

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

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In this edition

Argentina – Tax Treaty with Austria revoked	4
Cr Gustavo Director outlines the details of the termination of Argentina's tax treaty with Austria, beginning 1 Jan 2010.	
Australia – Taxation of Financial Arrangements	5
John Murray highlights the key rules pertaining to taxation of financial arrangements entered into from 1 July 2010 onwards.	
Austria – Amendments to the Corporate Income Tax Act 2009	6
Thomas Ausserlechner discusses the recent changes to the Corporate Income Tax Act.	
China – Strengthening Tax Collection and more Anti-avoidance measures	8
Edmund Chan analyses the various tax enforcement measures introduced to strengthen the tax system in China.	
Czech Republic – Information on Income Tax 2009 changes	14
David Cervinka comments on some of the changes announced in the Income Tax Law.	
Germany – Changes in Taxation of Non-residents	15
Dirk Altenbeck, Matthias Heinrich and Julia Meyer outline the changes in taxation for non-residents, particularly relating to withholding tax.	
Hungary – Major developments in taxation in 2009 and 2010	16
Vadkerti Krisztián summarises the tax law changes coming into effect from 1 July 2009 together with the guidance provided for 2010.	
India – Tax Update	19
S Hariharan, discusses the recent judgments pertaining to international taxation which are likely to have a far-reaching impact on foreign companies operating in India.	
Israel – Tax Reform Amendment 168	25
Shaul Tabach comments on the definition changes introduced in Amendment 168 and on the double taxation treaty signed with the United Kingdom.	

Italy – Tax Update	27
Salvatore Del Vecchio provides updates to various tax rules and the ratification of the Italy-US tax treaty.	
Japan – Tax Reforms on interest income issued by Foreign Corporations	29
Eiko Nakamoto highlights the recent tax reforms regarding interest income issued by foreign companies.	
Jordan – Tax Update	30
Mohammed Khattab provides a reminder of the incentives provided for both foreign and domestic investors while doing business in Jordan.	
Korea - Major Revisions	34
James Yoo discusses the major revisions to the corporate income tax and the tax incentive limitation laws in Korea.	
Malaysia – Recent Tax changes	35
M B Gathani and Lau Chin Chin summarise the recent changes to the various tax laws in Malaysia announced in the mini-budget.	
Portugal – New Accounting System and Tax Legislation in 2010	38
José Ramos highlights the provisions of the new accounting system and tax legislation to come into effect from 2010.	
Romania – Minimum Income Tax	39
Carmen Mataragiu comments on the changes to the tax code and tax procedures.	
Singapore - New measures introduced in the 2009/10 budget regarding taxation of companies	42
Wally Lee describes the significant new measures introduced in the 2009/10 budget in regard to the taxation of companies in Singapore.	
Slovak Republic – Changes in Income Tax and VAT Law 2009	46
Richard Clayton Budd, discusses the changes to the Income tax and VAT laws.	
Taiwan – Tax Update	48
Wisdom Lee outlines the recent changes to the various tax rules in Taiwan.	
Thailand – Tax Update	49
Damian Norris analyses the changes to the Corporate and Personal Income Tax rules in Thailand.	
United Kingdom – Tax Update	51
Ian Bingham summarises the main provisions of the tax laws announced in the Budget.	
US - Chicago – Changes to International Tax Landscape	56
Thomas B Murtagh discusses the tax proposals made by the Obama administration which, if implemented, would affect the effective tax rate of multinational corporations.	
US – Houston - President Obama’s proposed international tax proposals will bring big changes for multinational companies	58
Frank Landreneau discusses how US rules regarding deferred compensation can cause problems for non-US companies with US tax residents as employees.	

US – New York - Offshore Voluntary Disclosure Program

59

Leo Parmegiani discusses the IRS guidance on its Offshore Voluntary Disclosure Program. IRS guidance comes in the form of responses to Frequently Asked Questions (FAQs).

Argentina: Tax Treaty with Austria revoked

Argentina has given Austria a notice of termination of the Tax Treaty that had been in effect since 1983. The notice was sent through diplomatic channels on 26 June 2008.

The Official Authority said that the notice of termination was sent as a result of the special treatment given to government securities issued by Austria.

The convention ceased to have effect in respect for taxation years beginning after 31 December 2009.

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Australia – Taxation of Financial Arrangements

After a consultation period of more than a decade, Australia has finally introduced a tax regime that seeks to cover the tax treatment of financial arrangements. Specifically, the rules outline tax timing issues and enable taxpayers to elect to more closely align the tax treatment of financial arrangements with that adopted for financial accounting purposes.

In general, gains and losses from financial arrangements will be treated on revenue account, with one exception being the treatment of hedges where the tax classification of the hedge will be matched to that of the hedges item.

The effective date for the rules is 1 July 2010. Any financial arrangements entered into on or after that date will attract the new rules. There is an option to “opt in” early and apply the rules to financial arrangements entered into on or after 1 July 2009.

Further, there is an option to bring in “open” financial arrangements; that is arrangements on foot at the effective date the rules apply. Any unrealised gains or losses at that time are brought to account over four years.

It is important to note that certain exemptions to the rules exist. One such important exemption applies to entities that are not individuals and have an aggregated turnover of less than A\$100 million, hold financial assets with a total value of less than A\$100 million, and hold assets with a total value of less than A\$100 million.

Should you be entering into financial arrangements in Australia, we recommend you consult with your PKF Tax Partners to ascertain whether the new rules will apply and what impact the rules may have.

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Austria - Amendments to the Corporate Income Tax Act 2009

The Austrian parliament has recently passed a law amending the Corporate Income Tax Act with effect from 1 January 2009.

Previously, proceeds from an international participation were only tax-free if the shares were held in a legal entity comparable to an Austrian corporation, with a minimum share of 10% and a minimum holding period of one year.

This was deemed to be not in line with the Common European Law and regarded as a violation of the principle of equality. Therefore, the case was brought to the Supreme Administrative Court of Austria (VwGH 2008/15/0064) and subsequently to the European Court of Justice which judged that the current regulation was not in line with European Common Law.

As a consequence, the international holding privilege has now been adopted to meet EU rules.

What has changed?

Proceeds from participations with a share under 10% in legal entities domiciled in the EU or in a country of the European Economic Area (EEA) are tax-exempt provided that:

- the foreign entity is not tax-exempt in its home country or subject to a tax rate lower than 15% and
- the legal entity corresponds to Article 2 of the Directive Nr. 90/435/EEG or
- (for all EEA cases) a mutual comprehensive administrative assistance in tax matters is in place.

Proceeds from equity holdings exceeding 10% are tax-exempt regardless of the domicile provided that:

- the entity is comparable to an Austrian corporation and
- the foreign company is subject to a taxation level which is similar to Austria (ie 25%).

In all other cases, proceeds from an international participation are subject to corporate income tax (at the regular rate of 25%) in Austria. Possible

foreign withholding taxes can be credited against the Austrian corporate income tax according to the "credit method".

Adjustments in the Austrian group taxation

The Austrian group taxation system was introduced (among other aspects also) in order to attract and retain more international holding companies. The system allows to off-set losses of foreign group member companies against the profits of the parent company in Austria.

The taxation has been deferred until the foreign group member has been able to deduct these losses from profits in consecutive periods.

The new regime has tightened the rules to avoid deferred taxation in perpetuity. Economic reasons, such as a significant decrease of the scale of a business unit, will also now trigger subsequent taxation of foreign group losses deducted previously.

Changes of Double Tax Treaties

Since the 1 January 2009, the revised double tax treaty with Denmark and the newly concluded double tax treaty with Albania are applicable. In essence, both treaties correspond to the OECD Model Convention.

INTERNATIONAL TAX ALERT



Other recently revised double tax treaties are:

- Greece (applicable as of 1 January 2010)
- Turkey (needs to be ratified).

Newly concluded double tax treaties (need to be ratified are:

- Bosnia-Herzegovina
- Vietnam
- Bulgaria (already signed)
- Syria (already signed)
- Oman (on hold).

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China – Strengthening Tax Collection and More Anti-avoidance Measures

To ensure stable tax revenue growth, the State Administration of Taxation (“SAT”) has strengthened tax enforcement measures, including tax audit and anti-avoidance rules.

Anti-Avoidance Measures

Tax Audit Targets

Tax administration software is used to process the Related Party transactions annual reporting forms (“RPT Reporting Forms”). The RPT Reporting Forms consist of nine forms, of which Forms 1 to 7 are mandatory for all enterprises. For the other two forms, the Outbound Investment Form (Form 8) is only applicable for tax residents of the People’s Republic of China (“PRC”), while the Outbound Payment Form (Form 9) is applicable for all types of taxpayers, both PRC resident and non-resident.

The use of the software allows the tax authorities to compile and manage transfer pricing annual filing information and build a database to ***select targets for transfer pricing audits.***

Moreover, in 2009 SAT will place greater emphasis on tax audits across the country, with particular attention to the enterprises with the following characteristics:

- non-PRC resident enterprises
- major taxpayers which have not been inspected for more than three years
- with outbound investment or overseas subsidiaries
- entitled to tax refunds or exemptions on exports (including “Exempt, Credit, Refund”), especially central processing unit
- Operating in the following industries:
 - Clothing and shoe production
 - Electronic and telecommunications equipment production
 - Contract manufacturing of computers
 - Fast food restaurants
 - Large-scale retailers
 - Beverage production
 - Elevator production
 - Automobile manufacturing

 - Financing for construction of infrastructure
 - Tyre manufacturing
 - Pharmaceutical industry
 - Hotel chains
 - Large-scale chain supermarkets and TV shopping
 - Construction and installation
 - Private medical and educational/training services
 - Agency
 - Branded dealership and distribution
 - Auctions.

The tax authorities will also select an enterprise as an investigation target if it is required to prepare contemporaneous documentation on transfer pricing but fails to do so.

Related Party Transactions between PRC Domestic Enterprises

A PRC enterprise with foreign shareholding less than 50% with related party transactions only in the PRC is not required to prepare contemporaneous documentation. However, this does not mean that special tax adjustments will not be imposed on related-party transactions between two domestic enterprises. SAT will consider the effective tax rate of the investigated enterprise and its domestic related party to determine whether special tax adjustments will be imposed.

“The effective tax rate” would be the income tax actually paid divided by the taxable income, taking into account financial subsidies, the effect of tax holidays, and losses carried forward.

Anti-avoidance for Tax Treaties Abuse

New rules were issued to restrict non-PRC investors' ability to enjoy treaty benefits in respect of dividend from the PRC resident enterprise. The non-PRC investor has to obtain and maintain the following documentation:

- the tax residency certificate issued by the tax authority (or its authorized representative) of the other treaty country, in addition to the legal and factual support to residency status
- tax, if any, paid by the recipient of dividend in the other treaty country, particularly information on tax on dividend from a PRC resident enterprise
- the tax residency status of the recipient of dividend, ie whether it is a tax resident of a third country or region or of the PRC
- supporting documents for the non-PRC investor's entitlement to the dividend from the PRC resident enterprise, such as investment contracts, share certificates, profit allocation resolution, payment certificates and other ownership evidence
- information on the non-PRC investor's shareholding in the PRC resident enterprise
- other relevant information.

If there is no legal and factual support to claims of tax residency status of a treaty country or the primary purpose of the transactions or arrangements is to enjoy a favourable or preferential tax treaty, the tax authorities may make adjustments for the improper treaty benefits enjoyed.

Guidance on Tax Residency Status of Overseas Incorporated Enterprises

SAT will treat overseas incorporated enterprises as PRC tax residents if certain criteria are met. “The enterprise” which satisfies the following conditions shall be considered to have the place of effective management in the PRC and recognised as a resident enterprise:

- Senior management responsible for the enterprise's daily business operations are mainly located in the PRC and the senior management carry out its duties mainly in the PRC
- Critical financial decisions are made and appointment of key personnel approved by organizations or personnel located in the PRC
- Major assets, accounting records, company chops/seal, board of directors'/shareholders' meeting minutes etc. are maintained in the PRC
- 50% or more of the board of directors or senior management habitually reside in the PRC.

Worldwide income shall be subject to Enterprise Income Tax (“EIT”) if an enterprise is recognised as a tax resident enterprise of the PRC. This will widen the tax net of the PRC.

Although the new rule focuses on overseas incorporated enterprises whose major shareholder is a PRC enterprise or group and are controlled by PRC enterprises, this may be useful reference for the interpretation of the “tax residency” concept in the EIT Law and its Implementation Rules.

There is another implication for corporate investors of such overseas incorporated companies with shares listed in overseas stock exchanges, such as China Mobile Limited and China National Ocean Oil Corporation listed in the Hong Kong Stock Exchange. Dividend declared by such overseas companies whose major shareholders are PRC enterprises is subject to PRC withholding income tax of 10%. This affects the return to the foreign shareholders.

Tax Administrative Measure for Non-resident Enterprises

While the overseas incorporated enterprises controlled by a PRC enterprise fall into the PRC tax net, non-resident enterprises that contract in projects or provide services in China are required to perform tax registration and tax filing starting from 1 March 2009. The enterprises should perform registration, record-filing and de-registration with their in-charge tax authority. They are also required to file EIT return quarterly and annually, regardless of whether they make loss or profit, and settle tax payment upon completing

their projects. These measures are to strengthen the collection of taxes from non-resident enterprises.

