

international tax alert

Issue 6 – January 2011

All Regions



Chairman's Note

Welcome to the sixth edition of the PKF International Tax Alert, a publication that summarises key tax changes from around the world. This publication is issued three times per year in soft copy format only and can also be found on PKF's International website at www.pkf.com



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AUSTRALIA

Taxation of Private Equity Investments in Australian Securities

The question of whether a gain made by a non-resident from the disposal of equity investments in an Australian entity is on capital account or revenue account is currently being tested by the Australian Taxation Office (ATO).

Generally, Australia does not tax non-residents on capital gains unless the asset is “taxable Australian property” (generally this is limited to direct and indirect real estate and resource investments).

However, the ATO has issued a tax determination that indicates the disposal of Australian equity investments in Australian companies will be taxed as ordinary income where the investment was made with the intention of building up the value of the investment and divesting it within a short to medium timeframe. The Tax Office says capital treatment only applies to the disposal of Australian equity interests where the investment is made and held on a longer term basis where the gain made on the ultimate disposal of the investment was not the main purpose of the investment.

Concessions for Limited Liability Partnerships (LLPs)

The ATO first raised this issue in draft tax determinations in 2009. However, the final determinations were released on 1 December 2010 in which the ATO has made some concessions in relation to its treatment of gains made by limited liability partnerships (LLP). The ATO will generally not impose Australian income tax on gains on such investments where the private equity vehicle is a LLP and the partners are resident of a country which has a double tax agreement with Australia and the other country treats the LLP as a look-through vehicle for tax purposes.

TPG Case Study

This issue came to prominence in 2009 when the ATO assessed the gain made by the private equity group, TPG, in relation to the public float of the Myer Group (an Australian department store chain).

The TPG structure involved a Cayman Island LLP which owned a Luxembourg company, which owned a Dutch company which in turn owned an Australian holding company. The Dutch company sold the Australian holding company of the Myer Group.

The ATO took the position that the Dutch company held the Myer shares with the intention of disposal at a profit and therefore the gain on the disposal of shares was on “revenue account”, in which case the exemption for capital gains for non-residents as described above was not available.

The ATO is also took the position that the gain made by the Dutch company was attributable to a business it carried on through a permanent establishment (PE) in Australia, in which case the business profits article in the Australia/Netherlands DTA would allow Australia to tax the gain.

Alternatively, if the gain was not attributable to a business carried on through an Australian PE and was therefore protected under the business profits article of the Australian/Netherlands DTA, the ATO argues the arrangement was a case of treaty shopping and the Australian general anti tax-avoidance provision (Part IVA) applied to deny the protection of the Australia/Netherlands Netherlands DTA.

Capital or Revenue Gains

The capital or revenue issue is dealt with in Tax Determination TD 2010/21 which indicates that, if the sale of shares is on revenue account and the income is sourced in Australia, the non-resident seller may be taxable in Australia. However, if the private equity entity is a resident of a treaty country, the profits will only be taxable in Australia if the private equity entity made the profit through carrying on a business through a permanent establishment in Australia.

The determination concludes that the revenue/capital issue depends on the facts based on weighing up the relevant importance of each of the factors driving returns (cash flow, operational improvements to increase earnings, and disposing of the target entity for a profit); the investment strategy agreed to by the parties before acquiring the assets; and the legal form and substance of the arrangements and structures used to implement these strategies.

The determination refers to an Australian Senate inquiry that reported that the purpose of private equity involvement in leveraged buy-outs is to acquire share in a target group with a view to improving the value of that group and for it to be resold at a profit.

Limited Liability Partnerships

The ATO also recently released draft determination TD 2010/D8 which states that, if the private equity entity is a LLP in a non-treaty country but the partners are residents of a treaty country, the LLP will be treated as a look-through entity for tax purposes and the gain will be treated as the income of the partners who will be entitled to the relevant treaty benefits. In such cases, the LLP will not be taxed in Australia and the partners will not be taxed provided the gain is not derived from carrying on business through a PE in Australia.

Australian source

Whether the profit has an Australian source has been dealt with in draft tax determination TD 2010/D7 which indicates that the source of the profit is not solely dependent on where the purchase and sale contracts are executed but rather all the aspects of the particular case will need to be taken into account. In relation to the typical private equity leveraged buyout, the important factors will be the location of where the following activities are undertaken:

- the business ability in assessing suitable target enterprises
- making operational improvements
- the steps making the acquisition of the business possible (such as arranging finance).

Where these activities are undertaken in Australia, the ATO considers the source of the profit will be in Australia.

Treaty shopping

The treaty shopping issue is dealt with in tax determination TD 2010/20. The ATO takes the position that Australia's general anti-avoidance rule in Part IVA overrides its tax treaties. In the TPG case the ATO had issued assessments under Part IVA to the Luxemburg SARL and the Cayman entity on the basis that the Dutch BV was interposed as part of a scheme to take advantage of the protection afforded by the Dutch treaty and therefore avoid Australian tax. This approach effectively treats the Cayman entity as the ultimate recipient of the funds.

However, where the entity is a LLP with partners which are resident in a country that has a tax treaty with Australia and that country treats the LLP as a look-through vehicle for tax purposes, TD 2010/20 says Australia will not use Part IVA to tax the gain.

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AUSTRIA

Transfer Pricing Guidelines

In the course of tax audits the question sometimes arises whether tax authorities are authorised to require compliance with the standards of the OECD transfer pricing guidelines and, if so, on which legal grounds. On 3 November 2010, the Austrian fiscal authority published new Transfer Pricing Guidelines to provide a lead as to which issues may prompt fiscal administrations to instigate tax audits (running losses, market strategies, unhedged exchange or interest rate changes, etc).

Austria basically follows the OECD guidelines on transfer pricing. The guidelines are not law as they only express the view of the Austrian Federal Ministry of Finance and are, therefore, not binding for taxpayers and courts in Austria. However, the Austrian tax inspectors have to follow them.

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CANADA

Recent International Tax Developments

TD Securities (USA) LLC Decision

Canadian Tax Court Decides US LLC Entitled to Treaty Benefits

It has been the position of the Canada Revenue Agency (CRA) that a US Limited Liability Company is not entitled to benefits under the Canada-United States Tax Convention (1980) (the Treaty) if the LLC is treated as a fiscally transparent entity for US tax purposes. The CRA considers a fiscally transparent LLC to not be liable to US tax and, therefore, not a “resident” of the US under the Treaty. This view precipitated the introduction of Paragraph 6 of Article IV(6) in the Fifth Protocol amendments to the Treaty to consider the LLC member to derive the income, gain or profit amount, effectively providing a look-through to the LLC member and allowing the LLC to claim a treaty benefit. Article IV (6) is effective for taxes withheld at source in respect of amounts paid or credited on or after 1 February 2009 and for other amounts, for taxation years beginning after 31 December 2008.

On 8 April 2010, the Tax Court of Canada released its decision in *TD Securities (USA) LLC v. The Queen*. The Court concluded that an LLC formed under US law was entitled to benefits under the Canada-US Treaty. The case was concerned with the 2005 and 2006 taxation years and was decided under the Treaty as it applied prior to the Fifth Protocol amendments.

On 16 June 2010, the CRA released its response to the decision at the Canadian Petroleum Tax Society’s 2010 Annual Conference. The CRA continues to be of the view that an LLC that is fiscally transparent for US tax purposes is not a resident of the US for purposes of the Treaty. Nonetheless, relief will be provided in certain circumstances involving years preceding the effective date of Article IV(6). The following is the text of their response.

On April 8, 2010, the Tax Court of Canada rendered its judgment in *TD Securities (USA) LLC v. The Queen*. The Court concluded that TD Securities (USA) LLC, a limited liability company (“LLC”) formed under United States law, was entitled to benefits under the Canada-United States Tax Convention (1980) (the “Treaty”).

Questions

1. If, based on TD Securities, a United States LLC has paid excess income or withholding tax under the Income Tax Act (Canada) (“Act”) prior to the Fifth Protocol to the Treaty entering into force, should the LLC apply for a refund of any excess?

2. Subsection 227(6) sets out a two-year period in which the CRA is required to refund any excess tax that was paid under Part XIII of the Act. What is the CRA’s position with regard to refunding the excess Part XIII tax?
3. What is the CRA’s position on the application of Article IV(6) of the Treaty, as introduced by the Fifth Protocol, in respect of a fiscally transparent LLC (ie., is this provision necessary for treaty benefits to be claimed by the LLC)?

CRA Response

The CRA continues to be of the view that an LLC that is fiscally transparent under the taxation laws of the United States is not a resident of the United States for purposes of the Treaty. This is consistent with the view of the United States tax authorities, as is evident in paragraph 90 of the decision. However, in light of the decision, the CRA will provide relief under the Treaty to an LLC in the circumstances described below. Where relief is available, the CRA expects there will be corresponding adjustments to any foreign tax credits claimed in the United States that relate to the refunded Canadian taxes.

Pre-Fifth Protocol (taxes other than taxes withheld at source)

The CRA will accept a claim for treaty benefits made by an LLC, in respect of a taxation year of an LLC to which Article IV(6) of the Treaty is not in effect if:

- the LLC can demonstrate that it was wholly-owned, throughout the relevant taxation year, by one or more persons who were residents of the United States for the purposes of the Treaty, and
- a notice of objection for the relevant taxation year is filed within the time prescribed by the Act, or where the CRA has confirmed an assessment to which the LLC has objected, the LLC appeals the assessment, within the time prescribed by the Act, and the LLC is not precluded from raising the claim in the notice of appeal.

Pre-Fifth Protocol (taxes withheld at source)

Where an item of income that is subject to tax under Part XIII of the Act was paid or credited by a Canadian resident to an LLC prior to February 1, 2009, and a refund application is made before the expiration of the limitation period specified in subsection 227(6), the Minister will refund the excess tax if the item of income, in its entirety, was fully and comprehensively taxed in the United States in the hands of one or more persons who were residents of the United States under the Treaty.

Where a taxpayer is subject to an assessment for failure to deduct or withhold tax under Part XIII of the Act on an amount paid or credited to an LLC, the CRA will reassess the taxpayer to reduce the amount owing to reflect the application of the

Treaty if the amount paid or credited, in its entirety, was fully and comprehensively taxed in the United States in the hands of one or more persons who were residents of the United States under the Treaty and

- the taxpayer has filed a valid objection to the assessment, or
- the CRA has confirmed an assessment to which the taxpayer has objected, and the taxpayer appeals the assessment, within the time prescribed by the Act.

Post-Fifth Protocol

With respect to an amount of income, profit or gain arising in circumstances where Article IV(6) of the Treaty is in effect, it is our position that Article IV(6) establishes the parameters under which the benefits of the Treaty may be claimed by a fiscally transparent LLC. Treaty benefits claimed by an LLC with respect to an amount of income, profit or gain will be recognized by the CRA only if the amount is considered to be derived, pursuant to Article IV(6) of the Treaty, by a person who is a resident of the United States and that person is a “qualifying person” or is entitled, with respect to the amount, to the benefits of the Treaty pursuant to paragraph 3, 4 or 6 of Article XXIX A.

Article IV(6) provides a look-through an LLC, partnership or other fiscally transparent entity to allow the person that derives the income to be eligible to claim Treaty benefits. Article IV(6) essentially provides that an amount of income, gain or profit will be considered derived by a US resident if the entity (eg, the LLC) is treated as fiscally transparent for US tax purposes and where:

- a. for US tax purposes, the US person is considered to have derived the amount through an entity not resident in Canada, and
- b. by reason of the entity being treated as fiscally transparent for US tax purposes, the US tax treatment of the amount is the same as its treatment would be if that amount had been derived directly by the US resident.

If you are aware of an LLC which paid more Canadian tax than it would have if the CRA had allowed Treaty benefits, you should follow-up with your PKF US or Canadian tax advisors to see how the CRA policy can be applied in your favour.

Branch Tax applicable under Canada – US Treaty

Canada levies a branch tax on the notional distribution of profits from a Canadian branch to the foreign head office. On 26 October 2010, we received a technical interpretation from the

Canada Revenue Agency on the application of Canada's 25% branch tax on non-resident corporations carrying on business in Canada after 2008 to:

- a US resident S Corporation which is fiscally transparent for US tax purposes
- a US limited partnership that has elected to be taxed as a corporation for US tax purposes but is viewed by Canada as a partnership, and
- a US limited liability company which is treated as a fiscally transparent entity for US tax purposes but is a corporation for Canadian tax purposes.

