

WORLD WIDE TAX NEWS

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UNITED KINGDOM

FOREIGN-DIVIDEND EXEMPTION NOW IN FORCE



The long-awaited tax exemption for foreign dividends became a reality on 1 July 2009, significantly improving the tax environment for UK-based multinationals and the attractiveness of the United Kingdom as a holding-company location.

From 1 July 2009, UK companies can repatriate dividends from their foreign subsidiaries and enjoy an exemption from UK tax, subject to certain conditions.

For medium-sized and large companies, the rules follow the draft legislation released in December 2008. All dividends are potentially taxable, subject to five broad exemptions, which themselves are subject to anti-avoidance rules. In practice, most dividends from foreign subsidiaries will be exempt, regardless of whether the dividend is paid from a low-tax country, out of passive income, or out of profits earned before the start of the new régime.

For small companies, an exemption has been introduced for dividends paid from a jurisdiction that has a tax treaty with the United Kingdom which has a non-discrimination article. Thus many dividends will be exempt, but dividends from non-treaty countries such as Brazil, Hong Kong, Jersey or Gibraltar will remain taxable, with a foreign tax credit for any foreign tax

suffered. 'Small' companies are those having fewer than 50 employees, and either turnover or balance-sheet assets (or both) of not more than EUR 10 million.

New thinking is required to take advantage of the new landscape. For example:

- In the past, earning profits in a low-tax jurisdiction gave rise to a tax deferral (until the profits were repatriated). Now the tax saving is a permanent benefit, a greater significance attaches to the location of overseas activities
- Similarly, foreign tax planning becomes more relevant as savings will not unwind later
- Foreign branches remain subject to UK tax. Incorporation should therefore be considered where a branch is generating low-tax profits
- Profits may have accumulated in low-tax jurisdictions, and groups may now wish to repatriate these for commercial reasons or to unwind upstream loans prior to the start of the worldwide debt-cap régime on 1 January 2010
- Holding structures may need to be revised to reduce withholding taxes (as a quid pro quo for dividend exemption, relief for these is lost), which are now a real cost, and in some cases, actually increased as a result of the exemption (as explained below) and in

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EDITOR'S LETTER

Welcome to Issue 19 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 BDO International Executive Office at mderouane@bdoglobal.com or by telephone on +32 (0)2 778 0130.

response to the abolition of the International and Superior Holding-Company exemptions from the CFC rules

- For small companies, there is the pitfall that dividends will not be exempt if paid by a company resident in a jurisdiction without the right type of tax treaty. In addition, onshore pooling relief has been abolished
- For medium-sized and large companies, the anti-avoidance rules will need to be considered. For example, in some cases, exemption will not be available for dividends on preference shares or where the dividend gives rise to a tax deduction abroad

Of relevance to all companies will be the impact on withholding tax of the dividend exemption. Some 32 of the United Kingdom's tax treaties with foreign jurisdictions do not reduce withholding taxes where the dividend itself is exempt from UK tax. These include the treaties with Germany, Israel, Portugal, Russia and Thailand, although in the cases of Germany and Portugal, the EC Parent-Subsidiary Directive may apply.

The new régime allows a company to make an election overriding the exemption. This may be necessary to address the withholding-tax issue or to enable a CFC 'acceptable-distribution policy' dividend to be made for a pre-commencement accounting period.

NICK UDAL

nick.udal@bdo.co.uk
T +44 207 893 2410

► Read more at www.bdo.co.uk

CANADA

TRUST RESIDENT WHERE EFFECTIVELY MANAGED

In a recent decision of the Tax Court of Canada, a Canadian judge has expanded the considerations to review when determining where a trust is resident. This decision will be of interest to anyone who has set up a trust in an offshore jurisdiction.

In this case (*The Garron Family Trust et al v the Queen*), the taxpayers reorganised the ownership of the shares of a Canadian company in a transaction similar to an estate freeze. In an estate-freeze transaction, an existing shareholder converts common shares to fixed-value redeemable and retractable preference shares, and new common shares are issued for nominal consideration with the intent that all future growth in the value of the company will be attributed to the new common shares. Barbados trusts (trusts the sole (corporate) trustee of which was resident in Barbados) were set up in this case to subscribe for the new common shares. Ultimately, the shares held by the trusts were sold and large capital gains were realised. The taxpayers took the position that under the provisions of Article IV of the Canada-Barbados tax treaty, the trusts were resident in Barbados and therefore the capital gain could only be taxed in Barbados (Article XIV of the treaty states that gains from the disposal of private-company shares can only be subject to tax in the contracting state where the taxpayer is resident for purposes of the treaty).

The judge determined that the trusts were factually resident in Canada, not in Barbados, and therefore the capital gains were subject to Canadian tax. In her ruling, the judge stated that a central management and control analysis can be used in determining a trust's residence for tax purposes. In particular, the judge ruled that simply determining where the trustees of the trust are resident will only be part of the exercise.

While the determination of the trusts' residence was ultimately based on the actual facts of the case, the judge questioned why the usual central management and control tests for corporate residence would not apply to a trust, as neither has a physical existence that can be resident in a place. This does, however, have to be balanced with the rôle of a trustee versus the rôle of management in a company. A trustee's responsibility is more specific and relates to the specific property held by the trust. In this case, there is considerable uncertainty what central management and control means, since the trust property in question was non-voting shares of the Canadian company. The ruling, however, does raise the issue of how much activity on part of a trustee is enough so that the central management and control of the trust will be where the trustee resides.



In making her ruling that the central management and control of the trusts in question was in Canada, even though the trustees were resident in Barbados, the judge made the following observations about the particular facts in this case:

- It seemed clear to the judge from various documents that there was an understanding that the Barbados trust company's rôle would be more limited than that contemplated by the trust indentures
- There was very little evidence as to how the investment of the cash proceeds from the sale of the shares was handled in the Barbados trusts, but what evidence there was suggests that it was under the direction of the principals of the Canadian company who were resident in Canada. The judge went on to conclude that the beneficiaries could to all intents and purposes direct the investment activity of the trusts
- No evidence was put forward showing that the Barbados trust company, which was the trustee of the trusts, took an active rôle in managing the trusts (although it did sign all legal documentation). It was also pointed out by the judge that there was an affiliation between the trustee and the accountants who were the main accounting advisers to the business. The representatives of the trust company were also found to lack personal knowledge of the property held in the trusts
- The judge stated that the trust company was run by individuals who did not possess experience in running a trust business. This was raised to counter the taxpayer's argument that the trustees fulfilled their fiduciary duties.