Tax Administrative Measure for Withholding Agents

Besides the new tax administrative requirements imposed on the non-PRC resident enterprises, the withholding agents **must** submit a copy of signed contract (including revised or renewed contracts) along with a registration to the tax authority within 30 days of signing of the contract. In addition, the tax withheld, together with the tax return, should be remitted to the tax authority within seven days after the taxes become payable.

The non-resident enterprises are required to pay the taxes if the withholding agent does not fulfill the withholding obligation.

SAT implements several measures for attacking tax avoidance or evasion activities including collection and analysis of data; more registration and filing requirements; anti-avoidance rules; and widening of tax net and tax audit.

More Restrictive Tax Rules for Corporate Restructuring

Even though enterprises which have undertaken corporate restructuring are one of the targets for tax audit, restructuring continues to be carried out in China.

The new tax rules cover:

- Equity acquisition
- Asset acquisition
- Merger
- Split off
- Change of legal form of an enterprise
- Debt restructuring.

For those corporate restructuring not satisfying a specific set of criteria in the tax rules, **taxable gain or loss will be recognised at the time of the transaction** and **tax losses may not be carried forward** in the case of a merger or split off.

Corporate restructuring that satisfies the following criteria may qualify for “special tax treatment”:

- the restructuring is for reasonable business purposes
- not less than 75% of assets or equity of the acquiree is acquired
- no change of the business operation for 12 months after restructuring (continuity of substantive operations)
- at least 85% of the total consideration paid by equity instrument
- the major shareholders of the acquiree must not transfer the acquired stock for 12 months after the acquisition (continuity of ownership).

“Special tax treatment” includes:

- deferral, but **not exemption**, of EIT on gains or losses on the transfer of assets and liabilities settled by equity instruments
- tax losses carried over in the case of merger although such losses are limited to fair value of the net assets acquired multiplied by interest rate of longest term government bond at end of the year in which merger occurred
- tax losses carried over in the case of split off
- acquirer's tax basis of the property received allowed to be the same as the transferor's tax basis of such property (ie the historical tax basis is adopted).

Cross-border group restructurings, such as transfer of equity of a PRC enterprise from a non-resident enterprise to its 100% directly-owned non-resident subsidiary, also qualify for “special tax treatment”, provided that the withholding tax rate applicable to the 100% directly-owned non-resident subsidiary is the same as the tax rate of the transferor and the transferor does not dispose the shares of the 100% directly-owned non-resident subsidiary and other aforementioned criteria are met.

For restructurings that do not qualify for “special tax treatment” or acquired shares or assets settled by non-equity consideration, the tax bases of the shares or assets received in the restructuring would have to be adjusted upward or downward to fair value accordingly.

As the “special tax treatment” for corporate restructuring is elective, acquirers should evaluate the pros and cons of applying “special tax treatment” even if qualifying criteria are met.

Once this special tax treatment is elected, taxpayers must submit relevant documentation to substantiate the qualification for the “special tax treatment” along with their annual EIT filings.

Failure to do so will result in the denial of the tax-deferred treatment.

Tax Incentives

While SAT tightens the anti-avoidance measures, additional tax incentives are provided by the PRC tax authority.

EIT Incentives for Clean Development Mechanism (CDM) Projects

The Ministry of Finance (MOF) and the SAT set out EIT incentives available to CDM project enterprises and the China CDM Fund. The policy shall be effective retroactively from 1 January 2007. The preferential tax policies include exclusion of the PRC government portion of revenue from transfer of carbon emission and tax holidays for income derived from specified CDM projects.

Accelerated Depreciation Allowances for Fixed Assets

More implementation details for accelerated depreciation allowance of fixed assets, including qualifications and calculation method, have been released.

An enterprise should file the application to the tax authority ***within one month*** of purchasing the fixed asset.

In addition, the tax authority will perform an on-site review of the working environment and condition of the fixed asset(s) adopting the accelerated depreciation method to check whether the requirements for the accelerated depreciation are met.

Other Incentives

To promote export of goods, the Ministry of Finance (MOF) and the SAT announced increase in the value-added tax (VAT) refund rates for export of certain commodities including textiles, clothing and electronic information-related products, as well as certain light industrial products and industrial chemical raw materials.

For the property development industry, presumed gross profit margins on pre-sold property under development (except for certain types of properties) for calculation of taxable profit is reduced by 5%.

More Supplementary Rules, Detailed Implementation Rules/ Guidelines on New EIT Law

Tax Deductibility of Asset Losses

Detailed rules on the EIT deduction of asset losses were issued to clarify the scope of asset losses and criteria for tax deduction.

The enterprise has to provide the valid documents, including economic certification issued by qualified professional bodies and other legally acceptable evidence to certify the actual asset losses.

Other Guidance on Application of CIT Law

SAT issued further guidance on tax treatment of several items as follows:

- Deferred income items
- Recognition of interest, rent and royalty income
- Losses caused by the additional deduction of 50% of R&D expenses
- Revenue basis for calculating the deduction limit for entertainment expenses, advertising and promotion expenses
- Provisions for assets impairment or risk reserves
- Pre-start-up expenses.

Value Added Tax (VAT)

Further Guidance on VAT Treatments on Fixed Assets

Before the VAT reforms in 2009, there was usually no input VAT credit on purchase of fixed assets, except in certain regions for certain industries. SAT clarifies that, if the input VAT attributable to the fixed assets has not been and is not allowed to set off against output VAT, the applicable VAT rate on disposal of *self used* fixed assets is 2% and no input VAT available for the buyer. If not, the applicable VAT rate is 17%.

For equipment which has been imported for self use before 2009 to qualify for duty free treatment, it has to be supervised by the PRC Customs for a certain period (usually five years). Early release from supervision is allowed after payment of customs duty and VAT. Compared with domestically purchased fixed assets for self use, VAT paid for these imported equipment is VAT creditable if the relevant VAT invoices are obtained from Customs after 1 January 2009.

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Czech Republic: Information on Income Tax 2009 changes

The key points arising from the introduction of Income Tax Law No. 586/1992 Collection are as follows.

The 2009 rate of the income and withholding tax for individuals finally remains on the same level as 2008 being 15 %, despite previously announcements of a planned drop to 12.5 %. The corporate income tax rate is reduced for 2009 from 21 % to 20 % with further reduction to 19 % for 2010.

There is a small reduction of social security insurance rate paid by employee and self-employed persons (12.5 % down to 11.5 % of a gross wage). Due to the worldwide financial crisis, the government intends to reduce social security insurance paid by employers, which is currently at the level of 26 %.

Already for the period of 2008, more strict thin capitalization rules are being applied, in particular for capital or other way related parties. The Income Tax Law Amendment for 2009 allows the omission of thin capitalization rules for unrelated parties with a possibility of retroactive application for the 2008 year.

In 2009, financial expenses (interest and other financial costs such as loan arrangements and guarantee fees) are non-deductible for where related party loans and credits exceed two times of the borrower's equity (three times if the borrower is a bank or insurance company). They are not included on subordinated debt and where the interest rate or the maturity of interest is derived from the borrower's profit.

There are also small changes in the tax exemption for dividend income and business share transfer income of parent company derived from a subsidiary company. The tax exemption is valid for dividend or other profit share income paid out by Czech subsidiary company (either resident or non-resident) to parent company (either resident or non-resident) under the conditions that:

- the parent company holds at least 10 % of the capital of the subsidiary
-
-
- both companies are resident in EU or its permanent establishment is resident on Czech territory.

A similar exemption is valid for income derived by the parent company for a share transfer in its subsidiary. From 2009, dividend income tax exemption applies for tax residents of Norway, Iceland and Switzerland. In relation to Switzerland, the tax exemption previously valid for dividend income of the Czech parent company coming from Swiss subsidiary is not valid any more while vice versa still remains. Based on conditions of the double taxation agreements, the dividend and business share transfers income of the parental company in subsidiary in the third countries is subject to tax exemption from 2008.

Income coming from Czech-based company business share transfer is newly considered as Czech-sourced income (previously just income paid by tax resident). The tax exemption described under the point 4 remains valid.

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Germany – Changes in Taxation of Non-residents

From 1 January 2009, the German legislative body changed the rules for taxation of non-residents. In particular, the legislation concerning withholding tax is affected and the following article explains the current rules for withholding tax in Germany.

Individual persons without domicile or habitual residence in Germany are taxable in Germany with income from German sources. The same applies for corporations without registered office or management in Germany.

A German company which pays remuneration for specific services to individual or legal persons not resident in Germany is obliged to withhold taxes for these payments.

The taxes have to be withheld for the following allowances:

- Artistic, sporting, entertainment or similar services if derived from appearances in Germany
- amounts paid as consideration for the use of, or for the privilege of using, any copyright, industrial property right, industrial, commercial or scientific experience, eg plans, samples, methods (royalties)
- supervisory board members.

Allowances paid to non-resident artists, sportsmen and actors from exploitation of their appearances or their work (eg in TV, radio and exhibitions), if the appearances did not take place in Germany, are no longer subject to withholding tax. The same applies to allowances for authors, journalists, cameramen and photographers, as far as the allowances paid are not for use of rights (as above).

The tax is 15% plus solidarity surcharge (5.5%) which leads to a total tax of 15.83%. For members of boards of directors, the tax rate is 30% (31.65 % including solidarity surcharge). Income from these sources may be exempt from German taxation under a double taxation treaty. Reduction or exemption from taxation according to a double taxation agreement is granted only upon application. If the claim is made in advance, the German company is allowed to reduce the withholding tax or refrain from tax withholding. There is also an option to make the claim afterwards but, if so, the tax has to be withheld and then the German tax authority will refund the taxes after claiming.

A remaining tax is final for individuals without a business (eg permanent establishment) in Germany. Individuals with business in Germany and corporations are obliged to make a tax assessment in Germany. The withholding tax will be credited against the assessed income tax.

For persons who are resident in an EEA country some special rules apply. They may opt to deduct related expenses during the withholding process. The withholding tax rate is 30% (31.65% including solidarity surcharge) for individuals and 15 % (15.83% including solidarity surcharge) for corporations resident in EEA. Furthermore, they always have the option for a tax assessment. The withholding tax will be credited against the assessed income tax.

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Hungary – Major developments in taxation in 2009 and 2010

The Hungarian Parliament has adopted the changes of the tax acts effective from 1 July 2009, and the proposal for the legislation from 2010 has already been submitted to the Parliament.

Changes from 1 July 2009

We summarise the major features of the new legislation.

The main aim of the changes is to make the Hungarian economy more competitive and to handle the effects of the financial crisis. The increase of VAT and excise duties allows the decrease of personal income tax and social security contributions.

Value Added Tax

The standard rate of VAT will be increased to 25% from 1 July 2009.

A new discount rate of 18% will be introduced for the following products and services:

- Milk, dairy products
- Bread and other pastry
- District heating.

The discount rate for district heating is planned to be effective only from 1 August 2009 because the European Commission has to be informed first. The Commission will decide in three months' time whether to allow the 18% rate for this type of heating.

Personal Income Tax

The annual taxable income up to which the 18% rate can be applied is going to increase as of 1 July 2009 but the changes will be effective for the whole year of 2009.

Personal Income Tax:		
Annual taxable income		
0 - 1,900,000 HUF		18 %
Annual taxable income		
1,900,001 HUF -		36 %

Social Security Contributions

The rate of social security contributions is going to be decreased from 29% to 26% up to a monthly taxable income of 143.000 HUF. The part of the income above the limit is taxed at 29%.

The rate of employer's contribution will decrease from 3% to 1% up to a monthly tax base of 143.000 HUF, while it remains unchanged above this amount. The rate of entrepreneurial contribution is to be decreased from 4% to 2.5% up to the above mentioned limit.

Expected changes from 2010

The Ministry of Finance has already revealed the guidelines of the legislation expected to be adopted for 2010.

Measures against offshore companies

The pre-tax profit will be increased by the after-tax profit of the controlled foreign companies (CFC) less the dividend paid, in proportion to the ownership share. In case of individuals, the same amount will be deemed as income, and taxed at the standard 17/32% rates.

Companies can reduce their corporate income tax base by the dividend received from CFC that is accounted as revenue (but this may not exceed the above increase of tax base).

Incentives for employment

The rates of personal income tax are to be decreased to 17% up to an annual taxable income of 5 million HUF, and 32% above this limit. However, it will be charged on a wider tax base, which will then include the social security contribution as well.

Most of the personal income tax exemptions will be abolished, including the exemption for insurance, costs of education, and supplementary fees to pension or health insurance funds. The currently exempt benefits in kind are also going to be taxed, except for social benefits.

The decreased rates of social security contributions will apply to the whole of the taxable income from 2010.

Changes in the taxation of property

A new, value-based tax will be introduced on property worth at least 30 million HUF. The annual payable tax will be 0.35% of the value up to 50 million HUF and 0.5% on the part of the value above the limit. The tax will be based on the market price of the property. Similar tax will be introduced on certain tangible assets (boats, planes, luxury cars).