Article X(6) of the Treaty gives Canada the right to impose the branch tax on a non-resident corporation that carries on business through a permanent establishment in Canada, subject to an exemption on the first \$500,000 of cumulative earnings attributable to its Canadian permanent establishment. Article X(6) restricts the rate of tax to 5% on cumulative earnings in excess of \$500,000.

The CRA views a US S Corporation as a corporation and so it would be subject to branch tax on the notional distribution of its earnings. Although the earnings of an S Corporation that are attributable to a PE in Canada may be considered to be derived by the shareholders of the S Corporation, the CRA has confirmed that its current practice is to treat the S Corporation as a resident of the US for purposes of the Treaty. As a result, the CRA will extend the benefits of Article X(6) to the S Corporation. Therefore, the 5% will be available to the CRA.

Relative to the branch tax treatment for a limited partnership, the CRA's technical interpretation stated that the Income Tax Act provides that the income of a partner is to be computed at the partnership level as if the partnership were a separate person resident in Canada. However, the income is not taxed at the partnership level but is taxed in the hands of the partner as if the partners had derived the income directly (ie, the income retains its original character and source). Thus, a non-resident corporation that is a member of a partnership that carries on business in Canada through a PE is subject to tax in Canada on any income that it earns as a member of the partnership and is subject to the branch tax. If the partner is a US resident corporation, the 5% branch tax rate will apply by virtue of Article X(6). Although the interpretation did not state this explicitly, Article IV(6) will not apply if the limited partnership is not fiscally transparent for US purposes. Canada's position on attribution of income to partners pre-dated the Fifth Protocol amendment

introducing IV(6). Presumably, each partner that was a US corporation will be entitled to its own \$500,000 branch tax exemption, but the technical interpretation does not address that point.

The CRA views a US LLC as a corporation and so it will be subject to branch tax. In the technical interpretation, the CRA indicates that it does not consider the LLC to be a resident of the US under the Treaty. However, the LLC may claim treaty benefits on behalf of its members in respect of items of income, profit or gain that the member is considered to have derived pursuant to Article IV(6) of the Treaty. From related discussions with a senior CRA Rulings Officer, we understand that the CRA will not give the benefits of the Treaty in respect of the proportion considered to be derived by US resident individuals who are members of the LLC. The portion allocable to persons other than US corporations (or up the ownership chain through other fiscally transparent entities to US corporations) will be taxed at 25%; not 5% or 0%. The official also verbally indicated that the CRA was still undecided on whether an LLC was entitled to one \$500,000 branch tax exemption or more than one \$500,000 exemption if there are two or more members of the LLC are US corporations.

The technical interpretation stressed in each instance that the benefits are only available if the US person or entity is a "qualifying entity" under the Limitation on Benefits provisions in Article XXIX A of the Treaty.

Tax Treaty Developments

Switzerland Protocol

A Protocol amending the Tax Convention between the Government of Canada and the Swiss Federal Council signed on 5 May 1997, was signed on 22 October 2010, in Bern, Switzerland.

Consistent with the Government's policy announced in Budget 2007, the Protocol includes provisions reflecting the standard developed by the Organisation for Economic Cooperation and Development for the exchange of tax information.

People's Republic of China

On 4 November 2010, it was announced that negotiations to update the income tax treaty between Canada and the People's Republic of China would commence the week of 6 December 2010 in Ottawa.

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CHINA

Corporate Income Tax (CIT)

Administrative Measures for Corporate Restructuring

In July 2010, the State Administration of Taxation (SAT) published further clarification of certain definitions and concepts stated in the tax rules on corporate restructuring issued last year (please refer to July 2009 issue). "The Administrative Measures of Corporate Income Tax Treatments for Corporate Restructuring" (Notice 4) clarifies some outstanding technical issues (eg application of preferential tax policies after corporate merger and spin-off, the limit of the utilisation of tax loss on mergers and treatment of restructuring lasting for more than one fiscal year). Notice 4 is effective from 1 January 2010 but it is applicable to certain corporate restructurings which took place from 1 January 2008.

Business Tax (BT)

Business Tax Exemption on Offshore Service Outsourcing Business in Certain Cities

From 1 July 2010 to 31 December 2013, business tax is exempted on revenue derived from qualified offshore outsourcing service provided to overseas customers by those companies registered in the 21 designated cities (outsourcing companies) or their direct subcontractors. The qualified offshore outsourcing service business refers to qualifying Information Technology Outsourcing (ITO), Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO). The 21 designated cities are Beijing, Tianjin, Dalian, Haerbin, Daqing, Shanghai, Nanjing, Suzhou, Wuxi, Hangzhou, Hefei, Nanchang, Xiamen, Jinan, Wuhan, Changsha, Guangzhou, Shenzhen, Chongqing, Chengdu and Xi'an.

Double Taxation Agreement (DTA)

Interpretation Notes on the DTA between China and Singapore

SAT issued Interpretation Notes (IN) on DTA between China and Singapore. It is the first time for SAT to give a set of extensive interpretations and practice guidelines for implementation of a DTA. This IN provides clear guidance and many examples to illustrate tax treatments of permanent establishment (including the case where a contracting state establishes a permanent establishment in a third state), beneficial owner, dividends, interests, royalties, capital gains etc.

The interpretations in this IN prevail over all of the previous interpretations of tax treaties generally and will also be applicable to other DTAs entered by China with other countries if other countries' provisions of the relevant articles are consistent with Singapore's.

New DTA between China and Finland

A new DTA and protocol was signed between China and Finland to replace the old DTA and protocol entered in 1986 and 1995 respectively.

Compared with the old DTA and protocol, the new DTA and protocol provide more preferential tax treatments on dividend, royalty, capital gain and tax credit. Below is a summary of the comparisons:

Current	
Dividend	10%
Royalty	10%
Chinese tax credit on dividend paid by Finnish tax resident company	Applied if the Chinese tax resident company owns no less than 10% of Finnish tax resident company shares
New	
Dividend	5% or 10% ¹
Royalty	7% ² or 10%
Chinese tax credit on dividend paid by Finnish tax resident company	Applied if the Chinese tax resident company owns no less than 20% of Finnish tax resident company shares

Criteria: Finnish tax resident company having a direct or indirect participation of at least 25% in the capital of the Chinese tax resident company at any time during the 12-month period preceding such disposal of shares; or the shares derive 50% of the value, directly or indirectly, from immovable property in China.

¹ 5% is only available to beneficial owners that is a company (other than a partnership) and holds directly at least 25% of the capital of the company paying the dividends, otherwise, a 10% withholding tax rate will be applied.

² 7% is only available to royalties for the use of, or the right to use of, industrial, commercial or scientific equipment.

Other Taxes

Surcharges

Effective from 1 December 2010, foreign invested companies have to incur additional tax costs because they will be subject to urban maintenance and construction tax and educational surcharge (surcharges). In general, the surcharge will be levied at 10% of turnover tax (ie value added tax and business tax). Currently, foreign invested companies are exempted from surcharges. This unifies the treatment on surcharges between the domestic companies and the foreign invested companies.

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CHILE

Tax changes approved during 2010

Several changes to tax laws have been approved during 2010. Some of them are temporary changes and have been approved as a result of the need to finance the damages caused the earthquake.

First Category income tax

The First Category Tax rate has been raised from 17% to 20% and 18.5% applicable on the income for the years 2011 and 2012 respectively. The First Category Tax is applied on the taxable income from industry, commerce, mining, fishing, agriculture, real estate, investments and other activities involving the use of capital. Except when is a sole tax on the income, this tax is a credit against the global taxes due (35% Additional Tax rate in case of taxpayers without residence or domicile in Chile).

From 2013 onwards, the First Category income tax rate returns to the permanent rate of 17%.

Specific Tax on Mining Activities

This tax is a progressive one applicable to mining activities on the taxable income exclusively from the sale of mining products. From 2011 onwards, the progressive average tax rates will go from 0.5% if the value of the annual sales exceeds the amount equivalent of over 12.000 metric tons of fine copper, up to 4.5% if the value of the annual sales ranges over the equivalent of 40.000 metric tons of fine copper up to 50.000 metric tons. If this last bracket is exceeded, then the tax changes to a progressive scale applicable to the operational margin (from 5% to 14% tax rate on an operational margin that amounts to more than 35% or less than 85%). The new tax system is applicable since current year on to enterprises starting up in 2010.

Stamp Tax

This tax affects any document involving loans and borrowings and is calculated either on the amount expressed on the document or on the amount of money involved. From July 2010 onwards the tax rate has been lowered to 0.05% per each month or a fraction of it that has passed since the issuance of the document and its due date, with a maximum total rate of 0.6%.

Sight documents or documents issued without a due date are subject to a 0.25% flat rate.

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CYPRUS

Tax Changes

Amendment to the Russia-Cyprus Double Tax Treaty signed and Cyprus taken off Russian black List

On 21 April 2009, the Russian Federation and the Republic of Cyprus signed a Protocol amending the Double Tax Treaty between the two countries which had been in place since 1998. The new version of the treaty came into force once the Protocol was ratified by both states and was signed on 7 October 2010.

The removal of Cyprus from the black list, placed there in 2008, means that Russian companies with Cypriot subsidiaries can qualify for the Russian dividend participation exemption.

Furthermore, one of the most beneficial aspects of the Treaty is that the withholding tax rates applying to cross border payments remained unchanged.

Please see below most important amendments.

1. Changes relating to Capital Gains on Indirect Sale of immovable property

Capital gains on the disposal of shares remain subject to taxation in the country of tax residence of the seller.

Currently, capital gains from the sale of shares in a Russian subsidiary by its Cypriot parent company are tax-exempt in both jurisdictions, even if the subsidiary owns real property in Russia. (In Cyprus such capital gains are not subject to taxation.)

The amended treaty now provides that gains derived by a resident of the contracting state from the sale of shares of a company which has more than 50% of their value from immovable property situated in another contracting state may be taxed in that country. This provision is in line with the OECD Model Tax Convention on Income and Capital. This provision is planned to come into effect four years after the Protocol takes effect and is expected to be applicable from 2014.

In the following cases, the exclusive taxing right will remain with the country of residence of the seller:

- the disposal qualifies as a corporate reorganization or
- the disposed shares are listed on a recognised stock exchange or
- the seller is a pension fund, provident fund or the government of the two countries.

2. Exchange of Information Article

The Protocol introduces an article on the Exchange of Information between the competent authorities of the Contracting States. It is identical to the Article 26 of the OECD model.

It clarifies powers and obligations of the tax authorities of both countries and aligns itself towards OECD standards on fiscal transparency and exchange of information on tax matters.

The information exchange is restricted in various ways by the domestic laws of the Contracting States. Cyprus is not required to supply information which is not obtainable under its own laws or in the normal course of administration. Moreover, the new transparency requirements should not adversely affect legitimate tax-efficient structures.

3. Limitation of Benefits

The Treaty has also been amended by the insertion of a new Article on «Limitation of Benefits.»

The operating principle of this new Article is that the benefits provided by the Treaty to Russian and Cypriot residents will not be available if the main purpose (or one of the main purposes) for establishing residence in one of the Contracting States is to obtain such tax benefits which would not otherwise be available.

The rule seems to have a relatively narrow application, as its scope is limited to companies that are not registered in either Contracting State but are nevertheless claiming Treaty benefits. So, it appears that this anti-avoidance rule would not apply to a Cypriot incorporated company or a Russian incorporated company but only to foreign companies claiming tax residency through the management and control test.

Distributions from Mutual Funds and Depository Receipts

Dividends now include distributions from mutual funds and other collective investment vehicles with the exemption of real estate funds and they are subject to the normal withholding tax rates of 5%/10%.

The definition of Dividends has been extended to include distributions from shares held in the form Depository Receipts.

5. Changes relating to interest

The definition of interest now includes income from debt-claims of every kind, whether or not secured by mortgage or carrying a right to participate in the debtor's profits but does not include penalty charges for late payment or interest which is reclassified as dividends by virtue of other provisions.

Any interest and interest which is reclassified as dividends from the Russian Tax authorities will be subject to the same withholding tax rates as dividends.

Summary

An immediate, positive consequence of the revised Article, is that Cyprus will be removed from the so-called "black list" of non-compliant countries issued by the Russian Ministry of Finance two years ago.