The judge appeared to establish that in her mind, there is a two-part test in determining the residence of a trust. First, the credibility and level of activity of a trustee would be determined before looking at where a trustee is resident. It would seem that if the trustee is acting in a full and active manner, then the trustee's residence would be relevant. However, if the trustee's level of activity and knowledge is lacking, then other criteria should be reviewed to determine where the central management and control of the trust is, and therefore where the trust is resident.

It is very likely that the taxpayers will appeal against this decision (at the time of writing, the deadline for filing the appeal had not expired).

JOHN HERRING

jherring@bdo.ca
T +1 604 688 5421

► Read more at www.bdo.ca

UNITED STATES OF AMERICA

FOREIGN-REPORTING DEADLINE EXTENDED

The Internal Revenue Service has extended the deadline for reporting foreign bank accounts under the voluntary disclosure programme to 15 October 2009.

In March 2009, the Internal Revenue Service (IRS) announced a voluntary disclosure initiative, whereby taxpayers with unreported income and incorrect income tax returns and foreign-account disclosure forms (Form TD F 90-22.1, or the so-called 'FBAR' forms) may disclose the fact of their delinquency to the IRS without the risk of criminal prosecution and with the assessment of a specific structured penalty régime. Until recently, taxpayers considering participation in the March 2009 voluntary disclosure programme were required to enter the programme no later than 23 September. See *BDO World Wide Tax News* 2009 Issue No. 2 for more details).

Under a series of frequently asked questions (FAQs) issued in the winter of 2008/2009 and modified throughout the summer of 2009, taxpayers with no unreported income but with certain defaulting information returns (such as FBAR forms and Forms 5471 or 3520) are provided a simplified method in which to submit such delinquent forms without the risk of penalties.

On 21 September, the IRS extended to 15 October 2009 the date taxpayers are required to enter the voluntary disclosure programme. The extension, therefore, provides interested taxpayers additional time in which to make an initial contact with the IRS in order to receive consideration for the programme or to take advantage of the simplified filing procedure provided in the FAQs.

Regarding FBAR forms specifically, Notice 2009-62, released on 7 August 2009, extends the FBAR reporting deadline to 30 June 2010, for (i) persons with signatory authority over, but no financial interest in, a foreign financial account, and (ii) persons with a financial interest in, or signature authority over, a foreign commingled fund. This relates to filings with respect to 2008 and earlier calendar years.

BOB PEDERSEN

rpedersen@bdo.com
T +1 212 885 8000

► Read more at www.bdo.com

CALIFORNIA CHANGES 'DOING BUSINESS' DEFINITION

The state of California is changing the definition of what it means to do business in California. Entities and individuals considered to be doing business in California are subject to that state's income tax.

Hitherto, a person has been considered to be doing business in California if he engages in the state in any activity for pecuniary gain or profit. For taxable years beginning after 31 December 2010, the definition is extended to include so-called 'bright-line tests'. A corporation will be considered to be doing business in California if:

- Its sales in California exceed the smaller of USD 500 000 and 25% of the corporation's total sales (including sales by an agent or independent contractor of the corporation) or
- Its Californian property exceeds the smaller of USD 50 000 and 25% of the corporation's total real and personal property or
- Its payroll in California exceeds the smaller of USD 50 000 and 25% of the total remuneration paid by the corporation

The limits are subject to revision by the California Franchise Tax Board.

ROCKY CUMMINGS

rcummings@bdo.com
T +1 408 278 0220

► Read more at www.bdo.com



EUROPEAN UNION

COURT STRIKES DOWN FINNISH DIVIDEND TAX FOR SICAVS

See under Finland.

SPAIN'S FORMER CAPITAL GAINS TAXATION UNLAWFUL

See under Spain.

UK MAY NOT CHARGE STAMP DUTY RESERVE TAX ON SHARE ISSUES

See under United Kingdom.

CROATIA

CRISIS TAX ON INDIVIDUALS AND COMPANIES

Croatia has enacted a temporary additional income tax ('crisis tax') on individuals and companies. Initially, the tax applied to dividends and other profit distributions receivable by companies and to the employment income of individuals, but on 24 September, Parliament adopted amending legislation, extending the tax also to individuals' business income and certain other receipts.

Under the law as amended, the crisis tax also applies to:

- The income of an individual from independent personal services (where this is taxable on the basis of accounting profit)
- Rental and leasing income
- The proceeds of sale of immovable property
- Life insurance and voluntary pension contributions
- Income from capital (such as interest and income from share options)

Whereas the crisis tax on companies and employment income applies from 1 August 2009 to 31 December 2010, the crisis tax on the above sources of income applies from 1 October 2009 to 28 February 2011.

The tax is payable monthly and charged at two rates: at 2% on the slice of income between HRK 3000 and HRK 6000, and at 4% on the slice of income above HRK 6000. The income subject to tax is the average monthly income of the previous tax year (per the tax return) or the net income (where the income is paid subject to withholding tax).

VAT RATE INCREASED

The standard rate of VAT was increased from 22% to 23%, with effect from 1 August 2009.

INES ROŽIĆ

ines.rozic@bdo.hr
T +385 1 239 5741

DENMARK

CONTRACT MUST BE WITH DANISH EMPLOYER

To benefit from the special tax reliefs for expatriates, the foreign employee must actually have an employment contract with a Danish employer. A recent ruling by the National Tax Board rejected an application for the expatriate scheme from a foreign executive who was seconded to a Danish subsidiary of his foreign employer on these grounds, as there was no contract between the employee and the subsidiary.