From 2010, if a foreign shareholder sells or otherwise disposes of its share in a company owning property, it will be deemed as subject to corporate income tax, and will be taxed on the transaction.

The rules of registered participation will not apply to shares in companies that own property, so the sales of such participation will be taxed according to the general rules. Companies will qualify as property owning companies if 75% of the market value of their assets is property.

The rates of duty on the acquisition of property will be significantly decreased from 1 January 2010. However, the acquisition of shares in property owning companies will also be subject to the duty.

To mitigate the effects of the crisis, leaseback transactions (ie selling and leasing back the property, and buying back at the end of the lease period) will receive temporary exemption from the duty.

Other changes

The rate of simplified entrepreneurial tax will be increased to 30% from the present 25%.

Due to the changes in the Accounting Act, all enterprises can choose to do the bookkeeping and prepare the annual reports in euros.

INTERNATIONAL TAX ALERT



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India – Tax Update

International tax has the potential for extremely high litigation. Tax disputes in India often go right up to the wire – rather like tennis or cricket matches. This issue covers certain decisions of various authorities that underscore the above point.

Supreme Court Decision:

Taxation of expatriates

Taxation of expatriates becomes important given the increasing foreign technology agreements. The recent decision of Supreme Court in the case of **Eli Lilly and Company (India) Pvt Ltd** should be borne in mind when an employer decides upon the tax withholding obligations for his employees.

Assessee is a joint venture of a non-resident and a local company. The non-resident partner seconded a few employees to work with the JV. The assessee paid salary in India and tax was deducted on the same. However, no Tax Deduction at Source (TDS) was deducted on Home salary / special allowances paid by the non-resident as retention money.

The Revenue found that the entire work was done by the expat employees in India but no TDS was deducted on their Home salaries and took a view that as per Section 9(1)(ii) of the Income Tax Act 1961 the income derived by the expatriates was taxable in India and subject to Section 192(1).

Accordingly, TDS was to be deducted even on the home salary paid for services rendered in India.

The Supreme Court has held that the Indian subsidiaries of foreign companies employing expatriates will have to deduct tax at source on their entire salary just as domestic companies do.

High Court Decisions:

1. Treaty shopping could turn perilous

The instance of **E-trade Mauritius** is one that warns on the perils of treaty shopping.

The appellant E-Trade Mauritius is a limited company. It is a subsidiary of the E-Trade Financial Corporation of the USA. It sold shares of the Indian company, IL & FS Ltd, to a Mauritian company, HSBC Violet Investments (Mauritius) Ltd. The DTAA between India and Mauritius provides that capital gains arising in India to a resident of Mauritius would be subject to tax only in Mauritius. Hence, on a literal application, there should have been no tax liability in India. The Company accordingly claimed exemption from capital gains tax under Indo-Mauritius DTAA. But the Income Tax Department took the view that E Trade Mauritius was just an instrument of the US Company for routing investments into India and the gains are taxable under the Indo-US tax treaty.

Apparently the Income tax Department was buoyed by its success in the case of Vodafone in raising this issue.

The tax demanded was Rs.245 million (US\$ 5.27 million) and the remedy to have the tax demand annulled through revision proceedings also failed.

E-trade Mauritius dragged the Income Tax Department to the Mumbai High Court challenging the direction of the Income Tax Department in a Writ. The High Court felt that the tax deposited by E-Trade could not be refunded to them.

2. Should payments for advertising, publicity and sales promotion to a non-resident amount to a fee for Technical services or royalty?

Sheraton International Inc., USA entered into a commercial service agreement with ITC Hotels of India for advertising, publicity and promotion of their sales worldwide. The question was whether the payments by ITC Hotels under the agreement were royalties liable to tax in India.

The payments made to the non-resident will not fall under the definition of royalty as there was:

- No transfer/ use of all or any rights in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property.
- No imparting of any information concerning the working of, or the use of a patent, invention, model, design, secret formula or process or trade mark or similar property.
- No imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill.
- No use/ right to use any industrial, commercial or scientific equipments.
- No transfer of all or any rights in respect of any copyright, literary, artistic or scientific work or scientific work including films or video tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or distribution or exhibition of cinematographic films or
- There was no rendering of any services in connection to the above.

The payments made to the non-resident will not fall under the definition of fees for technical services as there is no rendering of any managerial, technical or consultancy services.

The payments made are to be treated as business income. But, since the assessee has no PE under Article 7 of the DTAA, it cannot be taxed in India.

Decisions of Authority of Advance Rulings (AAR):

1. Service PE under the Indo- Australian DTAA:

How to determine whether a Service PE exists is an issue that arose under the Indo-Australian Treaty.

The Australian company, **Worley Parsons Services Pty Ltd** (WPS) became the successful bidder for the assignment of Oil and Natural Gas Commission (ONGC) to review the technical and commercial bid documents (inviting bids from contractors) for installation of the new platform and to give its recommendations in respect of Mumbai High North Offshore field.

A Contract (No. 1) was entered into in May 2001 with ONGC Services to this contract were carried out by the applicant in Australia. The applicant's employees were in India for meetings in March and June 2001 for a total period of seven days for negotiation and field level data gathering.

The work was awarded by ONGC to Engineers India Ltd for February 2002. The applicant having become a successful bidder for review of designs and documents, as required by Engineers India, entered into a Contract (No 2) in April 2002 with ONGC. The scope of the contract as given in clause (17) thereof consisted of providing back up consultancy assistance for review of ONGC's detailed design and engineering documents through provision of required engineers. Further, the engineers were also required to assist ONGC in review and evaluation of various optimization and cost savings proposals. The work involved desk-top review of workings prepared by a third party in Worley's facilities in Australia. As the work entrusted to the applicant required inputs from the field and the ONGC staff, the employees of the applicant came to India and stayed for a total duration of 39 days in the financial year 2002-03.

Apart from the above, Contracts No 3 to 6 were entered to in relation to Mumbai High South Offshore Field (for short MHS) development. Contract No 5 related to designing a new process platform. Contract

No 6 related to rendering of consultancy services. ONGC prepared a scheme to implement seven separate packages for developing Integrated Process-cum-Gas Compressor Platform, several well platforms, drilling of new wells and new pipeline segments of 245 kms.

The applicant contended that:

- a) The services under various contracts except Contract No 5 cannot be brought within the sweep of 'royalties' as defined in Art. XII.3 of the DTAA
- b) there was no permanent establishment in India except in relation to Contract No 6 (Employees were present in India for Contract No 6 for 90 days in the year 2003-04 and 13 days in the next year) and
- c) Royalty income in respect of the Contract No 5 has to be apportioned in such a manner that only income attributable to the Indian operations is taxed in India.

It was held by the Authority for Advance Ruling that:

In so far as Services are concerned:

- The various contracts involving rendering of services in India were with one party
- The nature of work and services are of the same pattern
- Hence, services cannot be dissociated from each other for the purposes of Article 5(3)(c), which deals with Service PEs.
- The duration of the totality of services furnished under various contracts between the same parties during the 12 month period has to be taken into account.
- If so, the yardstick of 91 days stands satisfied, and the income attributable to the PE will be taxable in India.

In regard to the submission for apportionment of Royalty income and the plea that tax is applicable, this is only to the extent of income attributable to the operations on India.

Theory of territorial nexus: To execute the contract, the applicant's employees were present in India for 22 days in the year 2002-03 for on-the-spot study, reviewing the documents and providing clarifications. The transfer of plan/design indisputably took place in India. Though the bulk of the work connected with preparation of plan/design and study report was done from Australia, there is sufficient territorial nexus with India and the profits derived from this contract are liable to be taxed u/s 5(2) read with section 9(1)(vi) of the IT Act on gross basis at 15%. It is not permissible to split up such royalty income by allocating part of it to the work done in Australia.

2. Status of overseas Limited Liability Partnerships under Indian Tax Laws

The case of **Canoro Resources Ltd** involved interesting issues on the status of overseas LLPs under Indian Tax laws. Other issues like Transfer Pricing and scope of Article relating to Non-discrimination in DTAA are also discussed.

The applicant company, Canoro Resources Limited, is engaged in the business of exploration and production of petroleum and natural gas in India. It is a Canadian company having participating interest in three oil blocks out of which only one block ('Amguri' block) has started commercial production and the remaining two are in the exploration stage. The applicant has entered into separate Production Sharing Contracts (PSC) with the Government of India and the concerned participating company in respect of each of the above three blocks.

The applicant, the Government of India and the Assam Company Ltd, are parties to the PSC in respect of Amguri block in which the applicant holds 60% participating interest and is also the operator. The company proposed to restructure its business in India by transferring its participating interest in Amguri block to a partnership firm to be formed in Canada between it and its wholly owned subsidiary company, namely Legasi Petroleum International Inc, which is incorporated in Canada.

The questions that had been recasted and the respective rulings are given below:

- a. Can a partnership firm formed between the applicant and an entity in Canada be granted status of 'firm' for the purpose of taxation under the Income-tax Act if it satisfies the conditions listed u/s 184 of the Act?

Sec. 184 of the Income Tax Act prescribes certain conditions for a partnership firm to qualify as a firm.

Hence, the proposed partnership firm to be formed by the applicant with Legasi Petroleum International Inc. at Alberta, Canada can be assessed as a firm under the Income-tax Act, 1961, provided the requirements of section 184 are complied with.

- b. If it is a firm, what would be the residential status of the partnership under the Act, in view of the fact that all significant decisions relating to activities of the partnership would be taken by the management team of the firm outside India?

Since the control and management of the affairs of the partnership firm will be located wholly outside India, the said firm shall be a non-resident firm. However, the Revenue argued that the firm will carry its entire business operations in India only and, hence, it will become a resident firm.

Hence, the AAR held that the residential status of the said partnership firm is a question of fact which can be determined by the assessing officer at the relevant point of time.

- c. If it is a firm, would tax rate prescribed under the Act for a 'firm' be applied, while computing tax liability of the partnership in India?

Being a non-resident firm will not make any difference so far as the rate of tax is concerned, as the Income Tax Act does not differentiate between resident and non-resident partnership firms.

Hence, the aforesaid firm shall be liable to tax at 30 % plus applicable surcharge and excess in accordance with paragraph (c) of the First Schedule of the Finance Act, 2008.

- d. If it is a firm, would share in post-tax profits of partnership firm be exempt in hands of the respective partners, since Indian Tax laws do not tax the share of profits of partners?

The proposed partnership is to be assessed as a firm and hence share of partners in the total income of the firm shall not be included in the total income of such partners.

- e. Where a capital asset is transferred by a partner to the partnership firm as his capital contribution, whether Transfer Pricing provisions would apply since it is to be regarded as an international transaction?

The Transfer Pricing laws apply exclusively to international transactions carried out between associated persons – whether individuals, firm or company. These provisions are aimed at tackling the issue of price manipulation associated with international transactions. The apprehension of price manipulation is real even in international transactions between partners and firm, who are associated persons. Therefore, transfer pricing provisions should apply to such transactions.

- f. Whether by applying transfer pricing provisions for determining the consideration for transfer (of participating interest in Amguri block to the partnership firm as its capital contribution), the provisions of Article 24 (non discrimination clause) of DTAA between India and Canada would be attracted?

The non-discrimination provision prohibits a Contracting State from making any discrimination in the matter of taxation between its own national and a national of the other Contracting State, who are placed in similar circumstances. Article 3(h) of the DTAA defines the term 'national' to include both natural persons and artificial persons, such as companies, etc. The transfer pricing provisions relate to international transactions between associated enterprises. International transactions give rise to their own peculiar problems. 'International transaction' has been defined in section 92B of the Act to

mean transaction between enterprises, either or both of whom are non-residents. It may also be seen that Sec. 92B makes a distinction between enterprises on the basis of their residential status,

and not with reference to their nationality. The residential status of an individual depends on the number of days he lives in India.

In the case of a legal person, like a company, or in the case of a firm, it would depend on factors such as place of registration, situs of control and management, etc. It is possible that a national of India could be a non-resident for the purpose of this Act and a national of the other Contracting State could be a resident. Be that as it may, a cross-border transaction between Indian nationals, one or both of whom are non-residents and who are associated enterprises, will also attract the transfer pricing provisions, as they would apply to similarly situated Canadian nationals. Viewed from this angle, the discrimination clause has no basis in this case.

Hence, it was held that Article 24 of DTAA does not come to the aid of the applicant.

Decisions of Income Tax Appellate Tribunal (ITAT):

1. Whether various sites or projects for providing technical know-how, basic engineering services and supervisory activities can be considered as Permanent Establishment?

Krupp Uhde GmbH is a company incorporated in Germany. It is engaged in the business of providing technical know-how/license, basic engineering services and supervisory activities in connection with construction or installation of the specified machineries/ assembly provisions.

The question is whether the various sites or projects for the above activities can be considered as PE. Under Article 5(2)(i), Indo-German treaty prescribes a minimum period of six months for treating a site of the project as PE.