The black list was part of the new Russian holding company regime, introduced in 2008, which provided a tax exemption for dividends from foreign subsidiaries of Russian companies under certain circumstances. The exemption did not apply to dividends paid from subsidiaries in countries on the black list. As a result of removal from the black list, it is expected that Russia will treat dividends from Cyprus as tax-exempt (provided the other conditions are satisfied).

We advise clients who may be affected by these changes to contact us to review any implications that the new Amendments may have on their business.

New Double Tax treaties

Cyprus signed new Double Tax treaties with Kuwait and Denmark in October 2010.

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HUNGARY

Expected tax changes in 2011

The government has submitted the tax package for 2011 to the Parliament but it has not yet been adopted. We therefore outline only the expected changes. The package includes significant changes to the tax legislation, especially to personal income taxation, but there is also a major reduction in the corporate income tax rate.

Personal income taxation

The main aim of the modification is to introduce a flat rate of 16% for personal income taxation. The 16% rate will apply to all income of private individuals, including both the consolidated tax base and separately taxed income (ie interest, dividend, etc). The tax base will still be increased by the so-called tax base addition in 2011 and 2012 in the case of consolidated income. The tax base addition is 27% in 2011 but will be halved to 13.5% in 2012. The tax base addition will be fully abolished from 2013.

Tax credits will still be available up to the maximum amount of 12,100 HUF but it will only be applicable up to a lower income limit from 2011 (up to 3,960,000 HUF). All tax allowances will be abolished but a very generous child tax allowance scheme will be introduced instead. 62,500 HUF per child will be deductible from the monthly consolidated tax base if the employee has one or two children, and 206,250 HUF per child will be deductible if the employee has at least three children.

There are also significant changes in the taxation of benefits in kind. The general rule will be that benefits in kind are taxed at the standard 16% rate, with a 19% tax base addition. The tax (and the 27% social security contribution, plus 1.5% vocational training contribution) will be payable by the employee. If the employee to whom the benefit is attributable cannot be determined, the personal income tax is to be paid by the employer, in addition to a 27% healthcare contribution.

Certain items will continue to be exempt from social security and healthcare contribution up to individual limits, so only the 16% personal income tax will be payable (the 19% tax base addition also applies). These benefits include vacation vouchers, hot and cold meal vouchers, local travel passes, voluntary contributions to pension and healthcare funds.

Corporate income taxation

As of 1 July 2010, a 10% corporate income tax rate has been introduced up to a tax base of 500 million HUF. Above this limit, the standard 19% rate applies. According to the modifications, the 10% rate will apply to the whole of the tax base from 2013.

The 30% withholding tax on interest, royalty and service fees will be abolished from 2011.

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INDIA

Recent international tax decisions

UK DTAA

In the case of Airlines Rotables Ltd, the issue decided was 'Whether location of consignment stock, not used for business, is a Permanent Establishment or not'.

The assessee was a company incorporated under UK law. Its main business was to provide spares and components support for aircraft to the aircraft operators. Assessee entered into an agreement with 'J' Airways Ltd, an Indian company engaged in the business of air transportation, to provide certain support services in respect of aircraft. The arrangement was that when the airline discovered that an aircraft component became operationally unserviceable, ie when the component was not in a condition to be used or was not airworthy, the same was to be repaired or overhauled by the assessee. The assessee not only did the repairs and overhauling but also provided replacement for components which were under repair or overhauling by the assessee. In order to ensure that the replacement components were readily available and flight operations were not interrupted due to repairs and servicing of the components, the assessee provided stock of such components as agreed with the airlines at the operating base of the airlines. In addition to this, the assessee company also maintained a stock of components at its main depot in the UK from which the assessee company provided replacement components within the time limit specified in the agreement and which varied depending on the urgency of requirements. Stock kept in UK was under the direct control of the assessee and stock in India was in the possession of the airlines itself as a bailee because assessee did not have any storage and support facility in India.

The Assessing Officer was of the view that the assessee had a PE in India under Article 5 of India-UK tax treaty and accordingly receipts would be taxable in India as business receipts. However, the Tribunal held that:

1. There are three criteria embedded in the definition of PE:
 - a. physical criteria which is the existence of physical location
 - b. subjective criteria which is the right to use that place and
 - c. functionality criteria which is the carrying out of business through that place.

It is important that business must be carried on at a physical location in the other country. Consignment stock of the assessee was stored at a specific physical location in India but this storage was under the control of the airlines and the assessee did not have any place at its disposal to carry out its business from this place. It is also important that consideration received by the assessee was for repairing and overhauling of rotables and for use or right to use of the replacement equipment.

2. Repairs and overhauling work was done outside India so it would not be taxable in India.
3. As it was not established that 'J' Airways Ltd was a dependent agent of the assessee company, 'J' Airways could not be treated as a PE of the assessee. It was held that delivery of the components was for standby use of equipment and not for its sale, and therefore revenue authority was not able to establish that the assessee had a PE in India.
4. The consideration for use of replacement components was distinct from the overall receipts. Non taxability under article 7 would still mean that application of article 13 was to be considered and adjudicated upon and for purpose of quantification of taxable income, the matter was remitted back.

India-US DTAA

In the case of Wockhardt Ltd v. ACIT, the Tribunal held that sharing of management experiences and business strategies cannot be regarded as technical or consultancy service

The assessee was an Indian pharmaceutical company. At the assessee's request, the CKP Inc. of USA sent one of its professionals to India for two days to address the conference on future strategy held for the benefit of the assessee's employees. The assessee paid US \$ 80,000 for the said services rendered by CKP Inc. of USA and no tax was deducted under sec. 195 from the said payment because the amount so paid was not taxable in India. It was contended by the assessee that said company was a tax resident of USA and did not have any PE in India during the year under consideration as contemplated in article 5 of the DTAA between India and USA. It was also submitted that the said company did not make available any technical knowledge to the assessee company and therefore the payment made to the said company was not taxable in India.

The Assessing Officer treated the assessee as 'assessee in default' under sec 201 for non deduction of tax.

However, the Tribunal held that:

1. As per the provisions of sec. 90, an assessee is eligible to adopt provisions of the treaty if same are beneficial to the assessee. As per article 12 of India–US tax treaty the definition of fees for included services is restricted to technical or consultancy services and since the managerial services are not covered under the said definition, the same can not be taxed in India.
2. Perusal of presentation made by the professional showed that services rendered by CKP Inc. were essentially in the nature of sharing management experiences and business strategies, and the same had nothing to do with pharma and therefore could not be termed as technical services.
3. In view of the above it was held that the payment made was in the nature of business profits in the hands of CKP Inc as covered under article 7 of the Treaty, and since CKP Inc did not have any PE in India, the same was not chargeable to tax in India.

Indo – Ireland DTAA

No tax to be deducted at source on charges for activating enhanced features inbuilt in hardware

The assessee, an Indian company – Avaya Global Connect Ltd – was engaged in the business of selling ‘converged communication solution (CCS)’ to its customers. It had entered into an Agreement with AISL Ireland to purchase the CCS from AISL Ireland, and sold the same to various customers in territory of India. The CCS comprised hardware and standard software loaded on the hardware. The software consisted of various features, all of which were not activated at the time of supply of hardware, but the customers had the option to activate remaining features as per their specific requirement to enhance the functionality of the hardware. The software could not be de-linked from the hardware. The question was whether the activation charges remitted by the assessee to AISL qualified to be categorised as ‘fees for technical services’ and so whether the assessee was liable to deduct tax under section 195 while making this remittance.

The Tribunal held that:

Activation charges paid to AISL were part and parcel of original equipment supplied by them to the assessee and hence there was no basis at all to distinguish subsequent transaction from original sale transaction and to hold ‘activation charges’ as fees for technical services. Hence, the correct nature of the transaction was sale of product and not fees for technical services.

Indo-Mauritius DTAA

In the case of Velenkani Mauritius Ltd, the taxability of off-the-shelf shrink-wrapped software sale was determined.

The assessee company was a company registered in Mauritius. The manufacturing company was a company registered in USA. The assessee was involved in supply of the software purchased from the manufacturer to the clients located in India. During the relevant previous year, the assessee had supplied off-the-shelf shrink-wrapped software to Infosys Technologies Ltd in India.

Assessee submitted that software sold by the company to Indian entities was shrink-wrapped off-the-shelf software and hence consideration was for sale of copyrighted article which should be characterised as business income. So, according to assessee, it was not a payment in the nature of royalty. Also, since there was no PE, the business income was not taxable under article 7 of DTAA.

Assessing officer and commissioner were of the view that sale of software to Indian entities was liable to be taxed as royalty.

Tribunal referred the decision of Supreme Court in case of Tata Consultancy Services v. State of Andhra Pradesh, in which court said that software programme may consist of various commands which enable the computer to perform designated tasks. The copyright may remain with the originator of the programme but when copies are made and marketed it becomes goods which are assessable to sales tax.

Thus, Tribunal held that in the facts and circumstances of the case and in the light of judgments referred by it, sale of off-the-shelf shrink-wrapped software cannot be treated as income from royalty either under Income Tax Act or under the terms of DTAA.

Update on Vodafone UK Case

Vodafone, UK had acquired shares of a Cayman Island-based Hutchison Group (of Hong Kong) entity, which held a majority stake in Hutchison Essar Ltd (HEL), a telecom giant in India. This acquisition resulted in transfer of controlling stake in HEL from the Hutchison Group entity to Vodafone. Vodafone’s contention was that, since the shares acquired were that of a non-Indian company, the acquisition had taken place outside India and both buyer and seller were non-Indian companies, the transaction did not fall within the ambit of Indian tax jurisdiction and no withholding tax was payable on this transaction.

On the other hand, Indian tax authorities contended that, although the shares transferred belonged to a non-resident entity and the share transfer had taken place outside India (from one non-resident to another), what effectively exchanged hands

pursuant to the transaction was the “controlling interest” in HEL, India, and withholding tax was therefore payable on the capital gains arising out of the transaction.

The Bombay High Court held that from the perspective of income tax law, what is relevant is the place or the source from which the profits or gains have accrued or arisen to the seller. In this case, the income accrued and arose as a result of divestment of Hutchison Group’s Cayman Island based entity’s interest in India. If there was no divestment of such interest in India, there was no reason for the income to arise.

In view of the above, the Bombay High Court upheld a Rs 11,000-crore capital-gains tax demand imposed on the company by the income-tax authorities. Subsequently, on 15 November 2010, by passing an interim order, the Supreme Court asked Vodafone International Holdings BV to deposit Rs 2,500 crore within three weeks and furnish a bank guarantee of Rs 8,500 crore within two months in its ongoing tax appeal. The interim order will be followed by a full hearing on 5 February 2011. The company, while agreeing to pay, might also be exploring an out-of-court settlement in the tax dispute.

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ITALY

New transfer pricing regulation

The Law Decree nr.78, dated 31 May 2010 and converted by Law No. 122, on 30 July 2010, introduced significant changes to transfer pricing rules with its Article 26, which affect Italian resident companies setting up operations with related non-resident companies.

The changes are designed to reward companies that, in the eventuality of a tax audit, are in possession of supporting documents deemed appropriate to substantiate the adequacy of Group transfer pricing policies thus avoiding the application of penalties for inexact tax returns (penalty protection), ie shelter from penalties arising from tax audits which could range from 100% to 200% on any additional taxes being assessed.

These innovations should, therefore, bring further clarity since, as reported in the governmental commentary to the law, the documentation required from taxpayers is pursuant to OECD guidelines which aim to avoid double taxation in different tax jurisdictions.

In September 2010, the Italian Revenue Office released the relevant operative instructions. The guidelines basically introduce into domestic legislation the EU Code of Conduct on Transfer Pricing and the OECD Transfer Pricing Guidelines for Multinational Enterprises.

The Tax Office shall be informed by 28 December 2010 about the existence of transfer pricing documentation for all open fiscal years: the documentation referring to the current tax year will be notified in the annual tax return.

Accordingly, the following entities shall be obliged to draft the documents as follows:

- Holdings (eg an Italian resident company not controlled by any other resident or non-resident entity and controlling in its turn one or more non-resident companies): a Master File and a Country File
- Sub-holdings (eg an Italian resident company controlled by any other resident or non-resident entity and controlling in its turn one or more non-resident companies): a Master File that only includes their controlled companies and a Country File
- Affiliate companies (eg an Italian resident company controlled by any other resident or non-resident entity and not controlling any non-resident company): a Country File.

