mining operations for such companies, so that hedging losses may be offset against mining profits.

Other important changes include the extension of the loss carry-forward period from five to 10 years for companies in the energy sector, the introduction of VAT zero-rating for certain agricultural machinery, and increased allowances for personal income tax.

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# Latin America

## Chile


### Corporate-tax payments eased

Monthly payments on account of the First Category (corporate) tax have been reduced to help companies during the current crisis. The reductions apply to payments in respect of the 2009 calendar year as follows:

- by 15% for taxpayers whose gross income was no greater than UF 100 000 (approximately EUR 2.64 million or USD 3.5 million) in 2008 and
- by 7% for taxpayers with gross income greater than UF 100 000 in 2008 or who commenced trading in 2008.

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