But in this case the company had entered into various contracts with different parties and had carried out supervisory works at them for less than six months period on each of them. However, the Revenue insisted that for considering the PE, it is not the period of supervisory work done at one site, but all sites together should be taken into account.

Moreover, the minimum period of six months for various sites cannot be considered together particularly when different contracts had no effective interconnection with each other.

The date of commencement of the threshold limit of six months would depend on the facts of each case considering the terms of contract.

If the supervisory activity is carried out under a separate and independent contract, then the minimum period of six months would commence only when such activity itself had commenced and not from the date of the project.

The period can be counted from the date of commencement of the project only where there is one single indivisible contract for various activities undertaken by the non-resident.

The intervening period caused on account of various factors should be not be excluded while computing the minimum period of six months as an activity once commenced continues until its completion and the intervening period cannot be excluded.

2. Whether Reimbursement of salary under the secondment agreement can be treated as a fee for technical services?

Whether a secondment arrangement can be construed as provision of technical services under the Act and whether the reimbursement received by a Foreign Company is liable to tax in India in the hands of the Foreign Company is a question that arose in the case.

IDS SOFTWARE SOLUTIONS (INDIA) PVT LTD is a company engaged in the business of software development. It entered into a secondment agreement with its US holding company.

The Bangalore Income Tax Appellate Tribunal in the above case held that payment made under secondment arrangement by an Indian Company to a Foreign Company was not Fees for Technical Services and hence not liable to tax in India.

The Indian Company was the 'economic employer' of the secondee and employer-employee relationship existed between the Indian Company and the secondee.

The key reasons were that the secondee's employment as Managing Director was ratified by the Indian Company and that the secondment agreement between the Indian Company and the Foreign Company constituted an independent employment contract between the Indian Company and the secondee. Also, the secondee worked exclusively for the Indian Company and under its supervision/ direction/ control, the secondee's costs were borne by the Indian Company and the Indian Company had discretion to reject or remove the secondee.

Further, the Foreign Company did not warrant the quality of the secondee and the Indian Company was to indemnify the Foreign Company for any claim arising due to the secondee.

Hence, it was held that the secondee was an employee of the Indian Company and reimbursement made by the Indian Company to the Foreign Company represented salary for services rendered by the secondee to the Indian Company and was not for services rendered by the Foreign Company to the Indian Company. Thus, salary, which has already been subject to TDS in India, cannot suffer further TDS while remitting the same to the Foreign Company.

In relation to the question whether the payment can be treated as fees for technical services, the Tribunal observed that the Article VI of the agreement which provides for indemnity, ie the liability of the assessee company to indemnify the US Company from all claims, demands, etc., consequent to any act or omission by the seconded employee, is inconsistent with the claim of the department that this is an agreement for rendering technical services. The Article further provides that nothing in the agreement shall be construed as a warranty of the quality of the seconded employee. It is not usual to find such a stipulation in an agreement for rendering technical services. Hence, the payment cannot be treated as fees for technical services.

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Israel – Tax Reform – Amendment 168

Tax Relief for new and returning residents

The Israeli Knesset approved on 9 September 2008 a major tax reform for new and returning residents. Amendment 168 to the Israeli tax ordinance is in force retroactively from 1 January 2007.

The main provisions are as follows:

Change in the definition of a "foreign resident"

From 1 January 2007, individuals who leave Israel will only lose their Israeli residency status if they are outside of Israel for at least 183 days each year during two consecutive tax years, and their primary residence is outside of Israel for a further two years.

Change in the definition of a "senior returning resident"

"Senior returning residents" are treated in the same way as new residents. A "senior returning resident" is an individual who returns to Israel to reside, after being a foreign resident for: (a) at least five consecutive years if they return to Israel in the tax years 2007 through 2009 or (b) at least 10 consecutive years if they return to Israel after 2009.

Below is a summary of the prior benefits before the amendment 168 and the new benefits after amendment 168:

Benefit	Prior Benefit	New Benefit New resident and senior returning resident
"Passive income" -exemption from foreign assets purchased before and after becoming Israeli resident	Five years exemption for new and returning residents, but only for foreign assets purchased before becoming Israeli residents	10 years
Exemptions from foreign business income and foreign salary	Four years, but only for new residents on a business that runs five years before the resident became a new resident	10 years
Foreign companies that are "managed and controlled" from Israel, CFC, or foreign professional company	N/A	Those companies will be considered as foreign for 10 years
Foreign allowance	Payment of tax as it would have been in the foreign country	10 years exemption
Capital gain exemption	10 years exemption, but only for foreign assets purchased before becoming an Israeli resident	10 years
Tax return	Exemption – if certain conditions are met	No need to submit a tax return on the exempt income

Double Taxation Treaty-Israel and Britain

Israel and Britain have signed a "Double Taxation Treaty" enabling taxes paid in one country to offset taxes in the other, and exempting Britons living in Israel from paying taxes on their U.K. pensions.

Taxes on dividends in the country of origin will be deducted at a rate of 5%.

The Treaty also provides for a tax exemption on capital gains and royalties collected in the country of origin

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Italy – Tax Update

Step-up of real property

The opportunity to write-up the book value of real estate accounted in the FY2007 financial statements has been introduced. A higher value can be acknowledged also for fiscal purposes by paying a 3% substitutive tax (1.5% for non depreciable properties) but the fiscal effects start from 2013 for the deduction of amortization and 2014 for the disposal of assets. The step-up is not applicable to building land and real properties whose production or sale is made by the enterprise.

Fiscal relevance of merger/demerger and contribution transactions

Taxpayers can pay a 16% lump-sum substitutive tax in order that the relevance of the fiscal values of tangible and intangible assets and goodwill coming from extraordinary operations can be recognised. Such relevance begins from the fiscal period in which the tax has been paid. The depreciation of trademarks and goodwill is shortened to nine years in respect of the ordinary 18 year period.

This rule is an alternative to the chance of acquiring an asset step-up relevant for tax purposes, by paying a 12% substitutive tax (for amounts up to M€ 5), 14% (for amounts from M€ 5 to M€ 10) and 16% (for amounts over M€ 10).

Ratification of tax treaty between Italy and the US

The Italian Parliament ratified the tax treaty with US that will enter into force after the exchange of its instruments of ratification.

The most important changes introduced by the new Treaty are as follows:

- The partial creditability of Italy's local IRAP for US tax purposes
- As source states, both countries may tax dividend with equivalent amounts (ie a branch profits tax)
- The withholding tax rates on dividends, royalties and interest have been changed
- A more stringent limitation on the benefits clause to avoid the treaty shopping.

Book value of securities, shares and bonds

Due to the downturn trend of the financial markets, enterprises not applying the IAS/IFRS principles can evaluate their financial investments based on the last approved financial statement and not on their lower market value, if any.

Trusts

It is only since 1 January 2007 that the Italian Tax Code rules trusts as per Article 73, and the Ministry of Finance has introduced a tax definition of the trust and an anti-abuse rule with the Circular 48/E/2007, explaining the authorities' approach in formulating a tax regime applicable to a foreign law trust.

There are two kinds of trusts:

1. A "see-through trust" whereby the beneficiaries are identifiable. Any income resulting in the hands of the trustee, for tax purposes, flows directly to the beneficiaries as capital income;
2. An "autonomous trust" whereby no beneficiaries can be identified is subject to Italian corporate income tax regulations. The criteria to compute the taxable basis is related to the trust's residence and the activity carried on:
 - Trusts performing business activities are subject to the same rules provided for Italian companies
 -

- Trusts that do not carry on any business are subject to the same rules applicable to individuals, based on different sources of income, and the income so determined is subject to corporate tax.

An additional trust category can also be identified as a mixture of the above two. In this case, the trust is considered to be an autonomous trust for the income accrued and a see-through trust for portions paid to beneficiaries.

The residence of a trust is determined in accordance with Art. 73, paragraph 3 of domestic rules.

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Japan – Tax Reforms on Interest Income issued by Foreign Corporation

In Japan, scope of taxable income for foreign corporation or non-resident individual is income from sources in Japan. This 'Japanese source' rule for interest income was amended recently.

Outline of the Reform

Interest on bonds received by foreign corporation or non-resident individual becomes treated as Japanese source income, where the bonds are issued by a foreign corporation ('Foreign Bond Issuer') and interest on the bonds is connected with the business that the Foreign Bond Issuer carries on in Japan. 'Interest on bonds connected with the business in Japan' means any interest which is connected with the business that the Foreign Bond Issuer carries on through a permanent establishment (eg branch office or factory etc.) in Japan.

Unless a double tax treaty applies, such interest would be subject to 15% Japanese withholding tax in principle. This amendment applies to interest on bonds issued on or after 1 May 2008.

Background of the Reform

1. Adjustment of taxable income between Foreign Bond Issuer and Foreign Bond Holder

If a foreign corporation has a permanent establishment in Japan, it is subject to Japanese corporate tax in principle on its income from sources in Japan. The foreign corporation is allowed tax deductible operating or other expenses to the extent those expenses are incurred in respect of its business to generate income from sources in Japan. Accordingly, if the Foreign Bond Issuer pays interest on bonds and this interest is connected with the business it carries on in Japan, the Foreign Bond Issuer is generally able to deduct such interest in determining its taxable income in Japan.

On the other hand, before this tax reform, interest received by foreign corporation or non-resident individual on such bonds had been non taxable income in Japan and been exempt from Japanese withholding tax even if the interest was incurred in connection with the business conducted by the Foreign Bond Issuer in Japan and deductible in Japan by the Foreign Bond Issuer.

It means the Foreign Bond Issuer could reduce its taxable income in Japan by the tax deductible interest paid, and the foreign corporation or non-resident individual were exempt from Japanese tax on the interest received.

2. Prevention of double SPC scheme

Interest on bonds issued by a foreign corporation are deemed to arise in Japan by a tax treaty between Japan and the jurisdiction of the foreign corporation or non-resident individuals who receives the interest in general if the foreign corporation has a permanent establishment in Japan and the bonds are connected with such a permanent establishment. Under these circumstances, there developed a financial structure (called 'double SPC scheme') designed to eliminate Japanese withholding tax, whereby a foreign corporation issued bonds to investors resident in a treaty jurisdiction with Japan through another foreign corporation situated in a jurisdiction with which Japan does not have a tax treaty. This tax reform imposes Japanese withholding tax on interest paid under the double SPC scheme.

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Jordan – Tax Update

“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 good 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.

The following paragraphs recapitulate the incentives provided for both foreign and domestic investors doing business in Jordan.

Free Zones

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

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

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

Incentives offered by Free Zones include:

- Exemption from income taxes for exported goods, goods in transit trade, as well as profits gained from the sale or transfer of goods inside the Free Zone.
- Exemption from income and social 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.
- Exemption from custom duties for goods produced in the Free Zones and offered for domestic market consumption. This exemption is limited to the cost of materials and manufacturing expenses, provided this value is approved by the Free Zone Committee.

Industrial Estates

The 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

which will 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 (see the Qualifying Industrial Zones paragraph) status, which allows exporters of goods manufactured in these zones to benefit from duty-free and quota-free access to the US market.

Industrial estates offer the following incentives to investors:

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

Qualifying Industrial Zones (QIZs)

QIZs are areas that have been accorded a special status designated by the governments of Jordan and the US, whereby products manufactured in these zones can be exported to the US with payment of duty or excise taxes, and without the requirement of any reciprocal benefits.

In addition, there are no quotas on products manufactured in Jordan and exported to the US as a result of these and other facilities offered by the government of Jordan. Investors are able to economize between 15%-35% on the cost of production.

Aqaba Special Economic Zone Authority (ASEZA)

The Aqaba Special Economic Zone (ASEZ) was launched in 2001 as a duty-free, low tax multi-sectoral development zone encompassing the total Jordanian coastline (27 km), the sea-ports of Jordan, an international airport and the historical city of Aqaba with a current population of 90,000 people. It encompasses an area of 375 Km² and offers global investment opportunities in a world-class business environment ranging from tourism to recreational services, from professional services to multi-modal logistics, from value-added industries to light manufacturing.

A package of incentives offered by ASEZA include:

- Traded goods are exempted from customs taxes and fees, except for cars; (yet qualifying registered firms may import cars duty and tax free).
- Business activities are subjected to a 5% corporate tax with the exceptions of banking, insurance and land transport which will be subjected to the prevailing tax rates in Jordan .
- Full exemption from social services tax 7% sales tax for selected finished consumer goods and hotel and restaurant services.
- 10% land transfer tax, of which 6 % is paid by the buyer and 4 % by the seller.
- Exemption from land and building taxes on used property.
- No restrictions on repatriation of capital and profits.
-

- Businesses registered and operating in the ASEZ also enjoy similar incentives provided to the rest of the country such as 100 % foreign ownership in tourism, industry and a vast majority of services, in addition to full repatriation of capital and profits and liberal foreign currency regulation.
- Registered entities benefit from preferential access Jordan possesses with the EU, the United States through the QIZ and FTA, and the numerous Arab countries through protocols and free trade agreements.
- Investors can lease the land in the ASEZ for a period of 50 years, renewable in certain conditions, or purchase it for particular projects, which include hotels, health, educational, residential and commercial buildings.