The Master File and the Country File should be in Italian and made available in electronic format. Only sub-holdings may, in certain cases, keep a Master File in the English language.

The Tax Office has retained the right to not accept the transfer pricing documents and to apply tax penalties if those submitted are considered incomplete or the information included therein is false. However, it is still not clear under which circumstances the Tax Office may deem the documents to be insufficient.

Although the lack of documentation being submitted cannot alone give rise to penalties, it is easy to predict that the Ministry of Finance will focus its control efforts on those taxpayers who will not avail of such facility. In this respect, it must be taken into account that the so-called "large taxpayers" with a turnover of no less than € 200 million (by 1 January 2011 the limit will be reduced to € 100 million) will be subject to tax audits at least once every two years and transfer pricing policies will no doubt be one of the main items to undergo control by the tax auditors.

The topic of transfer pricing is still a complex issue since determining whether intercompany transactions meet the arm's length principle often includes a high degree of subjectivity as well as different critical levels depending on the type of operations. This is evident also in view of the fact that the Ministry of Finance has not made any more general comments since the Circular nr. 32 issued in September 1980 which still sets the guidelines on the practical application of the transfer pricing legislation.

Black list rules

The Italian Revenue Office issued new guidelines (clarification letter n. 51/E) on the application of the CFC rules as well as on the treatment of black-listed dividends and deduction of costs incurred in transactions involving black-listed countries on 6 October 2010. The guidelines follow the amendments to the CFC rule provided by Law n. 102/2009 that narrowed the safe-harbour clauses referring to the "relevant foreign market" definition and attracted the white list countries in the CFC regime upon certain conditions. Disapplication of the CFC rule requires two exceptions being alternatively met:

1. local market link

If the activity of the CFC is mainly carried out towards local customers or suppliers.

2. adequate level of CFC taxation

If the Italian company proves that the CFC does not result in the allocation of income to a tax haven.

The proof may consist in the adequacy of the CFC's effective global tax rate to the effective Italian tax rate. In addition, the Italian resident could also prove that the CFC's profits are systematically paid out to the ultimate Italian resident shareholders and that the structure was not created for tax avoidance purposes.

Moreover, the CFC rule has been extended to entities resident in tax jurisdictions other than black list (even EU) if their effective rate of taxation is lower than 50% of the effective Italian corporate tax rate applicable if they were resident in Italy and have more than 50% of their revenues of a passive nature (interests, royalties, dividends, intercompany fees). The application of the rule may be avoided by filing a tax ruling proving that the foreign entity "does not represent an artificial structure unduly aimed at achieving a tax benefit". The Guidelines also describe certain situations that indicate an artificiality of the structure (eg lack of business purpose).

A Ministerial Decree dated 30 March 2010 has introduced a new task for Italian Companies that incurs having to notify the Italian Tax Authorities regarding any invoices received from or issued to Companies located in black-listed countries. The frequency for filing the communication is quarterly when, in the current quarter and each of the previous four consecutive quarters, the sum of the abovementioned transactions has not exceeded Euro 50,000 per quarter. Otherwise, filing frequency shall be monthly.

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JORDAN

overview

“Jordan is committed to building a dynamic free economy that functions in the context of an environment attractive to investments, which is the result of a comprehensive and ongoing process of reform that leads to more openness to the global economy.”

His Majesty King Abdullah II ibn Al Hussein

For many years Jordan has been promoting the country as a place to do business for many reasons such as:

- Unique and strategic location
- World class infrastructure and communications
- Qualified and competitive human resources
- International agreements accessing a market of one billion customers
- Existence of Free Zones, Industrial Estates and Qualifying Industrial Zones (QIZs)

- Comparative investment environment
- Comparative advantages of competitive economic sectors and sub sectors.

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

There are different types of taxes that affect people and businesses in Jordan. The table below briefly highlights the tax structure in Jordan:

Tax	Description
Income tax on corporations and businesses: 1. Mining, Manufacturing, Hotels, Hospitals 2. Banks, Financial Institutions and Insurance Companies 3. All other Companies	Imposed on income generated by companies operating in Jordan
Distribution Tax	Levied on the distribution of company profits
Annual taxable income on individuals	Income paid to employees is taxable. Foreign employees working for non-Jordanian companies are exempt from paying all income tax. Personal and family tax exemptions apply.
Social Service Tax	A social service tax is due from each individual and equals 10% of the tax payer's income tax.
Universities Tax	This tax is payable by shareholding and foreign companies at a rate of 1% of net income before taxes and distributions.
Sales Tax	Taxpayers are manufacturers, merchants or service providers whose sales amount to JD 100,000 per annum and importers of any goods or services.
Property tax (real estate)	Property tax is levied at 10% (there is an 8% discount if the tax is paid ahead) which is based on the assessed annual rental value.
Service Tax	Service tax is levied at 10% of the yearly income tax on individuals.
Gift Tax	Gift Tax is levied on certain gifts such as lottery prizes and other similar winnings. The rate is 10% if such income exceeds JOD 1,000.
Stamp Duty	Specific stamp duty of 0.3% is levied on certain documents which paid for one time only and no taxed on the individuals.
Customs Duty	Customs duty is payable on goods imported into Jordan. The rates of basic customs duty may reach up to 300% depending on the governmental strategy.

Free Zones

Jordan's Free Zones were established to promote export-oriented industries and transit trade; to attract domestic and foreign direct investment; and to spur economic growth and job creation.

Free Zones accommodate processing industries, in addition to trading, warehousing and other activities. Commodities and goods of various origins are deposited in the Free Zone areas for storage and manufacturing, without payment of the usual excise fees and taxes.

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

Incentives offered by Free Zones include:

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

Industrial Estates

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

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

General sales tax / value added tax

The standard sales tax rate in Jordan is 16% with a higher rate applying to certain luxury items. Exemptions include some basic food stuffs, fertilizers, crops, fruits, seeds, books and newspapers. Jordan levies a sales tax of 16% on supplies of manufacturers, importers and suppliers of services.

Sales tax is charged on the sale of goods, transfer of right to use goods, lease transactions and also transfer of materials in execution of works are considered as deemed sales and are liable to sales tax. In this regard, 'goods' refer to movable property and even include intangible property such as copyright, trademark, patents etc

The sales tax is levied on inter-state as well as intra-state sales. The inter-state sales tax collected by the Central Government is known as central sales tax (CST) and intra-state tax collected by respective state governments is known as local sales tax (LST). Varying rates of sales tax are prescribed on different products. Most of the states levy sales tax at the first point of sales in the state. Consequently, subsequent sale of goods within the state are exempt from tax. The rate of sales tax is either 4% or 16%. State government initiative to promote industrial growth provides sales tax exemption, deferred payment facilities and sales tax set off.

Export sales and trading within a qualified Free Zone are sales tax exempted transactions in Jordan.

Corporate Income Tax

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

1. 14% of the taxable income for all companies and juristic persons except the below mentioned.
2. 24% of the taxable income for all basic telecommunication companies, insurance companies, intermediation companies, and financial companies including exchange companies and capital leasing companies.
3. 30% of the taxable income for banks and external branches.
4. 30% of the taxable income which was specified at the rate of 20% of the total net income, after deducting the foreign income tax, of the Jordanian companies' branches operating outside the Kingdom as declared in their final accounts which are certified by an external auditor.

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

Personal Exemptions on the Residential Natural Person

- An amount of JD 12,000 for the tax payer
- An amount of JD 12,000 for the dependents regardless of their number

Considering the following:

- In the case of joint or detailed declarations, the amount of exemption granted for the sole family should not exceed an amount of JD 24,000.
- For granting exemption relating to the dependents to be residents in the Kingdom.

Exemptions on Income Earned from Work and Employment

The law has included the following tax exemptions:

- a. Expenditures incurred from providing food meals to employees at work premises are tax-exempted.
- b. Expenditures incurred from providing housing and lodging services for employees used for work purposes are tax-exempted.
- c. Total value of the necessary equipment and habile provided for employees for work purposes.

d. The end-of-service indemnity paid in accordance with the related legislations or any collective arrangements approved by the Minister of Finance , as follows:

- 100% for the periods prior to the law force (until 31 December 2009).
- 50% for the period following to the law force (from 1 January 2010).

Tax Deductions from the Source

The law obligates the juristic person to deduct the following accrued taxes when the following expenditures are incurred:

- a. 5% Expenditures incurred from providing services for any resident (natural or/and juristic).
- b. 5% on the rental value paid for the lesser.
- c. 5% on the interests on deposits or deposits sharing in banks, which are considered taxable for the non-resident juristic person and natural person. For the remaining juristic persons, the tax is considered as a payment on their tax account.
- d. 7% on the amount paid for non-resident person directly or through the income realised from investment or use of any rights such as patents, copyright etc.
- e. 7% from the services performed by the non-resident if incurred inside the Kingdom or its outputs are used inside the Kingdom.
- f. The income tax on the salaries and wages paid in accordance with instructions that shall be issued later.

Income Exemptions

The law has included the following exemptions:

- a. All distributed dividends from stocks and financial shares that a resident would distribute except the joint investment funds descended to banks and financial companies.
- b. All dividends realised from inside the Kingdom as a result from trading in shares, stocks, bonds and treasury bonds except the one realised to the banks, financial companies, intermediation companies, insurance companies and capital leasing companies.
- c. Profits from trading in immovable funds, except:
 - The profits realised to the juristic persons.
 - The realised profits from trading in constructing and selling real estate.

Deduction Of Acceptable Expenses

The law has specified that the disbursements and expenses to be deducted are those expenses wholly and exclusively made or incurred for the purpose of producing the total income during the year. Moreover; executive instructions shall be issued for determining the expenses that are not deductible either related to the taxable income or the exempted income.

Amongst those expenses are:

- a. The value of assets that is less than JD 100 is considered as expense in the period in which the assets were acquired.
- b. The provisions of insurance companies related to the unearned premiums and the provision for claims under settlement and the arithmetic provision; so that what was deducted during the directly preceding tax period to be added to the income after deducting the share of the reinsurers in accordance with the executive procedures that will be described in the instructions issued in this regard.

Tax Declaration and Tax Payment Appointment

- c. The law obligates the taxpayer to submit the tax declaration and pay the tax before the end of the forth month from the tax period end in general.

- d. Taxpayers with total income more than JD 500,000 have to pay the tax in accordance with the executive instructions to be issued later as follows:

- Within 30 days from the end of the first half for the period covering the first half of the year.
- Within 30 days from the end of the second half for the period covering the second half of the year.

The law obligates the taxpayer to deduct the accrued taxes and pay them to the Tax Department within 30 days from the date of their payment or accrual. Otherwise, the tax is collected from the taxpayer as it is accrued in addition to the penalties specified by the law.

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KENYA

Thin Capitalisation provisions

In Kenya, as in many other countries, interest on corporate debt is tax deductible. Companies can take maximum advantage of this tax deductibility by determining the optimum amount of debt that they can carry and working with it. It should be noted that the revenue authorities attempt to limit abuse of tax deductibility.

The Income Tax Act contains provisions on thin capitalisation of foreign controlled companies. Thin capitalisation arises where a company incorporated in Kenya is controlled by a non-resident person alone or together with four or fewer other persons and the highest amount of all loans advanced to that company at any time during the year are more than three times the sum of the revenue reserves and the issued and paid up capital of that company. Where a company is thinly capitalised, the Kenya Revenue Authority will disallow for tax part of the interest charged in proportion to the amount of debt that exceeds the prescribed ratio of debt to capital. In addition, the deduction of exchange differences is also restricted.

Kenyan legislation has been amended to now define the term "loan" to mean:

- loans
- overdrafts
- ordinary trade debts
- overdrawn current accounts or
- any other form of indebtedness.

In this regard it should also be borne in mind that "loans" cover both local and foreign loans.

One technique for taking advantage of debt is the use of lease financing arrangements for the acquisition of assets, rather than outright purchase with company funds as (for the time being) the lease payments made under both capital and operating leases are tax deductible on the lessee.

Deemed interest

Where a company controlled by a non-resident person receives an interest free loan from the non-resident person, a deemed interest at the rate of the average 91 day Treasury Bill shall be imputed and taxed on the company.