Under the expatriate scheme, foreign researchers and key employees are taxed at a flat rate of 25% on their Danish-source income for up to three years (or at 33% for up to five years).

The decision shows how important it is that all the conditions for application of the scheme be met. In addition to the need for the employer to be Danish, the other conditions that must be satisfied include:

- The employee's monthly salary must be no less than DKK 63 800 after deduction of social security contributions (NB: this requirement does not apply to researchers)
- Tax liability in Denmark as a resident or non-resident on employment income must commence concurrently with the employment
- The employee must not in the preceding three years have been resident for tax purposes in Denmark nor as a non-resident have had taxable Danish employment income
- The employee must not have been employed by the Danish employer or any of its group companies at any time within the three preceding years

HANS-HENRIK NILAUSEN

hhn@bdo.dk
T +45 39 155200

▶ Read more at www.bdo.dk



FINLAND

NO WITHHOLDING TAX ON DIVIDENDS TO LUXEMBOURG SICAV

The European Court of Justice has held that Finland may not levy withholding tax on dividends paid by a Finnish company to a Luxembourg SICAV (*société d'investissement à capital variable* — a form of open-ended investment fund).

The case (*Aberdeen Property Fininvest Alpha Oy*, Case C-303/07) involved a Finnish-resident company (Aberdeen) paying dividends to its parent company, a SICAV incorporated in Luxembourg. SICAVs are exempt from corporate tax in Luxembourg. The Finnish tax authorities took the position that since a SICAV was not covered by the EC Parent-Subsidiary Directive nor accorded favourable treatment in the Finland-Luxembourg tax treaty, withholding tax at 5% was due. Aberdeen argued to the contrary that, since a dividend from a Finnish company payable to another Finnish company (including an incorporated investment fund) was exempt from corporate tax in Finland, a charge to withholding tax on a dividend to a Luxembourg company would constitute a restriction on the freedom of establishment guaranteed by the EC Treaty.

The European Court has found in favour of Aberdeen. It held that to charge withholding tax on a dividend to the Luxembourg SICAV while there would be no such tax on the dividend if it were payable to a Finnish-resident company was indeed in breach of the EC Treaty, and it rejected all arguments to the effect that such a restriction was in the public interest.

In response, Finland has already changed its law to comply with the judgment, with effect from 1 January 2009.

VAT RATES TO INCREASE

With effect from 1 July 2010, the standard rate of VAT is to increase from 22% to 23%. However, VAT on food served by caterers will from the same date be liable at the reduced rate of 13% instead of at the standard rate.

From 1 October 2009, the reduced rate of 17% applicable to basic foods and animal feed has been lowered to 12%, but will be increased on 1 July 2010 to 13%. The super-reduced 8% rate applicable to books, passenger transport, cultural events and medicines, will be increased to 9% from 1 July 2010.

HEIKKI MUIKKU

heikki.muiKKu@bdo.fi
T +358 20 743 2920

FRANCE

TAXPAYERS' CHANCE TO 'COME CLEAN' ON UNDECLARED FOREIGN ASSETS

The French government has announced an opportunity for French taxpayers sheltering legitimately derived but undeclared capital in jurisdictions considered to be tax havens to 'regularise' their position with the tax authorities.

Like the recent similar initiatives in Belgium, Ireland and Italy, the initiative does not constitute the offer of a tax amnesty, but provides an opportunity for taxpayers to bring themselves back into conformity with the law and avoid criminal proceedings. However, contrary to their Belgian or Italian counterparts, which proposed a generally rather modest fixed penalty (2.5% in 2001 for Italy, 9% for Belgium), the French authorities will examine each case separately and apply penalties and late-payment interest as appropriate.

The taxpayers will have to pay the taxes due in respect of the limitation period: the previous three years for income tax, the previous six years for wealth tax (*impôt de solidarité sur la fortune*), and inheritance and gift taxes.

Late-payment interest and, if necessary, penalties (which can amount to 80%) will

apply as appropriate. However, the tax authorities may mitigate these penalties, in some cases down to zero.

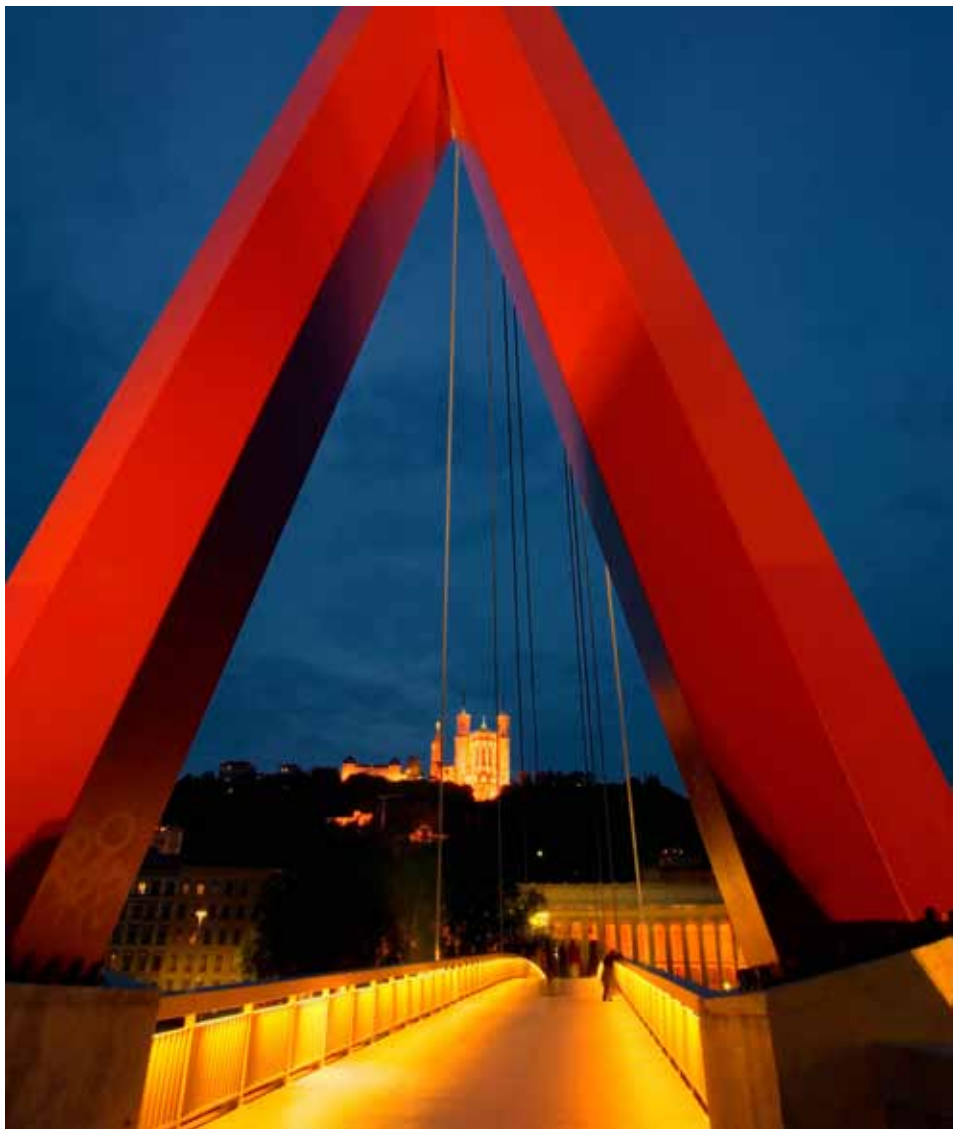
One of the most frequently occurring cases that may benefit from the initiative is that of taxpayers inadvertently not declaring foreign bank accounts. There are many former expatriates, for example, who kept bank accounts in their former country of residence, and omitted to declare them to the tax authorities when returning to France.