Classes of Free Zones

The free zones in Jordan categorized into two classes as follows:

Public Zones: the following free public zones are currently in existence in Jordan:

- Al – Hassan Industrial Estate
- Al – Hussein Bin Abdullah II Industrial Estate
- Aqaba Industrial Estate
- Ma`an Industrial Estate.

Private Zones: the following free private zones are currently in existence in Jordan:

- Ad – Dulayl Industrial Park
- Al – Tajamouat Industrial Park
- Cyper City Park
- Al – Qastal Industrial Park
- Al – Zay Ready Wear
- Al – Mushatta Qualifying Industrial Estate
- Jordan Gateway Project
- Al – Hallabat Industrial Park
- KADDB industrial Park.

Corporate Income Tax

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

Corporate Income Tax rates are deducted from taxable income as follows:

- 15% for Mining, Industry, Hotels, Hospitals, Transportation, Contractual Contracting
- 35% Banks and Financial Companies
- 25% Leisure and Recreational Compounds + Conventions and Exhibition Centers , Insurance Companies, Exchange Companies and Financial Services, Telecommunication, Business Services, Trade Companies, Others
- 0% for Agriculture Projects.

INTERNATIONAL TAX ALERT



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KOREA – Major Revisions

Corporate Income Tax Law (CITL)

Tax exemption to foreign companies on interest income and capital gains from national bonds and monetary stabilization bonds

With the revision of the CITL, if a foreign company makes an investment in national bonds and monetary stabilization bonds, the interest income and capital gains from such financial instruments would be tax exempt upon submission of an application for the exemption. This revision will be applied to investment income made on or after 21 May 2009, the promulgation date.

Improvement regarding the corporation heavy tax of corporation's non-business lands and houses transfer

The additional corporation tax (30%) regarding transferring non-business lands and houses will be excluded between 16 March 2009 and 31 December 2010. However, an additional corporation tax of 10% will be applied in speculative areas.

Proposed Presidential Decree (PD) of Tax Incentive Limitation Law (TILL)

Details of the tax deduction for job-sharing companies

With the revision of the TILL, if a Small and Medium sized Company (SMC), which i) has difficulties in its business, ii) maintains certain number of employees compared to the previous year and iii) has reduced salary expenses paid to its employees, 50% of the decreased salary amount is deductible from the taxable income of the SMC. The proposed revision to the PD of TILL provides details of the requirements to be eligible for the tax deduction as follows:

- Requirement for difficulties in business: Compared to the previous year, i) 10% or more decrease in annual sales, ii) 10% or more decrease in production, or iii) 50% or more increase in monthly average volume of inventories.
- Requirement for maintenance of regular employees: Compared to the previous year, the average number of regular employees should not decrease. The regular employees in this context refer to employees who have entered into an employment agreement with their employer under the Labour Standard Act. The average number of regular employees is calculated by dividing the total number of regular employees as of the last day of each month by the number of months.
- Requirement for salary expense reduction: Compared to the previous year, the total amount of salary expense paid per employee should decrease. Salary amount includes ordinary wages and regular incentives, and the total amount of salary expense paid per employee is calculated by dividing the sum of the salary expense paid to the company's regular employees in the current/prior year by the total number of regular employees in the current/prior year.

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MALAYSIA - Recent Tax Changes

Highlights of Mini Budget Announcement

In March 2009, Malaysia has announced the Second Economic Stimulus Package, (also called the “Mini Budget”) to further spur economic activity in the country and help to cushion off the negative impact to the businesses as a result of the global financial crisis.

The key tax changes or measures announced in the above Budget are outlined as below:

CORPORATE TAX

(i) **Carry-back of current year losses**

With effect from Year of Assessment 2009, the government has introduced “carry-back of current year tax losses” as a temporary measure in the tax system. Current year tax losses of up to RM100,000 be allowed to be carried back to the immediately preceding year of assessment. The carry-back tax loss is currently limited to losses incurred for year of assessment 2009 and 2010.

The above tax treatment is applicable to all businesses including sole proprietors and partnerships.

(ii) **Accelerated Capital Allowance (ACA)**

Qualifying expenditure incurred on plant and machinery will be given ACA and it would allow the assets be written down for tax purposes within 2 years.

The above will only apply for qualifying expenditure incurred between 10 March 2009 and 31 December 2010. Subject to conditions met, this incentive is mutually exclusive to certain incentives currently enjoyed by the taxpayer.

(iii) **Incentive for renovation and refurbishment of business premises**

To further stimulate the economic and business spending, capital expenditure incurred on renovation and refurbishment on business premises between 10 March 2009 and 31 December be given Accelerated Capital Allowance, which can be claimed within two years. The total amount of qualifying expenditure is capped at RM100,000.

(iv) **Incentive for Financial Institution to defer repayment of Housing Loan**

To support the financial institutions which have agreed to allow retrenched workers a moratorium on the repayment of their housing loans for one year, it has been proposed that the interest income of the above institutions in relation to the deferment of housing loan repayments be taxed only when the interest is received. The financial institutions need to observe the conditions as set out in the regulation in order to enjoy the deferment in paying taxes for the above interest income.

PERSONAL TAX

(v) **Tax relief for interest on housing loan**

This newly introduced tax relief is for Malaysia resident citizens in respect of the interest paid on housing loans up to RM10,000 per year for three consecutive years.

The above shall apply to Sales and Purchase agreement executed between 10 March 2009 and 31 December 2010 and shall be limited to one residential property for each individual.

(vi) **Tax exempt on certain allowances and benefits**

Various categories of tax exempt allowance for employees such as travelling allowance, meal allowance, child care allowance and other allowances announced by government in Budget 2009 have been gazetted recently.

The following Addendums to Public Rulings (PR) have also been issued by the tax authority to provide clarification to taxpayers in respect of the above exemption:

- *Addendum to PR 2/2004 on Benefit in-Kind*
- *Addendum to PR 1/2006 on Perquisites from Employment*

(vii) Tax exempt on Retrenchment Benefits

The existing tax exemption in respect of retrenchment benefits or compensation for loss of employment of RM6,000 for each completed year of services has been increased to RM10,000.

The above shall apply for payment made to employees who have retrenched or ceased employment on or after 1 July 2008.

Transfer Pricing and Thin Capitalisation Rules

Further to announcement of Budget 2009, Sec 140A has been introduced in the Income Tax Act 1967 effective from 1 January 2009 which incorporates transfer pricing and thin capitalization provisions.

In addition, relevant provisions in relation to Advance Pricing Arrangement ie Section 138C has also been enacted effective from 1 January 2009 to allow companies to enter into Advance Pricing Arrangements with tax authority to determine the pricing methodology to be used for their related party transactions.

The government will release more detailed Transfer Pricing Rules and APA rules in due course to clarify the scope of Section 140A and Section 138C. As for the newly introduced thin capitalization rules which should have been implemented with effect from YA 2009, the relevant guidelines or rules are yet to be released by the authority.

Withholding Tax (WHT)

(i) Exclusion of "reimbursement for hotel accommodation" from technical fee

Effective from 1 January 2009, reimbursements relating to hotel accommodation in Malaysia will not be included in the computation of gross technical fees for the purpose of withholding tax. However, other types of reimbursements would not be excluded from payment of WHT.

(ii) New WHT provision

Effective from YA 2009, the scope of WHT has been extended to cover the income of non-residents falling under Section 4(f) of the Income Tax Act 1967, and this generally includes commissions, guarantee fees and introducer's fee and etc.

Withholding tax of 10% would need to be imposed on the above types of payments made to non-resident person and remitted to the tax office within one month from the date of payment or crediting to the non-resident payer.

Tax Treaties

The Malaysia-Qatar double tax agreement (DTA) has been ratified on 28 January 2009 as the *Double Taxation Relief (The Government of the State of Qatar) Order 2008*. The DTA largely adopts the features common to other DTAs that Malaysia has concluded.

The reduced withholding tax rates of certain key category of payments are summarised as below:

- Interest 5%
- Royalties 8%
- Technical Service Fees 8%.

Public Rulings

Since 1 January 2009, the Malaysian Inland Revenue Board (IRB) has issued the following Public Rulings and addendum to Public Rulings (PR):

- i) PR 1/2009 on Property development**
- ii) PR 2/2009 on Construction contract**

The above rulings provide clarification in respect of the tax treatment for income derived from the business of property development and construction contract and the appropriate methods to be adopted by the above taxpayers in computing its taxable income.

- iii) Addendum to PR 3/2005 on Living accommodation benefit**

The PR 3/2005 clarifies that benefits of ESOS or share purchased plans would not need to be included in the formula for purpose of computing tax benefits of living accommodation provided to employee by the employer.

Compliance by Employers – New Scheduler Tax Deductions (STD) 2009

With effect from 1 January 2009, the Inland Revenue office has issued a new STD table and notes to ensure accurate deductions from the employees' remuneration by the employer.

All employers are required to comply with the above schedules immediately, subject to certain concession period available.

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Portugal – New Accounting System and Tax Legislation in 2010

Last April 23 the Council of Ministers has approved a new accounting system, more in line with International Accounting Standards, and the changes to be introduced to the Corporate Income Tax Code in the light of the accounting practice to be adopted. The publication of this legislation is expected to occur at any time and it will enter into force on 1 January 2010.

1. Portuguese Accounting Standards

The accounting principles currently in force, in which the historical value prevails and low importance is given to information commenting on the data in the financial statements, will be substituted by a new system, very close to IFRS, where market value and relevant disclosures are emphasised. The new system will require all professionals in the accounting and tax areas to upgrade their technical abilities and hence the market is now becoming very receptive to firms providing training and advisory services in connection with the new rules.

2. Changes in the Tax Law

The new accounting rules will have a significant impact of the financial position, equity and income statements of the Portuguese companies. In connection with the new standards, the Council of Ministers has approved a wide range of modifications to the Portuguese Income Tax Code. In some cases, the tax treatment will follow the new accounting rules but this will not always be the case. A transitory period will be contemplated to allow the deferral of the tax impact of the introduction of the new rules for a period of five years.

Being able to incorporate the new rules, producing high standard financial reports and ensuring that the new tax legislation is adequately observed, constitutes a fascinating challenge for companies, CEOs, accountants and tax and financial advisors. In PKF Portugal, we are looking forward to support our clients in this long term way.

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Romania - Minimum Income Tax

Considered as an anti-credit crunch measure, starting on 1 May 2009 and in place until 31 December 2010, a new Government Order (Order no. 34/2009) changing the Romanian Tax Code as well as the Romanian Tax Procedure Code shall be applied.

1. Changes in the provisions of the Tax Code

The minimum income tax

A new concept is introduced, namely the “**minimum income tax**” which constitutes an obligation for all Romanian companies and all foreign companies operating in Romania through a registered office, which shall be established depending on the total income registered as at 31 December of the previous year.

If the income tax determined on the basis of a real system is higher than the minimum income tax determined according to the taxation levels below, then the first amount shall be owed by the taxpayers.

Taxation levels

Annual income (lei)	Minimum annual income tax (lei)
0-52.000	2.200
52.001-215.000	4.300
215.001-430.000	6.500
430.001-4.300.000	8.600
4.300.001-21.500.000	11.000
21.500.001-129.000.000	22.000
Over 129.000.000	43.000

The abovementioned provisions do not apply to the following categories of taxpayers:

- Tax payers obliged to pay the profit tax but exempted from the payment of the minimum income tax
- Foreign companies and non-resident individuals performing activities in Romania which do not give rise to an association of persons in the legal sense
- Foreign companies which obtain income from/in relation to properties owned in Romania or from the sale/transfer of shares held in a Romanian company
- Resident individual associated with Romanian companies, for the income obtained in Romania as well as abroad, from associations which do not give rise to a new legal person. In this case, the tax owed by the individual is calculated, retained and paid by the Romanian company.

In the total income used as a calculation basis, the following are not included: inventory variation income, asset production income and others.

Determining the taxable profit – changes in the deductibility of expenses

Deduction of costs regarding:

- Functioning
- Maintenance
- Fuel
- Repairs relevant to cars

used by **management and administration personnel** within the company is limited to maximum one car relevant to one person with such attributions.

The modified text does not mention the categories of functions implied by the expression “management and administration personnel”. This shall allow interpretations by the tax audit teams within the Tax administration. Restrictively, this text might have in mind the directors/managers and the administrators of a company without also including department directors/managers.

Exemptions from the above mentioned provisions include vehicles used exclusively for:

- intervention, repairs, security and protection, couriers
- person transportation from and to the place the activity is unfolded
- vehicles used by sales agents and workforce recruitment agents
- vehicles used for the person transportation by means of payment, including taxis
- vehicles used for the lease by third parties, including for the instruction activities within driving schools.

Provisions and reserves

Asset revaluation reserves, including those relevant to lands registered as a result of

- fiscal depreciation, or
- selling/destroying obsolete assets

are taxed at the time the fiscal depreciation is deducted, with the occasion of the discharge of these assets.

The text does not provide for the tax regime applicable to the negative revaluation differences which are quite frequent in the new economic context. Correspondingly, these reserves should be recognised as deductible expenses for the profit tax calculation.