Transfer Pricing

Multinational companies operating in Kenya and engaged in cross-border trade with related overseas companies have, in recent times, endured a tax nightmare as a result of the Kenya

Revenue Authority's drive to enforce transfer pricing rules under the Income Tax Act. The Kenya Revenue Authority has identified transfer pricing as a major area of tax revenue leakage and has recently been conducting transfer pricing audits of multinational companies with a view to curbing 'profit dumping' in Kenya.

The operative legal provision on transfer pricing in Kenya is contained in Section 18(3) of the Income Tax Act, which provides that:

"Where a non-resident person carries on business with a related resident person and the course of that business is so arranged that it produces to the resident person either no profits or less than the ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of that resident person from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length."

Control now includes blood relations

Rule 5 of the transfer pricing rules stipulates that the rules will apply to:

"(a) transactions between associated enterprises within a multinational company, where one enterprise is located in, and is subject to tax in Kenya, and the other is located outside Kenya; or

(b) transactions between a permanent establishment and its head office or other related branches, in which case the permanent establishment shall be treated as a distinct and separate enterprise from its head office and related branches."

However, on 11 June 2010 new regulations were proposed extending the meaning of relationship for Transfer Pricing Rules to businesses managed, controlled or owned by individuals who are related to each other by marriage, consanguinity or affinity.

Tax amnesty to the Diaspora

Kenyan citizens living and working around the world are now encouraged to remit and invest their income in Kenya, without being charged penalties and interest in respect of undisclosed income of prior years ending 31 December 2010. In order to take advantage of this amnesty, Kenyan citizens are required to fulfil the following conditions:

- File their 2010 return and accounts on or before 30 June 2011
- The income so declared should not have been previously assessed or be under audit.

KRA is integrating its information systems with that of the Immigration Department to enable it monitor immigration status of Kenyans living abroad. As a consequence, Kenyans living abroad may be required to submit their tax returns to facilitate clearance of their travel documents to their host stations.

This change is effective from 11 June 2010.

Kenya New Constitution – 999-year land lease down to 99 years

Foreign ownership: During the campaigns for and against the proposed constitution, provisions in land emerged as a contentious issue. All foreigners with land leases of 999 years automatically convert to 99 year leases.

The new constitution indicates that “under the existing land holdings and agreements relating to natural resources that on the effective date, any freehold interest in land in Kenya held by a person who is not a citizen shall revert to the Republic of Kenya to be held on behalf of the people of Kenya, and the State shall grant to the person a ninety-nine year lease at a peppercorn rent”.

The constitution further states that any other interest in land in Kenya greater than a 99 year lease held by a person who is not a citizen shall be converted to a 99 year lease.

Two bills expected to overhaul the system of land management in the country have been forwarded to stakeholders, setting the stage for the implementation of one of the chapters in the proposed constitution that provoked intense debate during the referendum campaigns.

The National Land Commission Bill 2010 and the Public Land Bill 2010 are the first of several pieces of legislation designed to implement the new Constitution’s provisions on land.

Landowners opposed to the Proposal in the Constitution cite articles 65, 66 and 67, which addresses land holding by non-citizens, regulation of land use and property, and the proposed National Land Commission.

The draft says a person who is not a citizen may own land on the basis of a leasehold tenure only, and that any such leases granted shall not exceed 99 years. This means that as soon as the new draft become effective, all that land on 999-year lease will automatically revert to 99 years. A member of the Committee of Experts, the team who drafted the constitution, explained that “Large-scale farmers or investors need not worry because the 99-year lease is renewable”.

In Article 66, the draft states: „The State may regulate the use of any land or any interest in or right over any land, in the interest of the defence, public safety, public order, public morality, public health or land use planning”.

The landowners are also worried over provisions in the draft that state that Parliament will form a legislation to determine the minimum and maximum size of private land one can own.

Anti-money laundering legislation now in effect

The International Monetary Fund puts the aggregate size of money laundering in the world between \$725 billion (Sh56.5 trillion) and \$1.8 trillion (Sh140.4 trillion). Governments in East Africa are passing new laws relating to combating the finance of terrorism (CFT) and anti-money laundering (AML). They have signed up to international standards designed to restrict access to the legitimate banking system for criminal organisations. They argue convincingly that cutting off a criminal’s cash flow restricts the business of crime. As part of society, banks want to play their part in reducing crime and thus encouraging legitimate enterprise.

The Anti-Money Laundering Act 2009 takes effect starting Monday, 28 June 2010. The Proceeds of Crime and Anti-Money Laundering Act and Arbitration (amendment) Act provides mechanisms for detecting and seizing proceeds of money laundering. On New Year’s Eve, President Mwai Kibaki signed into law a Bill aimed at tackling money laundering and introducing measures to identify, trace, freeze and seize proceeds of crime.

In the new regulation now, any person who knows or ought to have reasonably known or suspected that any property is part of the proceeds of crime but conceals or disguises the nature or source of the same commits an offence. It also provides for the establishment, powers and functions of the Financial Reporting Centre.

Those found guilty of the offence of money laundering will serve a jail term not exceeding seven years, or a fine not exceeding Sh2.5 million, or both.

Financial institutions and professionals such as accountants risk high punitive fines if they breach several provisions of the Act. Stock brokers and insurance industry players are likely to be the most affected by these requirements as the current anti-money laundering practices in these sectors are weak.

Directors and employees of reporting institutions may also be personally liable under the Act.

Enactment of East African Common Market Protocol

1 July will mark the beginning of a process to create a Common Market in East Africa. The Common Market Protocol signed by Uganda, Kenya, Tanzania, Burundi and Rwanda identifies four types of East African citizens who can enter, stay, work and reside in another East African state.

Scope

The scope of co-operation under the Common Market is provided in Article 5 of the Protocol and applies to any activity undertaken in co-operation by the Partner States to achieve the free movement of goods, persons, labour, services and capital and to ensure the enjoyment of the rights of establishment and residence of their nationals within the Community. In furtherance of this goal, Partner States agreed to eliminate tariff, non-tariff and technical barriers to trade; harmonise and mutually recognise standards and implement a common trade policy for the Community; and ease cross-border movement of persons and adopt an integrated border management system.

The protocol is further expected to facilitate trade through the harmonisation of customs duties on goods and creating a more predictable tariff structure for external trade partners. Benefits of the Protocol / the Common Market include:

Trade opportunities / larger markets

- Improved competitiveness and higher returns on investment
- Free movement of persons
- Free movement of labour/workers
- Cross-border capital movements will also spur the growth of industrialisation driven by an expanding and more productive agricultural sector
- Service suppliers, providers and consumers from across the region will be guaranteed equivalent treatment to local providers.

From 1 July, individuals who wish to travel for any purpose other than earning money (such as visitors, students, medical tourists, people in transit), the self-employed, intra-corporate transfers of managerial and supervisory personnel and workers will do so freely.

At its launch, the Common Market Protocol will only apply to certain professions but the number of professions will expand over time. For workers, free movement will be in progressive stages depending on profession and the country in which you wish to work.

Workers will enter partner states by presenting their passports at the port of entry, declaring the usual information and providing a contract of employment.

For jobs that will last less than 90 days, workers will need a special pass and, for jobs lasting longer than 90 days, a work permit.

Special passes and work permits require different supporting documentation. Spouses and children will be allowed to travel with the worker if they apply. Movement of these groups is already happening but under a different dispensation.

The introduction of the East African Common Market provides an opportunity for business and entrepreneurs to flourish.

Professionals will be able to cross borders, increasing their employment opportunities, while businesses will have a wider field to choose from when recruiting or expanding.

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MALAYSIA

Double Tax Agreement

We are pleased to provide an update on some of the key Malaysian and international tax developments as summarised below.

Double Tax Agreement (DTA)

Protocols to amend the Articles on Exchange of Information

- DTA between Malaysia and Kuwait
- DTA between Malaysia and Seychelles
- DTA between Malaysia and United Kingdom

The protocols signed between Malaysia and the above countries pertaining to the article on Exchange of Information [EOI] have been gazetted via the following orders to incorporate the internationally accepted OECD exchange of information provisions.

- Double Taxation Relief (The Government of The State of Kuwait)(Amendment) Order 2010
- Double Taxation Relief (The Government of The Republic of Seychelles)(Amendment) order 2010
- Double Taxation Relief (The Government of the United Kingdom of Great Britain and Northern Ireland) (Amendment) Order 2010

DTA Between Malaysia and The Republic of Kazakhstan

The DTA between Malaysia and the Republic of Kazakhstan which was signed on 26 June 2006 has been ratified and is in force. Salient points of the DTA include:

- i. A building site or construction, installation or assembly project will constitute a permanent establishment [PE] if it exists for more than six months.
- ii. An installation or structure or a drilling rig or a ship used for the exploration of natural resources will constitute a PE if such use lasts for more than six months.
- iii. A PE is also deemed to exist if supervisory activities are carried out for more than six months in connection with:
 - a building site or construction, installation or assembly project; or
 - an installation or structure or a drilling rig or a ship used for the exploration of natural resources.

iv. Withholding tax of not exceeding 10% will be applicable on the following payments:

- Dividend (Note)
- Interest
- Royalties
- Technical fees
- Section 4(f) income.

The DTA is effective for the year of assessment:

- beginning on or after 1st January 2011 in respect of income tax; and
- beginning on or after 1st January 2012 in respect of petroleum income tax.

Note: Currently, there is no withholding tax on outbound dividends under the Malaysia Income Tax Act 1967.

Protocol Amending DTA between Malaysia and Indonesia

The Protocol amending the DTA between Malaysia and Indonesia was ratified on 15 July 2010. The major changes observed, amongst others, are:-

- i. Withholding tax [WT] rate applicable to the following payments:-
 - Dividends – WT on dividends paid by a company which is a resident of Indonesia to a resident of Malaysia is reduced from 15% to 10%
 - Interest – reduced from 15% to 10%
 - Royalty – reduced from 15% to 10%.
- ii. Article 10 on “Dividends” of the DTA shall not affect the provisions contained in any production sharing contracts relating to oil and gas sector concluded by the Government of Indonesia, its instrumentality, its relevant state oil and gas company or any other entity thereof with a person who is a resident of Malaysia.
- iii. Labuan entities carrying on Labuan business activity under the Labuan Business Activity Tax Act 1990 will not be entitled to the benefits under the tax treaty.

Application of the protocol took effect from 1 September 2010.

2011 BUDGET

The Budget proposals for 2011 were tabled in Parliament on 15 October 2010.

With the theme - "Transformation Towards a Developed and High Income Nation", the 2011 Budget emphasized the government's efforts to transform the nation into a developed and high income economy and this Budget is centred on the following four key strategies:

1. Reinvigorating private investment
2. Intensifying human capital development
3. Enhancing quality of life of the Rakyat
4. Strengthening public service delivery.

Some key changes announced in the above Budget are outlined below into the following categories:

- Changes affecting individuals
- Changes affecting companies and unincorporated businesses
- Investment incentives
- Stamp duty
- Indirect tax eg increase in service tax rate on all taxable services from 5% to 6% with effect from 1 January 2011.

Goods and Services Tax (GST)

There have been no further announcements with respect to the introduction of GST since the announcement earlier this year regarding the deferral of the second reading of the GST Bill in Parliament. However, on 13 July 2010 the Price Control and Anti-Profiteering Bill 2010 was tabled for the first reading at Parliament. The Bill is aimed at reforming the law on price control and enacting provisions to curb profiteering by businesses in Malaysia.

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NETHERLANDS

International Tax Issues

Below is a summary of recent tax developments in the Netherlands.

Corporate Tax rates for 2011

The Dutch corporate income tax rate for taxable amounts exceeding € 200,000 will be reduced from 25.5% (2010) to 25% as of 2011. Taxable amounts up to € 200,000 will remain taxable with 20% corporate income tax.

Extension of carry back period

Since 1 January 2009, a corporate income taxpayer can opt to extend the loss carry back period from one to three years for losses incurred in the 2009 and 2010 taxable years. The 2011 Tax Budget extends this option to losses realised in the 2011 taxable year. An election for the option to extend the carry back period should be made in the corporate income tax return for the relevant year. If opted for, two conditions will apply:

- i. the loss carry forward period will be reduced from nine to six years
- ii. the limitation of the tax losses to be carried back to the second and third year preceding the loss year is €10,000,000 for each year.