Taxpayers who apply for the initiative will be assured anonymity as far as possible.

The initiative was scheduled to operate for a 'few months', at least until the end of 2009, depending on its success. Once it has lapsed, taxpayers with non-declared foreign assets will again risk maximum penalties and possible criminal proceedings.

CARINE DUCHEMIN

cduchemin@djp-avocats-bdo.fr
T +33 1 80 181080



GERMANY

TEMPORARY RELAXATION OF LOSS AND INTEREST RULES

Germany has enacted temporary relaxations in its carry-forward rules for losses and in the restrictions on deduction of interest.

LOSSES CARRIED FORWARD

Under the existing rules, a direct or indirect transfer of an interest greater than 25% in the shares of a German company to any one shareholder within a five-year period results in a pro rata forfeiture of losses carried forward. A complete forfeiture occurs where more than 50% of the shares is directly or indirectly transferred. As related parties or groups with a common owner are treated as one shareholder, the rules potentially apply to any reorganisation within the chain of ownership above the German loss-making entity.

The new law establishes a temporary insolvency exception to this rule. The losses brought forward are not to be forfeited if the change in ownership occurs as part of a qualifying reconstruction, defined as any measure taken to:

- Prevent or overcome illiquidity or insolvency or excessive indebtedness while also
- Preserving the fundamental characteristics of the company's business organisation

This in turn would require:

- An agreement with the works council of the affected company concerning the preservation of jobs
- An undertaking by the company to pay over a period of five years from the change of ownership a total amount of gross salaries equal to at least 400% of the average annual gross salaries in the five years preceding the change

- An undertaking by the shareholders to make contributions to the equity capital of no less than 25% of the gross assets reflected on the company's balance sheet at the close of the preceding accounting period
- The contributions must be made within the 12 months following the change of ownership.

The relief will be retroactive, in that it applies to all changes of ownership occurring after 31 December 2007 and before 1 January 2010. Companies that have already undergone a change of ownership and forfeited losses as a result should review whether they qualify for the relief.

INTEREST DEDUCTION

Under the rules restricting the deductibility of interest, a business that is part of a group may not in most circumstances deduct net interest expense exceeding 30% of taxable EBITDA (earnings before interest, tax, depreciation and amortisation). However, the first EUR 1 million is always deductible. The new temporary relief increases this de minimis amount to EUR 3 million, for accounting periods beginning after 25 May 2007 (but not ending before 1 January 2008) and ending before 1 January 2010 (typically the calendar years 2008 and 2009).

DR GERHARD ENGLER

gerhard.engler@bdo.de
T +49 69 959410

► Read more at www.bdo.de



ISRAEL

NEW BUDGET MAKES SIGNIFICANT TAX CHANGES

Under the recently approved, now biennial budget for the years 2009–2010, some far-reaching amendments were included with respect to tax and social security legislation in an effort by the government to boost the Israeli economy. The following measures are, inter alia, included within the framework of these amendments:

- Raising the income ceiling for social security contributions (a temporary provision until December 2010) — according to previous legislation social security contributions are income-related, but liability to further contributions ceases once income reaches a ceiling, which is five times the average wage in Israel (currently approximately ILS 7500

a month). The amendment in the current budget doubled this ceiling for income generated between 1 August 2009 and 31 December 2010. Consequently, and in light of the fact that in Israel dividend income derived by an individual is not subject to social security contributions, it may be worthwhile considering, if applicable, the option of operating as a corporate entity and not as a salaried employee or self-employed individual. It must be stressed, however, that the Israeli Tax Authorities have recently announced that they will aggressively pursue individuals providing personal services via a wholly owned company merely in order to avoid social security contributions

- The corporate income tax rate will decrease gradually from the current 26% (for the year 2009) to 18% in 2016. The tax rate on dividend income received by individuals will, however, remain at the current rate of

20%/25% (dependent on the shareholding percentage) and consequently the effective tax rate for substantial shareholders will decrease to 38.5% (from the current 44.5%)

- With respect to the personal income tax rates, these will also decrease gradually and the rate for the highest tax bracket will decrease from the current 46% to 39% in 2016. In addition in the tax year 2010, there are scheduled to be certain amendments to the tax-bracket figures.