Individual income tax

Just as in the case of the companies' income tax, fuel expenses for vehicles are not deductible for the period between 1 May 2009 and 31 December 2010. The same exceptions as above apply for vehicles used for intervention, security and protection etc.

Value added tax

Within the tax-exempted deliveries in Romania, the law now also includes those assets for which the special limitation regime of the deduction right was introduced by the present order (letter g paragraph. (2) of art. 141 TC).

Order no. 34/2009 also imposes restrictions in relation to the deductibility of VAT in case of acquiring new vehicles, in the sense that for the duration it is applied, the VAT for any such vehicles destined for person transportation is not deductible.

A restriction to the maximum of one vehicle per person is also imposed in relation to the deductibility of the VAT appertaining to the costs regarding the functioning, maintenance and repairs of the vehicles used by management and administration personnel within the company. All other VAT appertaining to such costs is considered not deductible.

So far the Romanian VAT payers could register to pay either monthly or quarterly depending on their declared turnover, and the transfer from one category to another was made only after a 100.000 Euro yearly turnover threshold was surpassed. Starting from 1 June 2009, this transfer from one category to another is to be made also as a result of declaring an intra-EU acquisition or delivery. The taxpayer therefore has a five day term starting with the month following the one in which the intra-EU acquisition or delivery was made, to declare the transfer from a quarterly VAT payment to a monthly one.

2. Changes to the Tax Procedure Code

Some new minor offences were introduced by means of Order 34/2009 as a result of which mis-statements in the VAT recap statements to be handed in by taxpayers each month will be sanctioned with fines starting with 1 June 2009. All these provisions can be found in Art. 219¹ of the Tax Procedure Code.

The fine was established at 2% of the mis-stated amount, with a 50% reduction possibility in the amount owed if the correction is made as a result of the direct initiative of the taxpayer, and within the legal term limit.

An exemption from the above mentioned is provided only in the case in which the taxpayer can prove that the mis-statement was not due to a fact attributable to the tax payer.

The law does not define the facts non-attributable to the tax payer. Errors found in the VAT recap statements handed in prior to the application of the present order had to be corrected by 1 June 2009 the latest in order to avoid paying the fine.

One aspect to be considered is the fact that using an exchange rate different to that defined by art. 139¹ of the Tax Code may generate "undeclared differences".

The law does not state if the 2% sanction is also to be applied to negative differences.

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SINGAPORE - New measures introduced in the 2009/10 budget regarding taxation of companies

A. Research and development tax measures

New research and development (R&D) measures were introduced to encourage businesses to build up R&D capabilities in Singapore. The new measures apply to R&D expenditure incurred by a taxpayer who is the beneficiary of the R&D activities.

The new R&D measures introduced are:

1. liberalized R&D tax deductions
2. R&D tax allowance scheme and
3. R&D incentive for start-up enterprises.

Qualifying R&D activities

To qualify for the new R&D measures, the expenditure must be incurred by the taxpayer on R&D activities undertaken in Singapore which meet certain conditions and also do not fall within the list of specified excluded activities.

R&D is defined in Section 2 of the Singapore Income Tax Act ("SITA") as:

"any systematic, investigative and experimental study that involves novelty or technical risk carried out in the field of science or technology with the object of acquiring new knowledge or using the results of the study for the production or improvement of materials, devices, products, produce, or processes, but does not include:

- a) quality control or routine testing of materials, devices or products
- b) research in the social sciences or the humanities
- c) routine data collection
- d) efficiency surveys or management studies
- e) market research or sales promotion
- f) routine modifications or changes to materials, devices, products, processes or production methods
- g) cosmetic modifications or stylistic changes to materials, devices, products, processes or production methods or
- h) development of a computer software that is not intended to be sold, rented, leased, licensed or hired to two or more persons who are not related parties (within the meaning of subsection (3)) to each other, and to the person who develops the software or on whose behalf the development of the software is undertaken.

1. Liberalized R&D tax deductions

Previously, tax deduction was allowed only for R&D expenditure incurred by a taxpayer who carries on a manufacturing or service trade or business and the R&D expenditure must relate that trade or business.

With the liberalization of the R&D tax deductions from Year of Assessment (YA) 2009 to YA 2013 (both YA inclusive):

- a. Tax deductions on R&D expenditure can be claimed by a taxpayer who carries on any trade or business.
- b. Further tax deduction can also be claimed on up to 50% of the expenditure (total deduction is 150% of the expenditure).

Qualifying R&D expenditure for further tax deduction:

- staff costs (excluding directors' fees); consumables; or
- any other expenditure on qualifying R&D activities which may be prescribed by regulations.

2. R&D tax allowance scheme

This is a new incentive scheme targeted at encouraging businesses (particularly small and medium-sized enterprises) to engage in qualifying R&D activities in Singapore.

Under this scheme, a company will be granted a R&D tax allowance from YA 2009 to YA 2013 (both YA inclusive). The R&D tax allowance is 50% of a company's chargeable income for YA 2009 to YA 2013. The R&D tax allowance is capped at \$150,000 (based on 50% of the first \$300,000 of its chargeable income) for each YA. The R&D tax allowance can be utilized against assessable income in subsequent years. The last YA in which any R&D allowance can be utilized is YA 2016.

3. R&D incentive for start-up enterprises (RISE) scheme

This scheme allows loss-making start-ups which expends at least \$150,000 in a year on qualifying R&D activities in Singapore to convert the adjusted tax losses of up to \$225,000 (based on 150% of \$150,000) into a cash grant at the rate of 9%. The maximum cash grant is \$20,250 (9% of \$225,000). The scheme is available to a start up company in the first three YA of incorporation and falls between YA 2009 and YA 2013 (both YA inclusive).

Qualifying start up company:

The company must fulfil the following criteria:

- i) is incorporated in Singapore
- ii) is tax resident in Singapore
- iii) has at least one of its first three YA failing between YA 2009 to YA 2013 (both YA inclusive)
- iv) has total share capital which is beneficially held, directly by not more than 20 persons –
 - all of whom are individuals, or
 - of which at least one is an individual shareholder holding at least 10% of total number of issued ordinary shares

throughout the basis period for the YA of claim.

Qualifying R&D expenditure:

Qualifying R & D expenditure criteria:

1. qualifies for tax deduction under section 14D of the Singapore Income tax Act
2. is beneficially incurred by the company in respect of R&D activities carried out in Singapore in-house or outsourced to a R&D organization in Singapore
3. is not funded by any grant or subsidy from the Singapore Government.

B. Income tax exemption for foreign sourced income received in Singapore from 22 January 2009 to 21 January 2010

Under the provisions of the SITA, subject to conditions, the following foreign-sourced income received in Singapore by resident non-individuals is exempt from tax:

- foreign sourced dividends
- foreign branch profits and
- income from any professional, consultancy or other services rendered through a fixed place of operation outside Singapore.

The conditions are:

1. income tax must have been paid in the foreign jurisdiction from which the foreign sourced income is received
2. at the time the foreign-sourced income is received in Singapore, the headline tax rate (highest corporate tax rate) of the foreign jurisdiction from which the foreign sourced income is received is not less than 15%
3. the Comptroller of Income Tax is satisfied that the tax exemption would be beneficial to the person resident in Singapore.

Tax treatment for foreign-sourced source income received in Singapore from 22 January 2009 to 21 January 2010 will be tax-exempt. There is no requirement to meet the conditions mentioned in (1) and (2) above. With this tax exemption, foreign-sourced interest, rental or royalty received in Singapore from 22 January 2009 to 21 January 2010 will be tax-exempt.

If the tax exemption mentioned above is not beneficial to the resident non-individual, the tax payer can continue to claim relief for foreign tax paid.

C. Enhanced carry back relief

Under the carry back relief (CBR) system, current year unabsorbed capital allowances and trade losses (referred to as deductions) up to \$100,000 may be carried back to set off against the assessable income of the immediate preceding YA.

The CBR system for YA 2009 and YA 2010 is enhanced as follows:

1. The maximum amount that can be carried back from each YA is \$200,000
2. The maximum number of YA that the deductions can be carried back is three. That is, YA 2009 deductions can be carried back up to YA 2006 and YA 2010 deductions can be carried back to YA 2007.

D. Transfer pricing guidelines for related party loans and related party services

1. Related party loans

Currently, tax deduction on interest expenses claimed by the lender of interest-free loans or interest bearing loans that are not on arm's length basis is restricted. This practice will continue to apply for domestic loans and where the lender is also not in the business of borrowing and lending funds.

However, from 1 January 2011 onwards, the Inland Revenue Authority of Singapore (IRAS) requires all cross border loans to be on arm's length basis. Meantime, in the transitional period from 1 January 2009 to 31 December 2010, the interest adjustment mentioned above will continue to apply.

2. Related party services

There are two methods for determining the arm's length charge: direct and indirect.

The direct charge method involves identifying the work done, the cost of the services and the basis of charging. The indirect charging method uses the apportionment basis such as floor area and number of staff to charge the cost for services provided.

The IRAS suggests the CUP (Comparable Uncontrolled Price) and cost plus methods as the most appropriate for determining the arm's length fee for related party services.

The CUP method compares the price charged for related party transactions to the price charged for independent transactions in comparable circumstance.

It is common practice to charge a 5% mark up on costs for routine support services such as accounting, payroll, certain management or administrative functions. The IRAS is prepared to accept as an arm's length charge the 5% mark up on costs for routine services provided that such services are also not provided to an unrelated party.

Services provided on a cost pooling basis

Each party's cost sharing must be in the form of cash or other monetary contributions. The cost sharing without any profit mark up is allowed if the following conditions are met:

- i) The services are also not provided to an unrelated party
- ii) The provision of the services is not the principal activity of the service provider
- iii) The services provided are routine support services
- iv) There is documentation showing the intention to pool resources to share costs prior to the provision of services.

Strict pass through costs

If the group service provider acts as a paying agent and does not enhance the value of such services, the costs may be charged without mark-up to the related party only if the costs are the legal or contractual liabilities of the related party.

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Slovak Republic – Changes in Income Tax and VAT Law in 2009

Income tax

The Slovak Income Tax Act (No. 595/2003 Coll.) has been further amended for the 2009 tax period in response to the current economic crisis and European Union regulations. Although the amendment, Act No. 60, is effective from 1 March 2009, some provisions were made retroactive to the beginning of the year. This section and the next discuss the changes in income tax law resulting from this amendment.

For small businesses with no employees, prior year income under € 170,000 and income from an undertaking, self-employed gainful activities and/or leases, tax records can be used as the underlying documents for proving expenditures in lieu of single-entry (cash) accounting. Such an entrepreneur is not subject to obligations under the Slovak Accounting Act.

Income from bonds issued by the Slovak Government and registered outside Slovakia are no longer exempt from Slovak income tax.

Any method for excluding income earned outside Slovakia from income tax for the purpose of preventing double taxation may be used, independent of the applicable method in the double taxation treaty.

Accounting-related income tax issues

A newly-established company or a company established through the breakup of a larger company or merger with another company can exclude unrealised currency translation differences from taxable income. This option has been available to established companies who notify the Slovak tax authorities of their intention to exclude unrealised currency translation differences.

Any company with liabilities more than 36 months past due that decrease taxable income must include those liabilities in taxable income. This also pertains to bonuses, discounts and purchase price markdowns, which are accounted for as negative receivables and revenues under Slovak accounting standards.

Provisions for rebates and discounts that are debited to revenues are no longer recognised as tax deductible. The only provisions now recognised as tax deductible are those specifically mentioned in Sec. 20 of the Income Tax Act, which include provisions in the insurance system, provisions made by health insurance companies, unused employee leave including employer contributions, special purpose financial provisions, allowances for time-barred receivables and receivables from debtors in bankruptcy.

A company's formation costs are no longer recognised as an intangible asset for tax purposes, though the entire residual value of formation costs can be deducted in 2009. A building occupied temporarily or before a final permit of occupancy is issued can be depreciated for tax purposes, though such depreciation charges have to be reversed if the occupancy permit is not granted. Classification of plant and equipment into depreciation groups is now in accordance with EC Regulation No. 451/2008, although the taxpayer has the option to use the amended grouping starting in either 2009 or 2010. For some items, this would lead to fewer years for fully depreciating some plant and equipment, such as machines for processing food and clothing, agriculture and forestry equipment, printing and measuring devices, forklifts, electrical distributors and control equipment. Individually severable movable parts such as motors and gearboxes can be depreciated by component, although individual components are classified in the same depreciation group as the overall asset. The only items inside buildings whose components can be separately depreciated for tax purposes are computer distribution networks, elevators, escalators and air conditioning. Plant and equipment whose initial value is less than € 1,700 can be either written off in 2009 or depreciated.

Thin capitalization

Beginning with the 2009 tax period, thin capitalization rules were restored where the lender has at least 25% direct or indirect interest in the borrower's registered capital or vice versa. Interest paid on loans is no longer

tax deductible if it averages six times the equity reported at the end of the tax period prior to the period in which the level of interest is being figured.

This provision applies when the average calculated loan balance is greater than € 3,319,400. Thin capitalization rules do not apply to interest-free loans.