Changes in anti-abuse rules for profit companies

In summary, the carry over of losses realised in a year to be set off against the profits of another year is limited by a number of provisions. One of those limitations applies in case of a substantial change (30% or more) in the ultimate interest in the taxpayer combined with a substantial (30% or more) of the activities of the taxpayer unless certain asset and activities-tests are fulfilled. The limitation does not apply based on current law to the losses incurred in the year the ownership changes substantially. The Tax Budget 2011 proposes that losses incurred in the same year as the substantial ownership change cannot be set off against profits realised after the change in ownership. The rule *mutatis mutandis* applies for losses incurred after the substantial change in ownership but in the same year; i.e. those losses cannot be offset against profits realised prior to the change in substantial ownership.

Extension of accelerated and random depreciation

The Dutch government previously introduced a temporary measure for accelerated and random depreciation of business assets purchased or manufactured in 2009 and 2010 as part of a tax stimulus package. Assets qualifying under the package, can be depreciated in two years (with a maximum of 50%) if taken in use before 1 January 2012 or 2013 respectively. The 2011 Tax Budget extends this regime for one additional year, i.e. investments made in the 2011 calendar year can benefit from accelerated and random depreciation in 2011 and 2012. The accelerated and random depreciation is applicable to most business assets (exceptions apply to, amongst others, buildings, certain infrastructure projects, immaterial fixed assets and assets acquired to be leased to third parties).

Further improvement of the innovation box

Income from patents and research and development activities may benefit from the Dutch innovation box at an effective rate of 5% subject to certain conditions. The reduced rate applies to income exceeding the production costs incurred in relation to the patent or research and development activities. Since the introduction, the innovation box has been extensively improved and the 2011 Tax Budget again provides for a further improvement. Presently, the innovation box only applies for income from patents once the patent is actually granted. As from 2011, income arising in the period in which a patent is pending may be deducted from the production costs. Effectively, this means that more income is taxed at the reduced rate of 5% after the patent is granted.

EU

European Commission – Dutch rules on exit taxes and substantial interests held by foreign companies. On 24 November 2010, the European Commission (EC) decided to refer the Netherlands to the EU Court of Justice (ECJ) after having formally requested the Netherlands to change tax rules which impose an immediate exit tax when companies transfer their seat or assets to another EU Member State. These rules are considered contrary to the right to freedom of establishment by the EC.

In September 2010, the EC requested the Netherlands to change legislation that exempts domestic companies from tax on their income from substantial interests in Dutch resident companies but which taxes companies established elsewhere in the EU and EEA on income from substantial interests not forming part of a business enterprise. The EC considers this rule contrary not only to EU law on the free movement of capital but also to the freedom of establishment, as well as the EU Parent Subsidiary Directive.

Tax treaties

The Netherlands has further expanded, renewed and/or revised its extensive tax treaty network: Hong Kong (22 March 2010), Slovakia (7 June 2010), Japan (25 August 2010), Tunisia (8 September 2010) Panama (6 October 2010), and Switzerland (26 February 2010).

The new tax treaty with the United Kingdom, signed in 2008 and ratified by the United Kingdom in 2009, is currently in the process of being ratified by the Dutch parliament. It is expected that the tax treaty with the United Kingdom will enter into force on 1 January 2011.

Amendments of the wage cost facility for research and development

Dutch law contains a wage tax incentive for qualifying research and development activities. This incentive has the form of a reduction of the payroll tax and social security contributions payable by the employer. For 2011, a deduction of 46% will apply for the first € 220,000 of payroll costs that relate to research and development. The deduction for payroll costs above € 220,000 amounts to 16%. The rebate is maximized at € 14,000,000. As of 2012, the deduction will amount to 45% of payroll costs relating to research and development for an amount of up to € 150,000. A deduction of 14% applies for the excess payroll costs. The rebate will be maximized at € 8,500,000 in 2012.

Employment costs regulation

As of 1 January 2011, a new employment costs regulation will enter into effect which will drastically change the current scheme for tax-free allowances and benefits to employees. A transitional arrangement will be applicable up to 2013. During this period, the person liable to deduct and transfer wage tax / national insurance contributions (hereinafter: withholding agent (employer)) will be able to choose whether he wants to grant

allowances and benefits based upon the current regulations or on the basis of the new regulations, called the work-related costs scheme. As of 2014, only the work-related costs scheme will apply.

The main features of the work-related costs scheme are as follows:

- a clarification of what constitutes salary for the purpose of income tax and social insurance contributions. Basically, everything that is reimbursed or granted as part of the employment relationship will be deemed wages. In this way, all allowances and benefits that are still exempt at present can be included in the final tax levy
- the existing rules governing free allowances and benefits will come to an end
- the rules for the valuation of wages in kind will change
- the withholding agent (employer) can include allowances and benefits in the final levy. A maximum of 1.4% of the total wage bill (the so-called 'free space') can be used for allowances and benefits that are tax free. On the excess, the person liable to deduct and transfer wage tax / national insurance contributions will pay 80% wage tax by way of a final levy
- there will be a number of specific exemptions and zero-rated items.

The crux of the new scheme is that the withholding agent (employer) can spend a maximum of 1.4% of the total taxable wages on tax free allowances and benefits to their employees. On the amount that exceeds the free space, the withholding agent (employer) pays wage tax in the form of a final levy of 80%. The withholding agent (employer) can also continue to reimburse or grant certain benefits by making use of the specific exemptions. In this context, zero-rated items become important because their effect is to be granted exemption from tax as well. If you examine the new scheme and want to offer your employees allowances and benefits, you need to qualify under the specific exemptions and/or zero-rated items as much as possible in order to optimise your use of the free space.

Anti-abuse measures relating to real estate companies

The acquisition of a substantial interest of shares (1/3 or more) in real estate companies is subject to 6% Dutch real estate transfer tax. Under current law, a company qualifies as real estate company if

- i. the assets, on a consolidated basis, consist for 70% or more of Dutch real estate at the time of the share transfer or at any point in time in the 12 months preceding the share transfer (the Asset Test), and
- ii. (ii) if (at least 70% of) the Dutch real estate is used for acquisition, sale and exploitation (the Purpose Test).

The rules on real estate companies will significantly change pursuant to a proposal in the Tax budget 2011. The result of the proposal is that real estate transfer tax will be due more often. The main changes refer to the Asset Test (ie. the Purpose Test remains unchanged) and can be summarised as follows:

- the 70%-threshold will be reduced to 50% and also non-Dutch real estate is taken into account. As of 2011, the Asset Test is fulfilled if the entity's assets, on a consolidated basis, consist for more than 50% of real estate and for at least 30% of Dutch real estate at the time of the share transfer or at any point in time in the 12 months preceding the share transfer
- consolidation for purposes of the Asset Test is more often required. Presently, the assets of entities in which 1/3 or more are held, are (proportionally) consolidated at the level of the relevant company. As of 2011, (proportional) consolidation is also required if the relevant company together with group companies holds 1/3 or more in another entity, or if an individual that holds at least 90% in the relevant company, holds 1/3 or more in another entity
- certain assets will be excluded for purposes of the Asset Test to avoid the artificial creation of non-real estate assets (with the goal to remain below the 50% (and/or 30%) threshold):
 - receivables on the acquirer of the shares in the company and related parties thereto
 - receivables of the company on related parties
 - other assets than real estate up to the amount of debt granted by the acquirer or related parties thereto
 - other assets than real estate up to the amount of debt granted by related parties to the company.

Another change is that under the proposal, as of 2011, real estate transfer tax is also due if an existing substantial or non-substantial interest of shares in a real estate company is extended or converted into a substantial interest without the acquisition of shares. For example, if preferred shares (the lack of a right to dividend/profit does not give these shares an economic interest in the real estate company) are converted into normal shares (which gives the shareholder a right to the profits and therefore an economic interest in the real estate company).

Quarterly VAT returns

Whether an enterprise files VAT returns on a monthly or quarterly basis in principle depends on the size of the turnover of the respective enterprise. As part of the 2010 measures to combat the economic crisis, quarterly filing was allowed for enterprises that are normally required to file VAT returns on a monthly basis. This option will be made permanent from 2011 onwards. This measure will reduce the administrative burden and increase the liquidity position for business and industry.

This summary should by no means be regarded as an exhaustive outline of the provisions discussed herein and should not be regarded as a substitute for detailed legal advice.

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PARAGUAY

Overview of tax rates and incentives

According to the tax reforms initiated in 2004 in the country in relation to tax regulation, the tax system in Paraguay is based principally on the consumer taxes of VAT (Value Added Tax) and Income Tax.

Value Added Tax (VAT)

There are two rates according to kind of product:

- 5% on sale of properties on agricultural products and live stock production and marketing of pharmaceuticals products.
- 10% over the provision of other services and the sale of goods in general.

Medical assistance entities are exempt from paying tax when they give free services as are primary and high school educational establishments.

Selective Consumption Tax (ISC)

Income Tax

There is another Consumer Tax which is applied on fuel and oil products, snuff, alcohol and other luxury goods.

A general rate of 10% applies plus an additional tax of 5% for the distribution of local utilities and 15% on profits remittances sent abroad.

Tax incentives

Currently there are the following tax incentives:

1. The Maquila Regime allows a foreign company to operate in the country or sub-contract to local companies to produce goods or services that are re-exported with value added.

These operations are exempt from all taxes or charges that affect the process from the import of raw materials, supplies and manufacture until the exportation including VAT. It has a single rate of 1% tax.

2. The Law N° 60/90 about Investment Incentive promotes the importation of machinery and equipment of high technology to local industry. There is a 0% tariff on its importation and is exempt from VAT.

3. Zona Franca is a Tax Free Area that is a private areas properly closed and isolated within of the country territory. It enjoys tax breaks and other benefits specified by law for the development of every kind of industrial, commercial and service activity.

The application of Personal Income Tax has been postponed until 2013. Paraguay is currently one of only two countries in South America which still do not have this tax.

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ROMANIA

Recent tax changes

As anticipated in the August 2010 International Tax Alert, the changes to taxation system in Romania have continued.

1) The minimum income tax has been eliminated as from 1 October 2010

According to new amendments to the fiscal code, taxpayers are no longer liable to minimum corporate tax from the fourth quarter of 2010.

As at 30 September 2010, taxpayers liable to minimum corporate tax must submit and pay the corporate tax for the third quarter no later than 25 October 2010, according to the provisions of fiscal code in force as at 30 September 2010.

For the calculation of the corporate tax liability for 2010, companies must apply the following new rules:

- a. For the period 1 January – 30 September 2010:
 - Taxpayers are required to calculate their corporate tax liability for this period and compare it with the corresponding minimum corporate tax.
 - The annual tax return must be submitted and the annual corporate tax liability paid for this period by no later than 25 February 2011.
- b. For the period 1 October 2010 – 31 December 2010:
 - Taxpayers are required to submit their tax returns and pay their corporate tax for the fourth quarter of 2010 by no later than 25 January 2011 and submit their annual corporate tax return by no later than 25 April 2011 (with certain exceptions).

2) New rules introduced regarding advance payments of corporate income tax

The new rules for taxpayers to make advance payments in the fiscal year 2011 are as follows:

- For companies which during the period 1 January – 30 September 2010 were liable to corporate tax / minimum corporate tax and during the period 1 October – 31 December were liable to corporate tax, the quarterly advance payments will represent a quarter of an amount obtained by adding together the corporate tax paid in the two periods, updated to the present value by correction with the inflation index

- For companies which during the period 1 January – 30 September 2010 were liable to corporate tax / minimum corporate tax and during the period 1 October – 31 December have reported a fiscal loss, the quarterly advance payments will represent a quarter of the corporate tax / minimum corporate tax paid in the first period, updated to the present value by correction with the inflation index.

The advance payment system is applied at this moment only for banks. Starting with the fiscal year 2012, advance payments will also apply to other categories of taxpayer.

3) Late payment interest, penalties and charges

According to the new provisions of the fiscal procedures code, the main amendments are:

- A new rate for late payment interest of 0.04% per day of late payment was introduced. The previous rate was 0.05% applicable in the period 1 July 2010 – 30 September 2010 and 0.1% before 1 July 2010. Also, in the case of receivables written off through the offsetting procedure, late payment interest and penalties are calculated up to the date when the compensation takes place (ie the date when receivables exist simultaneously and are certain, liquid and chargeable).
- New late payment penalties due for outstanding tax liabilities of more than 30 days were approved as follows: (a) 5% for outstanding tax liabilities paid within the next 60 days (b) 15% for outstanding tax liabilities remained unpaid thereafter.