Unrelated to the Budget, as of 1 July 2009, the standard VAT rate in Israel increased from 15.5% to 16.5%.

ELI ALICE

elial@bdo.co.il
T +972 3 638 6868

► Read more at www.bdo.co.il

ITALY

UNDECLARED ASSETS TARGETED

The Italian government has announced a further amnesty for taxpayers with hitherto undeclared assets held abroad, while at the same time increasing penalties for those who fail to disclose.

From 15 September 2009 to 15 April 2010, Italian-resident individuals who hold assets abroad without complying with the relevant disclosure rules, can elect to disclose such assets on payment of a special 5% tax.

The following conditions apply:

- the assets must have been held abroad as at 31 December 2008
- and must be transferred back to Italy, unless they are held in another EU Member State or in Norway
- the taxpayer must file a special return to either a bank or an authorised financial services company, showing the amount and the kind of assets involved. The return is kept confidential and may not be disclosed to any third party (the tax authorities included) unless disclosure is duly authorised by the taxpayer
- the return may not be used against the taxpayer in any way by the tax authorities
- the tax authorities are prevented from issuing any assessment in respect of those assets to taxpayers who have filed the special return, up to the amount disclosed in that return
- taxpayers who have filed the special return may not be charged with criminal offences relating to non-declaration or misdeclaration of taxable income in that connection

“Taxpayers who are already undergoing an audit or have been served with an assessment connected to undisclosed foreign assets are not eligible for this amnesty”

Taxpayers who are already undergoing an audit or have been served with an assessment connected to undisclosed foreign assets are not eligible for this amnesty

The 5% tax is based on the presumptive gross return on the assets for the five years preceding repatriation or regularisation. The amnesty was formally approved on 3 October.

Meanwhile, as from 1 July 2009, assets held in tax havens, and not disclosed in the taxpayer's tax return as required by the applicable rules concerning monitoring of overseas

investments, are deemed to be unreported personal income. The burden of proving that this assumption is not correct has reverted to the taxpayer. Penalties due on such unreported income are doubled, and therefore range from 200% to 480% of unpaid income tax.

CFC RULES BROADENED

Until the 2008 financial year, Italy's CFC (controlled foreign company) legislation rule was applicable only in respect of holdings in companies located in blacklisted territories. With respect from 1 July 2009, the rules have been extended to apply also to foreign companies that:

- Are subject to an effective rate of tax that is less than half of that applicable in Italy and
- More than half of whose revenues are derived from financial investments, management of intellectual property or intercompany services ('passive income')

The CFC rules will not be applied if the taxpayer can prove that the foreign structure is not intended to obtain a tax advantage. A new exemption applies where the foreign entity predominantly carries on an actual industrial or commercial activity in the market of the jurisdiction in which it is located. However, the foreign entity must still not fail the passive-income test.

Where the CFC rules apply, the Italian shareholder is taxed on the appropriate share of the foreign entity's profits.

INCENTIVES FOR CAPITAL EXPENDITURE

Companies investing in new manufacturing plant, machinery and tools can benefit from a deduction from taxable income in the amount of 50% of the capital expenditure, in addition to the normal straight-line depreciation.

The assets expenditure on which qualifies are those included in class 28 of ATECO 2007 (a list of assets including plant and equipment for industrial and agricultural use, published by the tax authorities).

The incentive applies to capital expenditure incurred between 1 July 2009 and 30 June 2010. However, the additional depreciation is recaptured if the asset is sold before the beginning of the second accounting period subsequent to that in which it was purchased.

ATTILIO TORRACCA

a.torracca@studiosala.com
T +39 02 76 018118

LATVIA

VAT GROUPING TO BE INTRODUCED

Under a Bill expected to become law in October, Latvia will allow VAT groups to be registered from a date yet to be fixed, but unlikely to be earlier than 1 January 2010.

MARINA BIČKOVSKA

marina.bickovska@z-l.lv
T +371 6 722 2237



LITHUANIA

INTRA-EU INTEREST WITHHOLDING TAX ABOLISHED

We reported in BDO *World Wide Tax News* 2009 No 2 that Lithuania would be reducing withholding tax on payments of interest to qualifying EU company recipients to 5% from 1 July 2009, and that it was envisaged to abolish the withholding tax on interest altogether in 2011.

In fact, Lithuania has gone further, and will be abolishing withholding tax (currently 5%) on payments of interest to parties resident or established in another EU Member State, another EEA state or in a jurisdiction with which Lithuania has a double tax treaty, as early as 1 January 2010.

VILMA NARBUTIENĖ

vilma.narbutiene@bdo.lt
T +370 5 249 7415

NETHERLANDS

BUDGET PROPOSES 'INNOVATION BOX' AND EASES PARTICIPATION EXEMPTION

The recently published Budget for 2010 includes measures on an 'innovation box' for companies, taxing royalty and other intellectual-property income at 5%, and eases conditions for the participation exemption for corporate dividends.

THE INNOVATION BOX

The proposed innovation box is a development of the current 'patent box'. As things stand, royalties from inventions that can obtain a patent and from research & development activities can qualify for the patent box, within which they are taxed at a reduced rate of 10%. The proposed new rules would reduce the effective tax rate to 5%, remove the maximum limit on income that can benefit, and widen the range of economically owned inventions and research & development that can qualify. In addition, companies would be able to offset the full amount of a loss within the box against their other income, and not a partial amount as at present. The new box is particularly suitable for software-development companies and companies with commercial and trade secrets.

THE PARTICIPATION EXEMPTION

Currently, the exemption applies generally to shareholdings in other companies ('investee companies') of 5% or more, and exempts distributions received and capital gains made on qualifying shareholdings. To avoid abuse, a detailed regulation exists to exclude portfolio investments in low-taxed investee companies. This has, however, resulted in unnecessary administrative burdens. The proposed changes (discussed in an earlier form in the last issue of *BDO World Wide Tax News*) would alleviate these burdens considerably.