Value added tax

The Slovak Value Added Tax Act (No. 222/2004 Coll.) was also further amended by Act No. 83/2009 Coll. And effective from 1 March 2009. The amendment allows groups who are financially, economically and organisationally connected to register (and deregister) as a single taxable entity, although a person can only be a member of one group. Supplies of goods and services within the group are not considered taxable transactions and are not subject to VAT. If the group supplies goods and services, the specific member of the group who is supplying the customer and the group's tax identification number is shown on the invoice.

VAT may be deducted for any tax period within the year in which a taxpayer is entitled to deduct the VAT if there is a claim for a VAT deduction and the invoice can be supplied. When self-charging VAT, the VAT payer deducts the VAT at earliest in the tax period when there is a claim for VAT deduction and at latest in the final tax period of its business year.

Starting in April 2009, VAT has to be paid and can be deducted on the supply of goods and services in Slovakia for the period in which a person should have been VAT registered but failed to register for VAT. Such a person is also required to submit a VAT return for the above period.

The VAT Act now incorporates Article 199 of Directive 2006/112/EC, where the buyer of metal waste and scrap supplied in Slovakia is now required to pay VAT.

A VAT payer can ask the tax authorities, starting in April 2009, to return excess VAT deductions (where VAT deducted is greater than VAT due) within 30 days of the deadline for submitting a tax return if the registered VAT payer submits returns monthly, has been a VAT payer for 12 months and has no VAT due. This is also a response to current economic conditions.

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TAIWAN – Tax Update

New Estate and Gift Tax Rate

Estate and gift taxes are levied on the worldwide assets of Taiwan-domiciled individuals. If a Taiwanese national does not have a Taiwan domicile but has a residence in Taiwan, his worldwide assets are subject to the Taiwan estate and gift tax, provided the individual's total stay in Taiwan exceeds 365 days out of the two years before the date of decease or gift transfer. The tax rate of estate tax and gift tax vary from 2% to 50% and 4% to 50% on a progressive scale, respectively, but the Estate and Gift Tax Act was amended in January 2009 for both estate tax and gift tax and a flat rate of 10% has been effective since 23 January 2009.

Loss Carry Forward on Profit-Seeking Enterprise Income Tax

The Income Tax Act was amended in January 2009, the years of losses could be carried forward is extended to ten years (five years before amendment) while loss carry back is prohibited.

In the case of loss carry forwards these are only available to companies which keep a complete set of accounting records and which file blue returns or returns certified by a CPA.

Deduction and Exemption on Personal Income Tax

Caused by amendment of Income Tax Act and increase of the consumer price index, the 2009 deduction and exemption on personal income tax are as follows:

Standard deduction: NT\$ 76,000 (NT\$73,000 in 2008) for a single taxpayer, NT\$ 152,000 (NT\$146,000 in 2008) for a taxpayer and his (her) spouse.

Salary earner's special deduction: NT\$104,000 per salary or wage earner (NT\$100,000 in 2008).

Deduction for the disabled: NT\$104,000 per disabled person (NT\$100,000 in 2008).

Deduction for higher education of children: NT\$25,000 per person.

Personal exemption: NT\$82,000 (NT\$77,000 in 2008).

The tax brackets and rates of resident individual income tax are as follows:

Net Taxable Income (\$NT)	Rate on Excess (%)
1 - 410,000	6
410,001 - 1,090,000	13
1,090,001 - 2,180,000	21
2,180,001 - 4,090,000	30
4,090,001 -	40

Non-resident aliens staying in Taiwan for fewer than 183 days within a calendar year are taxed at 20% on gross income.

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THAILAND – Tax Update

Tax Rate Reduction on the Sale of Immovable Property

The reduced transfer fee of 0.01% (usual rate 2%) and specific business tax of 0.11% (usual rate 3.3%) for the transfer of certain immovable properties has been extended for a further year. The reduced rate will apply until 28 March 2010.

Tax Calculation for BOI-Promoted Projects

In a contrary ruling to a previous Board of Taxation decision, the Board of Investment Office has ruled that a company which has been granted BOI privileges can now calculate the profit and loss of each promoted project separately. Instead of combining the profit and losses of each project in that accounting period, any loss incurred by a specific promoted project can now be carried forward for offset against profits after the expiration of the tax holiday period.

Corporate Income Tax

Double deduction for training/ seminar room

Certain room rental expenses incurred in Thailand after 1 January 2009 for the training of staff including rooms used for seminar hire and overnight stays will now be entitled to a 200% write-off.

Transfer of Partial Business

Any company transferring part of its business during the 2009 year will be granted an exemption from Value Added Tax, specific business tax and stamp duty.

Debt restructuring

For debt restructuring of Non-Performing Loans (NPL) made during the period 1 January 2009 to 31 December 2009, NPL debtors will be exempt from income tax on the debt released by the financial institution or other creditors, provided certain complying conditions imposed by the Bank of Thailand are met.

The financial institutions and other creditors will also be allowed to write-off certain bad debts as a tax deductible expense without having to comply with the normal bad debt write-off rules.

Under the new measures, debtors of financial institutions (and other creditors) may also be exempt from a variety of taxes including income tax, VAT, SBT and stamp duty where there is a restructuring or partial restructuring of the business. They may also qualify for a reduction in the transfer fee where the restructuring involves a sale of real property.

Personal Income Tax

Deduction for the Purchase of Certain Immovable Properties

A personal income tax deduction will be allowed on the purchase of certain immovable properties used for primary residency. Those properties which qualify include buildings, buildings with land, and condominiums. The following conditions apply:

1. The amount must be paid in the period 1 January to 31 December 2009 and the eligible deduction shall not exceed Baht 300,000. The transfer of ownership must also be registered in that period.

INTERNATIONAL TAX ALERT



2. The taxpayer shall own such immovable property for at least three consecutive years from the date of registration and such property shall never partly or entirely be registered for transfer.

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United Kingdom – Tax Update

Introduction of changes to the UK taxation of foreign profits

Changes were announced in the Budget on 22 April 2009 in four main areas.

Foreign dividends exemption

The participation exemption regime covered in our previous tax update will now take effect for dividends received by UK companies on or after 1 July 2009.

The rules differ depending on whether or not the recipient of the dividend is a small company, as determined using EU definitions.

Broadly speaking, small companies will be exempt from tax on dividends provided they have not been paid as part of a tax avoidance scheme and the payer is resident in a qualifying territory. Qualifying territories are broadly those which have ratified a double taxation agreement with the UK which contains a non-discrimination article.

For other companies, the exemption will apply if the dividend falls within one of a number of 'exempt classes' and does not fall foul of various anti-avoidance provisions.

It will be possible to make an election to disapply the exemption to individual dividends where this results in a more favourable outcome, such as where the UK tax charge on the dividend would be largely or fully relieved through double tax relief and

- the dividend would fulfil an acceptable distribution policy (ADP) under the controlled foreign company (CFC) rules, or
- the amount of withholding tax suffered overseas is dependent on whether the dividend is subject to tax in the UK.

Worldwide debt cap

A new regime will apply to the UK members of large groups of companies with effect from accounting periods beginning on or after 1 January 2010.

The broad aim of the regime is to disallow deductions for finance expenses incurred by UK companies and UK permanent establishments of overseas companies (collectively known as 'relevant group companies') to the extent that those expenses, in total, exceed the consolidated debt finance cost of the worldwide group of which those companies form a part.

The disallowance is the difference between two amounts, the 'tested expense amount' and the 'available amount'. The tested expense amount is broadly the net amount of expenses relating to financing arrangements in the period on which the relevant group companies can claim UK tax deductions. Any company with net finance income, or net finance expenses of less than £0.5m, is ignored. The available amount is the worldwide group's gross consolidated finance expense (UK and non-UK).

Where deductions are restricted under the debt cap, the group will be able to choose which of the relevant group companies the restriction is to apply to and in what proportions. Only companies with net finance expenses for the period may be chosen. A return will need to be submitted to the UK tax authorities (HMRC) indicating the group's preferred allocation. Where no return is submitted, there will be a prescribed methodology that HMRC will apply in restricting the deductions.

To the extent that deductions have been restricted, an equivalent amount of finance income arising in relevant group companies with net finance income may be exempted from UK tax. Again, a return will need

to be submitted by the group indicating which companies it would like the exemption to apply to and in what proportions.

The new regime will place a significant administrative burden on large groups who will be required to prepare detailed calculations to comply with the requirements set out above. To ease the burden on some groups, a gateway test is to be introduced. The test will adopt a balance sheet approach and, if met, will exempt a group from the new legislation. The gateway test will be met if the sum of the UK group companies' net debt does not exceed 75% of the group's consolidated gross debt. Any company with net debt of less than £3m will be ignored for the purposes of calculating the group's UK net debt position.

CFC changes

As mentioned in our previous tax update, the holding company and ADP exemptions will be abolished from 1 July 2009, subject to transitional provisions.

Treasury consents

The Treasury consents legislation is repealed for transactions taking place on or after 1 July 2009. It is replaced with a new reporting requirement under which a monetary penalty will be imposed for non-disclosure.

If a reportable event takes place it must be reported to HMRC within six months of the event taking place (although companies will have until 1 April 2010 to report any transactions that occur before 1 October 2009).

Events are reportable if the value exceeds £100m and will apply to the following:

- an issue of shares or debentures by a foreign subsidiary
- a transfer by the reporting body, or a transfer caused or permitted by the reporting body, of shares or debentures of a foreign subsidiary in which the reporting body has an interest, and
- any situation which results in a foreign subsidiary becoming, or ceasing to be, a controlling partner in a partnership.

VAT - option to tax supplies of property

Property owners can opt to tax commercial property. The main purpose of opting to charge VAT on supplies of a property (sales or letting) is to recover VAT on costs relating to the property or prevent a VAT clawback. This is because VAT is only recoverable on costs incurred in making taxable, as opposed to exempt, supplies. Careful consideration is needed before opting to tax, to ensure that it will achieve the desired outcome.

Property owners can opt on a building-by-building basis; it does not automatically affect other buildings in the same ownership and it only binds the person making it. The option applies to the whole of a building and the land it stands on, and, from the date that it takes effect, all supplies made in respect of the property are liable to VAT at the standard rate, including where the original building has been demolished and a new building constructed.

Opting to tax now

A new automatic permission condition (APC) has been introduced, from 1 May 2009, for taxpayers who would otherwise need to request permission from HMRC to be allowed to opt to tax. The APC replaces the previous Condition Three regarding input tax incurred prior to the surrender of a lease set out in paragraph 5.2 of VAT Notice 742A (which has the force of law).

The APC also replaces two informal concessions concerning exempt supplies made prior to opting to tax, where the option gives rise to a requirement to be registered for VAT, and where exempt supplies have been

made prior to an option where HMRC looks for a 'fair and reasonable' input tax recovery. These informal concessions will continue to apply until 30 April 2010.

Revoking an old option to tax may save VAT

An option to tax may be revoked where more than 20 years have elapsed since it first had effect. Therefore, from 1 August 2009, landlords who opted to tax a property on 1 August 1989 will shortly have the first opportunity to revoke it, so that future supplies can be exempt from VAT. However, before doing this, the full ramifications and potential opportunities should be considered.

Landlords and owners may benefit from revoking the option to tax because they want to attract a tenant or a purchaser who cannot recover all or any of the VAT that it would incur on renting or buying the property (eg financial services organisations, charities, education providers, health providers, etc). However, care is needed where refurbishment works are required, on which VAT will be incurred.

If the net value of expected refurbishment works exceeds £250,000, they will fall within the Capital Goods Scheme. This means that the input tax would need to be adjusted over a 10 year period and, after the option is revoked (which would need to be agreed with HMRC), it would result in a clawback of part of the input tax claimed.

However, if the net value of the refurbishment work is less than £250,000 (which equates to £287,500 gross) then the recovery of the applicable input tax may only need to be considered in the year that it is incurred. For example, if a landlord was contemplating revoking an option to tax, refurbishment works to the value of, say, £280,000 gross could be carried out, and VAT £36,750 of reclaimed. (These figures will of course change when the 17.5% VAT rate resumes on 1 January 2010.)

As long as that landlord does not revoke the option until after the end of the VAT year in which the refurbishment works are carried out, (normally the end of March, April or May) the landlord should benefit from both full VAT recovery on the refurbishment and selling or letting of the property in the next VAT year free of VAT.

If the property is to be let, for direct tax purposes, the refurbishment works may qualify for capital allowances that can be offset against any rental income. Alternatively, if the property is to be sold, any refurbishment costs are likely to be available as capital enhancement costs that can be deducted when calculating the capital gain made on the sale. Furthermore, as stamp duty land tax is payable by the purchaser on the gross purchase price (ie including VAT), the fact that VAT would no longer be chargeable following revocation of the option, would result in a saving to the purchaser and this could be used by the owner to secure additional consideration during the price negotiations.

Tax disclosure and avoidance

Two measures were announced in this year's Budget which illustrate HMRC's determination to deal severely with those involved in tax evasion or who do not take their tax responsibilities seriously.