New late payment charges of 2% for the late payment of local tax liabilities were also introduced. These are computed to the amount of outstanding tax liabilities, assessed for each month or fraction of the month, starting the next day following the deadline and up to their settlement.

4) Self-employment: similarities with regular employment

Certain amendments have been made to the criteria based on which a work relationship can be reassessed as a dependent one.

Depending on the type of work performed, the staff may be hired not only on the basis of an individual labour contract but also through other contractual instruments such as civil conventions for service provision or assignment of copyright contracts.

The holders of such contracts are not qualified as dependent labour, they are not considered to be employees and they are not subject to labour laws. Their income is regulated as professional income not as wage income. Although, legally, the relationship under which they operate is governed by civil legislation, for tax purposes there are some similarities with work relationships.

Those who work in compliance with some sort of civil convention, as well as those who work under contracts of assignment of copyright, are required to pay contributions specific to employees (individual contributions to social insurance and unemployment insurance). Persons insured in other systems that are not integrated in the public pensions system and persons with the status of retiree are excluded from the rule.

For the income earned under civil conventions, individual contributions are due regardless of the frequency of the income or whether they are exclusively achieved. For copyright income, individual contributions are due only if the income is exclusively achieved on a regular or occasional basis as well as if it is routinely achieved at the same time as earning income from wages.

5) Electronic submission of certain tax returns became mandatory

Starting with reporting obligation due on 25 November 2010, the large and medium taxpayers and their secondary offices shall be obliged to submit the following tax returns electronically:

Form 100 Statement on the payment obligations to the state budget

- Form 101 Income Tax Statement
- Form 102 Statement on the payment obligations to the social insurance and special funds budgets
- Form 120 Tax return regarding the excises
- Form 130 Tax Return on the crude oil from the internal production
- Form 300 Tax return of the value added tax
- Form 301 Special tax return of the value added tax
- Form 390 VIES Summary statement on the intra-Community goods deliveries/ procurements
- Form 710 Corrective statement

The above tax returns shall be signed using a qualified certificate issued by a provider of certification services.

The transmission of respective tax returns shall be made by accessing www.e-guvernare.ro

For other categories of taxpayer, electronic filing remains optional.

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SINGAPORE

Tax Update

New Agreements for the Avoidance of Double Taxation (DTA)

Singapore signed DTAs with the following countries in 2010:

- Slovenia
- Saudi Arabia
- Panama
- Ireland

These new DTAs will be effective only after ratification by the respective governments.

The withholding tax rates applicable to dividends, interest and royalties, when received by the beneficial owner who is resident in the respective treaty country, are:

	Dividends	Interest	Royalties
Slovenia	5%	0% ⁽¹⁾ / 5%	5%
Saudi Arabia	5%	5%	8%
Panama	4% ⁽²⁾ / 5%	0% ^(1,3) / 5%	5%
Ireland	0%	0% ⁽¹⁾ / 5%	5%

⁽¹⁾ Interest received by the Government of the respective treaty country is exempt from tax.

⁽²⁾ The lower rate applies when the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends.

⁽³⁾ Interest derived and beneficially owned by a bank of a treaty country is exempt from tax if the payer is a bank of the other treaty country.

Goods and Services Tax – Time of Supply changes with effect from 1 January 2011

Under the current time of supply rules for Goods and Services Tax (GST), a supply is deemed to be made at the earliest of the following three events:

- a. When goods are removed/made available or when services are performed (Basic Tax Point)
- b. When payment in respect of the supply is received
- c. When tax invoice in respect of the supply is issued.

With effect from 1 January 2011, the general time of supply rule has been simplified and a supply will be triggered by the earlier of the following two events:

- a. When payment in respect of the supply is received
- b. When invoice in respect of the supply is issued.

This rule is applicable for most transactions. For certain transactions such as the sale of immovable property and the consumption of business assets for private purposes, the taxpayer is required to continue tracking the Basic Tax Point.

GST registered businesses are reminded to review their existing operational procedures so as to be ready for the new time of supply rule by 1 January 2011.

High Court Judgment

Under Section 12(6) of the Income Tax Act (ITA), interest, commission or fee or any other payment in connection with any loan or indebtedness borne directly or indirectly by a person resident in Singapore is deemed to be derived from Singapore. The person pays such "interest" to a non-resident person as required under section 45(1) to withhold Singapore.

In the recent case of ACC v. Comptroller of Income Tax, it was held that payments made pursuant to interest rate swap arrangements were not payments in connection with any loan or indebtedness borne by the taxpayer. As such, such swap payments are not subject to Singapore withholding tax.

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SLOVAK REPUBLIC

Tax updates

Change in Slovak VAT Rate

Subject to passage by the Slovak Parliament, the basic VAT rate will be increased from 19% to 20%. This increase is expected to be temporary, to last until 2013, as the Slovak Republic brings its budget deficit to 3% in accordance with eurozone guidelines. The Slovak Republic has been using the euro since 1 January 2009 but has seen in the last year a significant increase in its deficit due to current economic conditions. The 20% VAT rate is effective on 1 January 2011.

Another amendment in the value added tax act that may affect international companies doing business in the Slovak Republic is a provision where a person liable to pay tax is a taxpayer resident in Slovakia who is supplied goods and services from a foreign person and the place of supply is in Slovakia. This applies in the case where the foreign person is registered as a taxpayer in Slovakia although the foreign person has no permanent establishment in Slovakia and only became a taxpayer to conduct an incidental transaction.

Finance and operating leases

Lessees will depreciate finance-leased tangible property except land acquired after 1 January 2011 according to a standard depreciation schedule. Favorable depreciation of finance-leased tangible property that had been provided in income tax law will be repealed, although hire purchase leases and finance leases concluded before 2011 will still be subject to previous depreciation rules (ie. favorable depreciation).

For this reason, the definition of finance leases is being changed to remove lease term conditions.

When leased property is assigned, the new lessee will apply normal depreciation charges as a newly-acquired asset.

In the case of early termination of finance leasing, in double entry accounting, the lessee will adjust their taxable income by the difference between the leased assets residual value in accounting and its tax-related residual value. When an operating lease is terminated and the leased asset is purchased at a price lower than the residual value after standard depreciation, taxable income will be increased by the positive difference of rent that had been charged and standard depreciation, and the initial value of the acquired asset will be increased by this difference.

Any technical improvements to leased tangible property will no longer be considered under the category of "other assets", but will instead be an increase in the initial value of the leased asset.

Tax withholding

Any taxable person will have an option to have their tax obligation regarded as having been fulfilled when income was withheld for tax. In this case, the withheld income would not be declared on their tax return. However, if the taxable person decided to consider withheld income to be prepaid tax, the withheld income will be included in taxable income and declared on the return.

Dividends and gainful activities subject to social and health insurance deductions

In amendments to laws regarding social and health insurance, the concept of gainful activities is being introduced to incorporate concepts in income tax law, namely when there is a claim for income from dividends, among other income. Gainful activities also include activities where income is not subject to tax due to double taxation treaties. Legal entities which pay out dividends in favor of individuals would be required to pay insurance premiums of 14% of the assessment base on those dividends, while employees, self-employed individuals, voluntary insured persons and government insured persons who earn income from capital assets or other income would be required to pay insurance premiums on this income.

Individuals who have no permanent residence in the Slovak Republic and are insured by a health insurance company outside the European Union and/or are a shareholder, director or member of a corporate body in a company with a registered office in the Slovak Republic, or are employed by an employer whose registered office is in the Slovak Republic, cannot be covered by a Slovak public health insurance company and are not entitled to reimbursement for health care. In the cases mentioned in this paragraph, the 14% assessment on dividends will not apply.

Taxable persons with limited tax liability

For taxable persons with limited liability, income from sources inside Slovakia will also include rent or income from another use of movable objects, which include motor vehicles or other means of transport such as trailers and semi-trailers, railroad

locomotives and fleets of coaches. The amendment includes a listing of the applicable means of transport.

For taxable persons with limited liability, income from sources outside Slovakia will include any transfer of movable or immovable objects. This is a clarification of the difference between the higher value of contributions in kind set off in shareholder contributions and the value of a contributed asset under other income and fair value contributions in kind.

It should be mentioned that this summary is based on amendments to several existing acts that have been proposed as of 15 November 2010. Parliament is scheduled to pass the amendments at the end of November and there may still be further changes. In practice, the full text of the approved Acts of the Slovak Parliament should be used.

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SOUTH AFRICA

Tax Update

The Taxation Laws Amendment Bills for 2010 (the Bills) which were released for public comment in May 2010 have now been promulgated.

With reference to the proposed amendments to domestic tax legislation contained in the Bills indicated in the International Tax Alert dated 5 August 2010, the following has been enacted:

Transfer pricing rules applicable to cross-border transactions expanded

The proposed amendment has now been enacted with the result that the concept of transfer pricing has been broadened in the domestic legislation to incorporate the terms and conditions associated with an entire arrangement undertaken for the benefit of connected parties with a cross border nexus. This amendment will enable the South African Revenue Service (SARS) to impose transfer pricing adjustments if the terms and conditions of a transaction, operation, scheme, agreement or understanding differ from those that would have existed between parties acting independently of each other and the difference confers a South African tax benefit on one of the parties.

Regional holding company regime introduced

The concept of an SA resident Headquarter Company (HQC) which will enjoy tax relief in areas typically affecting foreign investment holding companies resident in SA has now been introduced. The proposed aspects of tax relief as previously indicated in the Bills have been retained in the promulgated legislation.

Briefly, a qualifying HQC will enjoy relief from SA's controlled foreign company (CFC) legislation; Secondary Tax on Companies (STC) on dividends declared to qualifying shareholders; and SA's thin capitalisation rules on qualifying loan funding from foreign investors.

Regional investment fund regime and foreign investment structures

As was proposed in the Bills, SA domestic tax legislation has been amended to ensure limited liability partnerships and companies will be taxed in SA as look-through partnerships provided such partnerships are treated accordingly in the relevant foreign jurisdiction.

Consequently, for purposes of SA tax, a general partner of a partnership (or a trust beneficiary) will be treated as an independent agent in relation to qualifying partners and trustees. Independent agent status means that the activities of a general partner (or trustee) within South Africa will not create a permanent establishment status for the qualifying partner (or trust beneficiary).

Restriction on cross-border interest exemption for non-residents introduced

With effect from 1 January 2013, the current blanket exemption of interest earned by non-residents from tax in SA will be removed by subjecting such interest to a 10% withholding tax. However, interest earned on certain forms of domestic investments, such as government debt instruments, listed debt instruments and bank deposits will not be subject to the withholding tax.

Latest developments in South Africa transfer pricing rules

South Africa (SA) has existing transfer pricing rules which requires that transactions for the supply of goods and services between SA residents and non-residents who are connected persons in relation to one another must be conducted at arm's length prices. The wording of the current rules focuses on isolated transactions and the adjustment of the consideration charged for specific transactions as opposed to overall arrangements driven by an overarching profit objective.

The current transfer pricing rules have been amended with effect from years of assessment commencing on or after 1 October 2011 to bring them in line with the transfer pricing concept found in double tax treaties, which provides for the proper allocation of profits between tax treaty partners where the terms and conditions of transactions between associated enterprises differ from the terms and conditions that would have occurred between independent enterprises. The amended rules no longer merely focus on isolated transactions but rather on any transaction, operation, scheme, arrangement or understanding entered into between SA residents and non-residents who are connected persons in relation to one another.

The new rules empower the Commissioner for the South African Revenue Service to adjust the terms and conditions of a transaction, operation or scheme to reflect terms and conditions that would have occurred between independent persons dealing at arm's length.

In an effort to encourage foreign investors investing in SA, SA has introduced a SA resident Headquarter Company (HQC) regime for years of assessment commencing on or after 1 January 2011 which affords qualifying HQCs tax relief in areas typically affecting foreign investment holding companies resident in SA. The amended transfer pricing provisions and thin capitalisation provisions will not apply to any loan, advance or debt obtained from foreign investors provided such funds are on-lent by an HQC to qualifying foreign companies in which such HQC is invested and the HQC directly or indirectly holds at least 20 per cent of the equity shares and voting rights in the foreign company.