Under the new rules, a shareholding of at least 5% would qualify, as long as it was not held with the intention of being owned as a portfolio investment. This represents a reintroduction of an old rule, and is considered to be an important improvement, since there is much experience with this rule. The Ministry of Finance has confirmed that the possibility of obtaining advance rulings should be greatly improved as a result.

“Not all portfolio investments will be disqualified”

Not all portfolio investments will be disqualified, however. A portfolio investment will still qualify provided that:

- The investee company is subject to a 'reasonable' rate of tax on its profits or
- The investee company's assets do not consist of a majority (i.e. over 50%) of 'free portfolio assets'. Free portfolio assets are assets that are not essential to the business of the company. The previous definition of what constitutes a free portfolio asset has been modified, and real property, whether held as a portfolio investment or otherwise, is not to be considered as a free portfolio asset. A temporary excess of free portfolio assets will no longer necessarily disqualify the investee company

WITHHOLDING TAX ON EU/EEA DIVIDENDS

Under the Netherlands legislation implementing the EC Parent-Subsidiary Directive, dividends paid by a qualifying Netherlands company to a corporate shareholder in the European Union are free of withholding tax if the recipient owns at least 5% of the distributing company. Following recent judgments in the European Court of Justice, the government is proposing to amend the qualifying conditions as follows:

- Neither the Netherlands distributing company nor the EU recipient company need be of a type listed in Annex 1 to the Directive nor be liable to a tax listed in Annex 2 to the Directive
- The recipient company's investment in the Netherlands distributing company should be such as would qualify for the participation exemption if the investor company were resident in the Netherlands
- Recipients in a form comparable to Netherlands investment companies are excluded from the exemption
- Recipient companies in Iceland and Norway but not Liechtenstein (EEA) will qualify if the other conditions are met

OTHER MEASURES

Other measures proposed in the Budget include:

- An option for taxpayers to carry losses back three years (instead of one). The amount would be limited to EUR 10 million (compare the United Kingdom's maximum of GBP 100 000 (EUR 108 000) in similar circumstances over two years). The carry-forward period in such a case would be reduced from nine to six years
- Accelerated depreciation of 50% per annum in 2010 and 2011 for qualifying expenditure incurred in 2010
- An increase in the employer's credit for research & development against salary withholding taxes
- Incentives for environmentally friendly cars

HANS NOORDERMEER

hans.noordermeer@bdo.nl
T +31 10 242 4600

► Read more at www.bdo.nl



NORWAY

DIVIDEND WITHHOLDING TAX FOR EEA INVESTMENT FUNDS

Following the judgment of the European Court in the *Aberdeen* case (see under Finland), the Norwegian tax authorities have announced a change in policy regarding a charge to withholding tax on dividends paid from Norway to an investment fund resident in another EEA Member State.

Previously, it was the view of the Norwegian tax authorities that in order for a dividend paid to an EEA investment fund to be exempt from Norwegian withholding tax, the investment fund had to be subject to tax in its state of residence. That requirement has now been dropped, but it remains a condition for exemption from withholding tax that the fund would have been subject to tax in Norway had it been resident there.

Although Norway is not a Member State of the European Union, it is part of the European Economic Area (EEA) and as such bound by the EEA Agreement, which covers matters such as withholding taxes on intra-EEA dividends.

BJØRN KLEIVEN

bjorn.kleiven@bdonoraudit.no
T +47 23 119100

SPAIN

VAT UP, SMALL BUSINESS TAX DOWN

From 1 January 2010, the rate of corporate income tax for small businesses will be reduced as a temporary measure. Currently, the normal rate of corporate income tax is 30%, but companies whose turnover did not exceed EUR 8 million in the previous year pay tax at 25% on the first EUR 120 202.41 of taxable income. For companies that had a prior-year turnover of less than EUR 5 million and fewer than 25 employees, the rate of tax will be further reduced to 20%, to apply to all taxable profits, provided that they do not reduce their number of employees.

An equivalent reduction of five percentage points, from the appropriate rate of income tax, will also be available to individuals carrying on business with fewer than 25 employees and who do not reduce this number.

For individuals, capital gains and dividend income will cease to be charged at a single flat rate (18%) as from 1 January 2010. The first EUR 6000 will instead be taxed at 19% and any balance over EUR 6000 at 21%.

As from 1 July 2010, Spain will be increasing its standard rate of VAT from 16% (one of the lowest in the European Union) to 18%; the reduced rate will go up from 7% to 8%, but the super-reduced rate will remain 4%.

NON-RESIDENTS' CAPITAL GAINS FORMERLY TAXED UNLAWFULLY

The European Court of Justice has held that the way in which non-resident individuals' capital gains were taxed in Spain before 2007 was unlawful, paving the way for potential claims for repayment.

Before the law was changed with effect from 1 January 2007, residents' capital gains were taxed at a flat rate of 15% (but subject to income-tax rates if the asset had been owned for less than one year); non-residents' gains, however, were taxed at a flat rate of 35%, regardless of the period of ownership.

As expected, the Court has held (in *Commission v Spain*, Case C-562/07) that this treatment was discriminatory and could not be justified, and was thus in breach of the EC Treaty's article on the free movement of capital.

CARLOS LÓPEZ

carlos.lopez@bdo.es
T +34 91 436 4190

SWITZERLAND

INCREASE IN VAT APPROVED

Switzerland too is increasing its standard rate of VAT. The increase, approved as the constitution requires, by a referendum of all citizens, will take effect from 1 January 2011, and is a modest one, up by 0.4 points to 8.0%.

It should be noted that new VAT legislation will take effect in Switzerland from 1 January 2010. The new legislation will completely replace the existing VAT Act and brings with it significant changes in key areas of VAT. This leaves businesses with only a few months to prepare for the transition. Changes will occur in tax liability and input-tax deduction, how self-supply is taxed, how turnover is qualified and how tax is calculated.

HANS-PETER MARK

hans-peter.mark@bdo.ch
T +41 44 444 3777



UNITED KINGDOM

WORLDWIDE DEBT CAP LOOMS

The 'worldwide debt cap' rules will apply to many groups from 1 January 2010, leaving a short window for preparation and planning.