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UK

International Tax Issues

1. Update on UK double tax agreements (DTA)

(a) UK/Qatar DTA

A DTA between the UK and Qatar has been signed for the first time (on 25 June 2009) and will take effect generally from 1 January 2011 (or from 1 January 2004 in respect of profits, income and gains from shipping and air transport). The treaty generally follows the OECD model and the key features are as follows:

The treaty generally exempts dividends from withholding tax where the recipient is the beneficial owner, except in relation to certain collective investment schemes deriving income from immovable property.

Interest is exempt from withholding tax in a number of situations, such as where it is beneficially owned by an individual, a company regularly and substantially traded on a stock exchange or a company at least 25% owned by residents of Qatar.

Royalties are generally subject to a 5% withholding tax rate.

The treaty includes both a 'non-discrimination' and a 'mutual agreement' procedure article.

(b) UK/South Africa DTA

A protocol amending the UK/South Africa DTA was signed on 8 November 2010.

South Africa is changing its system of taxing dividends paid to non-residents by abolishing its secondary tax on companies and introducing a withholding tax. The Protocol amends the provisions of the Convention dealing with the taxation of dividends to set limits to the withholding tax. The rates will be as follows:

- a. 5% of the gross amount of the dividends if the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividends
- b. 15% of the gross amount of the dividends in the case of qualifying dividends paid by a UK resident real estate investment trust, or an equivalent entity resident in South Africa
- c. 10% of the gross amount of the dividends in all other cases.

The Protocol also updates the provisions dealing with the exchange of information between the UK and South Africa and introduces a new provision regarding assistance in the collection of taxes.

The Protocol will enter into force once both countries have completed their legislative procedures and will take effect in both countries in respect of dividends from the date that South Africa changes its system of taxation at the shareholder level and for the other provisions from the date that it enters into force.

2. Controlled Foreign Companies – interim improvements

HM Treasury has issued details of measures it is considering as part of an 'interim improvement' of the controlled foreign companies (CFC) regime which subjects the profits of subsidiaries of UK companies to UK corporation tax in certain circumstances. The improvements are expected to be implemented in 2011, before a more substantial set of reforms is enacted, scheduled for implementation in 2012. The aim is to simplify the existing rules, making them easier to operate and, where possible, enhancing the UK's competitive position.

A working group has been set up to assist with the design of these measures so they may well develop over the course of the coming months. However, the improvements currently being suggested are set out below.

Broadly speaking, the Government would like to provide an exemption for foreign-to-foreign transactions where there is no erosion of the UK tax base (so called 'commercially justified' activities). This could include a full exemption for transactions involving intellectual property that clearly have no connection with, or impact on, the UK tax base. This could be implemented either through a brand new exemption, or an extension of the existing rules (known as the exempt activities and motive tests).

The Government also recognises that it needs to assist UK multinationals to make overseas acquisitions and reorganisations. As such, it is considering extending the period of grace under which newly acquired subsidiaries are exempt from the rules.

Other suggested improvements include:

- An increase in the threshold for 'chargeable profits' from £50,000 to £200,000, below which the subsidiary is not subject to these rules.
- A relaxation of the requirement that a CFC must be effectively managed in its territory of residence to qualify for the Exempt
- Activities Test.
- Amendments to HMRC guidance to assist with self-assessment of the CFC position of joint venture companies and US LLCs.

3. Changes to the tax rules applicable to capital distributions

As reported in earlier International Tax Alerts, a UK dividend exemption regime has applied since 1 July 2009 such that, in most cases, UK resident companies and UK permanent establishments of foreign companies are not subject to tax on dividends received from UK and overseas companies. As originally worded, this exemption regime does not apply to distributions 'of a capital nature'.

Changes will be introduced through a Finance Bill, which is currently being debated in Parliament, so that distributions of a capital nature (arising, for example, from a capital reduction) will be included within the exemption regime (with effect from 1 July 2009). This amendment will have no effect on the tax treatment of disposals, such as where a subsidiary repurchases share capital from its parent.

Companies will be able to elect to disapply these rule changes for distributions made before 22 June 2010 if the changes put the company in a less favourable position.

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USA

Clarification of Economic Substance

I. Introduction

On 30 March 2010, the Health Care and Education Reconciliation Act of 2010 was signed by President Obama. The Act “codified” and clarified the judicially created economic substance doctrine (the ES doctrine) by adding new subsection 7701(o), “Clarification of Economic Substance Doctrine” to the Internal Revenue Code. Under the economic substance doctrine, anticipated tax benefits from a transaction may be denied notwithstanding the fact that all statutory and administrative requirements are satisfied if the transaction does not result in a meaningful change to the taxpayer’s economic position other than a purported reduction in federal income tax.

The goals of codification, as stated by the Joint Committee on Taxation (JCT) include:

- To provide partial certainty by resolving the lack of uniformity in different judicial versions of the tests
- To increase level of profit and business purpose required relative to some tests stated by courts
- To change taxpayers’ cost-benefit analysis and deter some aggressive taxpayer behaviour.

Although cross-border transactions were not specific targets of the legislation, economic substance is relevant in evaluating many cross-border transactions. Going forward, the new economic substance statute will likely play a larger role in litigation and controversies concerning issues such as transfer pricing.

II. Summary of provision

Internal Revenue Code section §7701(o), provides a two prong test so that “in the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if:

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer’s economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.”

The potential for profit will not be considered in determining whether the transaction meets these requirements unless “the present value of the reasonably expected pre-tax profit from the

transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.” In determining pre-tax profit, fees, and transaction expenses, and to the extent provided in regulations, foreign taxes would be taken into account.

However, before the two-prong test is applied, it must be determined whether the economic substance doctrine is relevant to the transaction. The determination of whether the economic substance doctrine is relevant to a transaction is specifically stated as to be made “in the same manner as if this subsection had never been enacted.” The JCT report states that “if the realization of the tax benefits of a transaction is consistent with the Congressional purpose or plan that the tax benefits were designed by Congress to effectuate, it is not intended that such tax benefits be disallowed.”

A new 40% strict liability penalty would be imposed on underpayments resulting from transactions found to lack economic substance or failing to meet the requirements “of any similar rule of law.” The penalty would be reduced to 20% of the underpayment if the transaction were disclosed by the taxpayer. However, in September 2010, Service officials advised Examination teams that the new penalty could not be issued without review by an appropriate director of field operations.

III. Application to cross-border transactions

Based on the strict language of the statute, it appears that there are many transactions generally thought to involve legitimate tax planning that would not satisfy the standards for economic substance, so the question of whether the doctrine should be applied may be the most critical question in the analysis.

The JCT report outlines what many refer to as “safe harbors” under the provision. According to the JCT report “the provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages. Among these basic transactions are:

1. the choice between capitalizing a business enterprise with debt or equity
2. a US person’s choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment
3. the choice to enter a transaction or series of transactions that constitute a corporate organization or reorganization under subchapter C

4. the choice to utilize a related-party entity in a transaction, provided that the arm's length standard of section 482 and other applicable concepts are satisfied."

Though the report specifically lists related party transactions, it appears that its inclusion is conditional upon the transaction satisfying the conditions of Section 482 and all applicable concepts. The term economic substance is already referred to in the transfer pricing regulations and it remains to be seen whether the term, as used in the regulations, will be interpreted under the guidance of the new statute, or continue to be interpreted under applicable common law. Though there are no bright lines in transfer pricing analysis, the addition of the economic substance provision complicates matters further.

The substantial penalties associated with the new provision, along with the requirements of the new schedule "Uncertain Tax Positions," and the existing transfer pricing regulations will inevitably impact how tax advice is rendered and only serves to highlight the importance of proper compliance.

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FATCA – US tax legislation with global implications – many potential unintended consequences

The US Treasury has long been concerned that US citizens and companies are hiding substantial income abroad. Recent US legislation targeted to this issue raises significant reporting and practical concerns for other countries. Keep in mind as you read through the rest of this that the stated purpose is to find and identify US persons or companies who are purportedly hiding income outside the US.

The recently enacted (March 2010) Foreign Account Tax Compliance Act (FATCA) as part of the Hiring Incentives to Restore Employment Act (HIRE). The FATCA provisions had been under consideration of several months and are targeted, as noted, at US taxpayers who are failing to report their taxable US income to the US.

The new US rules, arguably an over-reaction, require US payors to withhold 30% from virtually any payment to any foreign entity unless that entity meets reporting and documentation requirements as broadly stated in the legislation and as further defined by the Internal Revenue Service in Regulations. The legislation addresses "Withholdable payments to foreign financial institutions" and also "Withholdable payments to other foreign entities" (new Internal Revenue Code Sections 1471 and 1472). The new rules will generally be effective for payments made after December 31, 2012.

Foreign financial institutions

Foreign financial institutions (FFIs) are defined very broadly as foreign entities that:

1. accept deposits in the ordinary course of banking or similar business
2. as a substantial part of their business, hold financial assets for the accounts of others
3. are engaged primarily in the business of investing, reinvesting, or trading in securities partnership interests or commodities. The definition also includes any other interest (such as derivatives) in such securities, partnership interests or commodities.

Under the legislation, FFIs are required to enter into an agreement with the Secretary to annually report extensive information about each financial account held by a US person or a US-owned foreign entity.

Payments beneficially owned by foreign governments, international organizations, and foreign central banks are exempted from the FFI withholding requirements. In addition, the Secretary has the authority to exempt any other class of persons identified as posing a "low risk of tax evasion."

Non-financial foreign entities

Non-financial foreign entities (NFFEs) are defined as any foreign entity, including corporations, partnerships, and trusts, that is not a foreign financial institution. NFFE's must provide the US withholding agent with either (a) certification that the NFFE does not have any substantial US owners, or (b) the name address and tax identification number of each substantial US owner. The US withholding agent must not know or have reason to know that the information provided is incorrect, and must report the information to the Secretary of the Treasury. Substantial US ownership for this purpose is defined as more than 10% direct or indirect ownership except in cases where the US owner is a financial institution. In this case the requisite ownership is more than 0%.

Other than the requirement to identify indirect 10% US owners, the documentation and reporting requirements for NFFEs seem to be less onerous than those for FFIs.

In addition to the exceptions granted to FFI payees, the following NFFEs are also exempt:

1. Publically traded companies
2. Foreign corporations that are members of the same "expanded affiliated group" as the US payee, and
3. Entities organised in US possessions, and wholly owned by residents of the possession.

Withholding

Withholdable payments with respect to both FFIs and NFFs include:

- (i) any payment of interest (including any original issue discount, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and any other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and
- (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.

Withholding agents are liable for the tax required to be withheld. Beneficial owners of payments withheld upon will be allowed to file claims for refunds from the US Treasury in cases where the withheld amount is in error, even if the withholding was initially proper due to incomplete disclosures. Refunds, when available, are limited to the 30% withheld less the withholding that would have been required under an applicable US income tax treaty. Claims for refund will likely be particularly common when the withholding is 30% of the sale price of a US asset producing interest or dividend income.

Certain US payors excepted from withholding requirements

The legislation exempts a number of US institutions or organizations from the requirement to withhold including:

1. Publically traded corporations, and certain corporations related to the publically traded corporation

2. Federal, state and local governments, the District of Columbia, US possessions and any wholly owned agency or instrumentality of the same

3. Any bank

Real estate investment trusts, regulated investment companies, common trust funds, and certain tax exempt trusts.

Conclusion

Much of the impact of this legislation will depend upon how the Internal Revenue Service and Treasury execute in the implementation of the new rules. As one might expect there have already been numerous requests for the Secretary's exemption under the "low risk of tax evasion" exception. Treasury officials have stated that they will focus first upon identifying carve-outs or exempt foreign entities along with further definition of terms such as "financial institution" and "US accounts". IRS Notice 2010-60, issued in October 2010, addresses many of these questions and raises others.

Also of concern to many practitioners and commentators are the likely unintended consequences of this legislation. Will FFIs choose not to accept US depositors or investors? Or will they choose to abandon further investment in the US unless exempted from these rules? How will foreign organizations who wish to comply with these rules reasonably be able to identify their depositors or owners who become US tax residents during the year? How will other countries respond?

There has been talk of repeal of some of the 2010 US tax reporting legislation by the newly elected US Congress next year but there has been no discussion to date about a repeal of the new withholding rules.

Stay tuned. There is much more to know and to do about these new rules.

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