The delayed introduction of the worldwide debt-cap rules was welcome, but the start date is now rapidly approaching. For larger groups, the new rules will apply to their next accounting period beginning after 31 December 2009. Groups caught by the rules will have a potential restriction in the deductibility of their UK interest expense, as well as a substantial additional UK compliance burden.

The worldwide debt cap will not apply to small and medium-sized groups, defined as groups with fewer than 250 employees and with turnover not exceeding EUR 50 million and/or assets not exceeding EUR 43 million.

For large groups, the onerous obligations of the new régime will apply unless the 'Gateway Test' can be passed. Such groups should therefore assess now the possibility of passing this test so that they can plan accordingly.

The Gateway Test is passed for an accounting period if the UK net debt of the group is less than 75% of the worldwide gross debt of the group. A foreign-parented group with significant debt outside the United Kingdom should be able to pass this test, while a group financed by equity, or a UK-parented group, may not be able to pass the test.

It is not possible to be certain whether or not the test is passed until after the end of the accounting period as the measured debt amounts are calculated as the average of the amounts at the start and end of the accounting period. Whilst this may give rise to difficulties in calculating payments on account, it will in some circumstances allow groups to benefit by managing their financial position at each balance-sheet date.

To prepare for the Gateway Test, we suggest groups apply it now to the debt amounts at their last balance-sheet date, or the estimated amounts at their next year-end if possible, to see whether it looks likely that the Gateway test could be passed.

If the Gateway test will clearly not be passed, planning needs to be considered now.

The 'UK net debt of the group' is calculated by aggregating the 'net debt amount' of each UK company or foreign company with a UK branch. A company with net receivables or cash, or indeed net debt below GBP 3 million is disregarded. Thus, it can be seen that reorganising how balances fall between UK companies can affect the outcome.

The worldwide gross debt is, broadly, the liabilities of the group per the consolidated accounts. This is measured 'gross', so using surplus cash to reduce the gross debt shortly before a balance-sheet date will adversely affect a group's ability to pass the test, for example.

Other areas for consideration include unwinding upstream loans following the introduction of the UK dividend exemption and seeking an advance thin-capitalisation agreement (ATCA) from Her Majesty's Revenue & Customs to identify any debt that could be capitalised without increasing the UK tax burden.

STAMP DUTY REPAYMENTS MAY BE DUE

The European Court of Justice has held that the United Kingdom's levy of 1.5% stamp duty reserve tax (SDRT) on shares issued into a clearance service is unlawful.

As explained in BDO *World Wide Tax News* 2009 No 1, SDRT is normally payable in the United Kingdom at a rate of 0.5% on share transfers where there is no written instrument of transfer; where there is such an instrument, stamp duty (at the same rate) is payable. However, where the shares are entered into a clearance service (not widely used in the United Kingdom but prevalent in Continental Europe), the SDRT charge is 1.5%, but subsequent transfers of shares within the service are free of SDRT and stamp duty.

In the case concerned (*HSBC Holdings plc, Vidacos Nominees v Commissioners of Her Majesty's Revenue & Customs*, Case C-569/07), the banking group HSBC made an offer for the shares of a French bank, in return for cash or shares in itself. In order to make opting for the shares more attractive, HSBC agreed to place them in a French clearance service. As a result, it was eventually assessed to SDRT of over GBP 27 million, but applied for a repayment on the grounds that the charge to SDRT was unlawful under the EC Capital Duty Directive (69/335/EEC).

The Capital Duty Directive provides that the only tax that Member States may levy on the issue of share capital is capital duty. Article 12(1)(a) of the Directive exempts taxes on share transfers from the scope of the Directive, so there is no question, for example, that stamp duty or stamp duty reserve tax in themselves may be unlawful.

Following the Advocate-General's opinion, the European Court has now held that the initial acquisition of shares immediately following their issue (as happened in this case) could not be considered a transfer, and that consequently, the SDRT charge in this instance was not exempted under Article 12(1)(a). It followed that, since it did not take the form of the capital duty prescribed by the Directive, the SDRT charge in this instance was unlawful.

Other companies that have paid SDRT in similar circumstances should review whether they are in a position to claim repayment of the tax following this judgment.

NICK UDAL

nick.udal@bdo.co.uk
T +44 207 893 2410

► Read more at www.bdo.co.uk

GOODBYE, HOUSE OF LORDS

A historic, if symbolic, change in the United Kingdom's juridical practice took place on 1 October. The House of Lords, for centuries the United Kingdom's highest court in tax matters as indeed in all other cases, both civil and criminal, was abolished and replaced by the Supreme Court. All eleven Law Lords (the judges sitting in the House of Lords as a court) were, however, sworn in as judges of the Supreme Court, where they were joined by a twelfth judge. The new Court has a dedicated building, so tax and other appeals will no longer be heard by judges sitting on the red leather benches of the House of Lords (which, of course, remains the second chamber of the UK Parliament)



AUSTRALIA

NON-RESIDENTS' LEASEHOLD GAINS

Non-residents of Australia are liable to Australian capital gains tax only where they dispose of 'taxable Australian property'. In the case of real (immovable) property, this is taxable if it consists of:

- Real property situated in Australia or
- A mining, quarrying or prospecting right (to the extent that the right is not real property), if the minerals, petroleum or quarry materials are situated in Australia.

The question arises whether leasehold property is or is not real property for this purpose. For disposals after 19 May 2009, this question has been settled for good, following an amendment to the Income Tax Assessment Act 1997, which explicitly stipulated that the term 'real property' included leasehold property. The question still remains open, however, for disposals occurring before 20 May 2009.

The Australian Taxation Office has recently published TD 2009/18, in which it asserts that the term 'real property' in ITAA 1997 was always intended to include leasehold property. However, this view is still to be tested in the courts.

VINCE TROPIANO

vince.tropiano@bdo.com.au
T +61 29 286 5555

▶ Read more at www.bdo.com.au



PEOPLE'S REPUBLIC OF CHINA

TREATMENT OF ROYALTIES CLARIFIED

The Chinese tax authorities have clarified the treatment of certain royalties and payments analogous to royalties under China's tax treaties.

In Circular *Guoshuihan* (2009) No 507, the authorities explain that the phrase "[payments for] information concerning industrial, commercial or scientific experience" in treaties refers to payments for the use of proprietary technologies. The Circular also elaborates that proprietary technology generally refers to information or data that is essential concerning certain production processes and that is not disclosed to the public and is proprietary in nature. Where such technology is transferred or licensed, and the transferee or licensee pays service fees for guidance etc on how to use the technology, these payments will be treated as royalties if the supply of the service by the service provider does not give rise to a permanent establishment in China of the provider. In the latter case, the payments will be business profits of the provider.

Payments that will always be treated as business profits and not as royalties include fees for pure after-sales services for goods; professional services (management, consultancy etc); services provided under warranty; and certain other payments designated as business profits by the tax authorities.

TRANSFER-PRICING DOCUMENTATION REQUIREMENTS EXPANDED

In Circular *Guoshuihan* (2009) No 363, the Chinese tax authorities have strengthened the supervision and investigation of cross-border related-party transactions. According to the Circular, enterprises established by multinationals in China which perform only limited functions and assume limited risks, such as those associated with the single function of production (as in toll processing or import processing), distribution or contract research and development, are not considered to bear market risks or strategic decision risks. This being the case, these enterprises should maintain a reasonable level of profit in China, based on the transfer-pricing principle of 'functions and risks' commensurate with 'profitability'. Where these enterprises with limited functions and risks incur losses, they are required to prepare and submit the contemporaneous documentation for the year in which the losses are incurred to the responsible tax authority before 20 June of the following year, regardless of whether their related-party transactions have or have not exceeded the prescribed thresholds under *Guoshuifa* (2009) No 363 (i.e. CNY 200 million per year for annual related-party transactions on purchases and sales of goods or CNY 40 million per year for other related-party transactions, such as provision of services, royalties or financing).

ALFRED CHOI

alfred_choi@bdo.com.hk
T +852 25 415041

▶ Read more at www.bdo.com.hk

INDIA

NEW DIRECT TAXES CODE HERALDS WIDE CHANGES

Wide-ranging changes to direct taxes affecting residents and non-residents may be in store from 1 April 2011, according to the Direct Taxes Code issued recently by the Indian Ministry of Finance for consultation and discussion.

Proposals included in the Code are aimed at simplification and increased equity and efficiency. Some proposals could, as they stand currently, widen the Indian tax net considerably as far as non-residents are concerned.

Tax reductions for both individuals and corporates are envisaged. For corporates, the differential tax rates for domestic and foreign companies would be abolished and replaced by a single common rate of 25%. Domestic companies currently pay income tax at 30% whereas foreign companies have a 40% rate. In addition, the surcharges for both domestic companies (10%) and foreign companies (2.5%) would be abolished. For individuals, the three income-tax bands (10%, 20% and 30%) would remain, but the thresholds for their application would be increased substantially. Thus, whereas the top 30% tax rate currently applies to the band of taxable income in excess of INR 500 000, it would in future apply only to taxable income above INR 2.5 million.

For companies, there is a proposed extension of the definition of residence for tax purposes. This could have the result that many more companies would become subject to Indian tax on their worldwide income than is currently the case. A resident company is liable to Indian income tax on its worldwide income, whereas a non-resident company is taxable on Indian-source income only, subject to treaty provisions. Currently, a company is deemed to be resident in India if it is a company incorporated under Indian law, but also if the

place of control and management of its affairs is situated wholly in India at any time during the tax year. The new Code would also consider a company to be resident in India if the place of control and management were situated *partly* within India at any time within the tax year.

Furthermore, even where a company is clearly non-resident, the Code proposes a widening of what is considered to be Indian-source income. Currently, income is considered to have its source in India where it accrues or is deemed to accrue in India or is received or deemed to be received in India. Income accrues or is deemed to accrue in India if it is derived from (i) a business connection in India; (ii) a property in India; (iii) an asset or source of income in India or (iv) the transfer of a capital asset situated in India. The new Code would insert the words 'directly or indirectly' before all these heads and in head (iv) so that income would be deemed to accrue in India if it was directly or indirectly derived from all four sources and in the case of source (iv), if it was derived from the transfer directly or indirectly of a capital asset situated in India. The insertion of the words 'or indirectly' could have a far-reaching impact, and could result in the imposition of a liability to Indian tax in respect of the transfer of an asset wholly outside India.

ANISH MEHTA

anish.mehta@bdoharibhakti.co.in
T +91 226 672 9999

► Read more at www.bdoharibhakti.co.in

COLOMBIA

WEALTH TAX PROLONGED AND AMENDED

Colombia's current wealth tax is due to lapse on 1 January 2011, but a bill introduced in the Congress by the Finance Ministry proposes to extend its life for a further four years, until 1 January 2015. As amended, the tax would be charged on individuals and companies alike, with net wealth of COP 3000 million or more. In calculating net wealth, debts to related parties would not be taken into account. The first COP 220 million of an individual's main residence would be left out of account as would the value of shareholdings in Colombian companies. The rate of tax would be 0.6% (half of the current rate of 1.2%).

RAMÓN SALGADO

rsalgado@bdo.com.co
T +57 1 623 0199

CURRENCY COMPARISON TABLE

Below are illustrative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 8 October 2009.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Chinese renminbi (CNY)	0.09933	0.1465
Colombian peso (COP)	0.000358	0.0005285
Croatian kuna (HRK)	0.1379	0.2035
Danish krone (DMK)	0.1343	0.1981
Euro (EUR)	1.0000	1.4747
Pound sterling (GBP)	1.0894	1.6072
Indian rupee (INR)	0.0146	0.0216
Israeli new shekel (ILS)	0.1811	0.2675
US dollar (USD)	0.6780	1.0000

CONTACT

Contact partner Mireille Derouane, in Brussels on mderouane@bdoglobal.com or +32 (0)2 778 0130 for more information.

www.bdointernational.com

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