Personal liability of some senior accounting officers

Senior accounting officers (defined as 'the director or officer of the company who, in the company's reasonable opinion, has overall responsibility for the company's financial accounting arrangements') of some large companies now face an onerous new reporting obligation. Such officers will now be required to take reasonable steps to establish and monitor accounting systems within their companies that are adequate for the purposes of 'accurate tax reporting'. They must also certify annually that the systems are adequate, or specify the nature of any inadequacies. Relevant companies must notify HMRC of the identity of the senior accounting officer.

Fixed penalties of £5,000 will be chargeable on:

1. the senior accounting officer if he or she fails to take reasonable steps to establish and monitor accounting systems within their companies that are adequate for the purposes of 'accurate tax reporting'
2. the senior accounting officer if he or she fails to certify to HMRC that the systems are adequate
3. the company if it fails to notify HMRC of the identity of the senior accounting officer.

Naming and shaming serious tax defaulters

Provisions are being introduced that will enable HMRC to publish the names of companies and individuals who have deliberately understated more than £25,000 of tax and this leads to a penalty being charged. Taxpayers who make an unprompted disclosure or a full prompted disclosure within the required time will not be affected.

The details published will include not only the relevant names and amounts, but also addresses and the business sector. The details can be published in any way that HMRC sees fit (including online) but can only be displayed for a year. HMRC must inform the taxpayer whose identity is to be published so that the taxpayer can 'make representations' to object.

Those who have deliberately evaded a much smaller figure, just £5,000 of tax, will be required to submit returns for up to the following five years showing more detailed tax information, for example, details of the nature and value of any balancing adjustments within business accounts.

Changes to tax rates for high earning individuals

A range of measures were announced in Budget 2009 which will begin to take effect from 6 April 2010 and aim to shift the burden of taxation towards those UK resident individuals who have the highest incomes.

New 50% tax rate

From 6 April 2010, individuals with incomes over £150,000 per year will suffer a 50% tax rate on their taxable non-dividend income above £150,000 per year (such income is currently taxed at 40%). A 42.5% dividend tax rate will apply where taxable income is over £150,000 a year (such dividends are currently taxed at 32.5%). Taking into account dividend tax credits, this means that the effective dividend tax rate for high income individuals will increase from 25% to 36.11%.

Personal allowances changes

For individuals with total net incomes over £100,000 per annum, the personal allowance will be reduced by £1 for every £2 of net income over £100,000. Net income takes account of losses, pension payments (in full, see example above) and allowable contributions to charity.

Although the level of personal allowance for 2010/11 has not yet been announced, the effect of this is likely to be that the basic personal allowance will be reduced to nil for net incomes over approximately £113,000 per year. As a result the marginal tax rate between £100,000 and £113,000 will be 60%.

Relief for pension contributions

The Government intends to introduce new pension rules from 2011/12 onwards to limit the tax relief given to high income individuals. At present, individuals paying tax at the 40% rate are entitled to claim tax relief at this rate for contributions they make to private and employer sponsored pension schemes. It is proposed that, for those individuals with taxable income in excess of £150,000, the rate of relief will be reduced on a sliding scale to a 20% rate for individuals earning more than £180,000.

In advance of this, the Government is introducing 'anti-forestalling rules' to prevent such individuals benefiting from making substantial increases in their pension provision in 2009/10 and 2010/11.

INTERNATIONAL TAX ALERT



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US – Chicago – Changes to the International Tax Landscape

International business transactions as well as individual taxpayers holding offshore investment accounts have come under heightened IRS scrutiny in recent months. In fact, IRS Commissioner Douglas Shulman recently commented before The Organization for Economic Cooperation and Development that "[he has] made international issues a top priority since "Day One" of [his] tenure as IRS Commissioner." He went on to say that "[he is] proud to lead the IRS' renewed, refocused and reinvigorated enforcement efforts" with respect to international activity.

As part of these efforts, at the end of 2008, Congress significantly strengthened the penalty provisions surrounding the informational reporting of transactions on Form 5471 (covering foreign corporation owned by a US resident) and Form 5472 (covering US companies owned by certain foreign owners). There has also been a significant surge in the IRS' focus on using offshore bank accounts in tax haven jurisdictions to avoid the imposition of US tax. Although much more difficult to identify and control, Commissioner Shulman is also hopeful that Congress will pass an extension of the statute of limitations to assist the IRS in enforcement actions against such individuals.

As further evidence of the focus on international transactions and with a goal of stemming perceived abuses in the tax code and generating revenue to chip away at a rising US budget deficit, the Obama administration recently unveiled a series of proposals that would have a drastic impact on the effective tax rate of multinational corporations. These proposals still have a long way to go before being enacted into law and, based upon their current wording, would not become effective until 2010, but they do demand your attention now so that you can prepare your clients accordingly.

The following four measures have been put forth as the most significant revenue raisers:

- (1) the mandatory deferral of deductions associated with foreign source income that is not currently subject to US tax
- (2) the requirement that the computation of the deemed foreign tax credits under Section 78 be based upon the consolidated earnings and profits and tax pools of all foreign subsidiaries
- (3) a matching requirement to prevent the separation of creditable foreign taxes from the associated foreign income in the context of hybrid arrangements and
- (4) a requirement to make the check-the-box election to treat an entity as a separate corporation for certain overseas disregarded entities.

You may be wondering how these provisions will really affect your clients. As with many changes in the tax law, modifications that are targeted at specific abuses often lead to changes with more sweeping application. For example, if a US entity were to borrow money to acquire a subsidiary located in a foreign jurisdiction, under the deferral rule mentioned above, the interest incurred on the debt used to acquire that subsidiary would be treated as non-deductible so long as the foreign entity's earnings were not subject to US tax.

This would be the case even if there were no tax avoidance motivation in the acquisition. What this will mean to you and your clients is that additional care must be taken to source your US client's expenses between domestic and foreign source income in order to determine the current deductibility of such expenses. Additionally, you must then track those deferred expenses until the foreign income to which it is attributed is repatriated. Complicating the process are certain exceptions; one of which is the allowance of current deductions for research and experimentation expenditures.

The second proposal could lead to a significant dilution of a US entity's allowable foreign tax credits. Generally speaking, when a foreign subsidiary makes a distribution to a US parent, the US parent is eligible to take a foreign tax credit based upon the taxes paid by the foreign subsidiary. This rule is in place to create parity between subsidiaries that are treated as separate entities and those that are treated as branches for US tax purposes. Currently, that deemed-paid credit is calculated on a subsidiary by subsidiary

basis, taking into account the earnings and profits and tax pool of that particular subsidiary. As proposed, if a US parent has two or more subsidiaries, if one subsidiary is in a high tax jurisdiction and one is in a low tax jurisdiction, its deemed paid tax credit will be based upon a blending of the two subsidiaries' earnings and profits and tax pools. The likely effect will be to reduce the current foreign tax credit available.

The third provision was proposed to deal with the situation described in the *Guardian Industries* case. In that case, a US company owned a Luxembourg subsidiary that it had treated as a disregarded entity. That subsidiary filed a consolidated return in Luxembourg with its subsidiaries and remitted tax based upon the consolidated taxable income of the group. The US parent included in income only the income of the first tier Luxembourg subsidiary, but claimed a credit based upon the full amount of tax paid in Luxembourg by the consolidated group.

The US Court of Appeals for the Federal Circuit held that because the tax imposed in Luxembourg was legally owed by the parent entity, which was disregarded for US tax purposes, the full amount of the tax was creditable in the US, despite the fact that the lower tier subsidiaries' income was not includable for US purposes.

The fourth proposal will serve to severely limit the use of the check-the-box election to choose the tax status of foreign entities in multijurisdictional organizational structures. Under the proposal, unless the subsidiary of a controlled foreign corporation is incorporated in the same country as the controlled foreign corporation, that subsidiary will be required to be treated as a separate corporation for US tax purposes. As a result, US companies will not be able to avoid the implications of the controlled foreign corporation rules through the use of a lower tier disregarded entity in low tax jurisdictions.

The administration also introduced six additional provisions that purportedly serve as "loophole closers." These provisions would

1. limit the ability of US multinationals to shift income outside the US through intangible property transfers
2. tighten the earnings-stripping rules
3. repeal the boot-within-gain cap in the case of cross-border reorganizations
4. repeal the 80/20 company rules
5. revamp the withholding rules to address the issue of using equity swaps and
6. modify the foreign tax rules with respect to taxpayers that are subject to a foreign levy while receiving economic benefits from the levying country ("dual-capacity" taxpayers) to allow foreign levies to be creditable only if that country imposes an income tax.

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US – Houston – President Obama’s Proposed International Tax Proposals Will Bring Big Changes for Multinational Companies

On 11 May 2009, the Treasury Department released its highly-anticipated *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals*, otherwise known as the Treasury Green Book. In addition to the Obama administration's other tax proposals, the Green Book provides details on the administration's international tax proposals that were presented in a fact sheet released by the administration on 4 May 2009. In total, the administration's international tax proposals are estimated to raise approximately \$210 billion over 10 years (FY2010-FY2019).

A summary of these international tax proposals that were initially identified in the 4 May fact sheet and that are more fully described in Treasury's Green Book include the following:

1. Disallowance of the entity classification election, known as the “check-the-box” election, for a foreign eligible entity to be treated as disregarded from its owner if the owner is created or organised in a jurisdiction other than the jurisdiction in which the foreign eligible entity is created or organised (with an exception for foreign eligible entities wholly owned by a US person)
2. Deferral of deductions, other than research and experimentation expenses, related to foreign-source income that is not currently subject to US income tax
3. Changes to the US foreign tax credit system by (i) requiring deemed paid foreign tax credits to be determined on a consolidated basis, and (ii) implementing a matching rule to prevent the splitting of foreign income taxes from the underlying income; and
4. Bolstering of the information reporting and withholding systems that support US taxation of income earned or held by US persons through offshore accounts or entities.

The additional international tax proposals described in the Green Book include the following:

1. Clarification of the definition of intangible property for purposes of transfer pricing and narrowing of the rules regarding intangible property transfers
2. Modification of the "earnings-stripping" rules for certain expatriated entities in further limiting their ability to deduct interest expense items
3. Repeal of a rule that would limit the recognition of gain in certain cross-border reorganizations
4. Repeal of the "80/20" company rules; Under the existing "80/20" company rules, a US corporation that meets certain requirements can pay interest that is considered foreign-source and is entitled to distribute dividends free of US withholding tax
5. Modification of application of the withholding tax rules to securities lending transactions and equity swaps
6. Modification of the tax rules applicable to dual-capacity taxpayers.

In addition, the Obama administration's proposals include a provision for the codification of the economic substance doctrine. The administration also proposes to extend through 31 December 2010, the subpart F "active financing" and "CFC look-through" provisions which currently provide relief for taxpayers in allowing them to redeploy earnings overseas without immediate taxation in the US tax base.

While there has been a significant amount of press and discussion in the tax community regarding the administration's proposed changes to the international tax rules, the release of the administration's budget and the accompanying Green Book is only the initial starting point for what could be a long legislative process for the many tax proposals included in the proposed budget. Nevertheless, lawmakers will be facing

significant revenue pressures as they work to advance their priorities on health reform and other initiatives in the coming months. The substantial revenue figures associated with these international tax proposals likely will keep them at the forefront as these other initiatives are being debated.

Executives need to become familiar with these international tax proposals and to assess how the proposals could affect their companies. Given the significance of these proposals, business executives should consider speaking to their tax advisors with regard to what impact they may have on their current operating structures. Further, preliminary discussions should begin with respect to identifying what alternatives there may be and what restructuring initiatives may be considered, if these proposals become enacted into law.

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US – New York - Offshore Voluntary Disclosure Program

What is the Offshore Voluntary Disclosure Program?

This program is a practice that has been employed by IRS investigators in criminal matters for many years. The objective of the program is to bring taxpayers who have used undisclosed foreign financial accounts and undisclosed foreign entities to avoid or evade tax into compliance with United States tax laws. Another peripheral goal of the program is to enable the IRS to gather information on how foreign bank accounts are being promoted as a way to avoid or evade tax. Data gathered during this process will be used in developing additional IRS strategies to inhibit promoters and facilitators from soliciting new clients.

Taxpayers are strongly encouraged to make a voluntary disclosure because it will enable them to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution. Voluntary disclosure is especially important because the IRS takes into account “timely”, accurate and complete voluntary disclosures when deciding which cases get recommended to the Department of Justice for criminal prosecution. The definition of timely for these purposes is ‘before the IRS has initiated a civil examination regardless of whether it relates to undisclosed foreign accounts or entities’.

How Does a Person Make a Voluntary Disclosure?

A voluntary disclosure is made by following procedures described in the IRS Internal Revenue Manual. Individuals can initiate the process by calling their local IRS Criminal Investigation (CI) office followed by a letter stating their intention to make a voluntary disclosure. Ideally, the letter should include all identifying information; name, address, social security number, date of birth and passport number.

The letter should provide details of the unreported income or incorrectly claimed deductions or credits taken related to the undisclosed foreign accounts or foreign entities including a reason for the omission. The IRS CI will follow up on the facts and circumstances to assess the timeliness, completeness and truthfulness of the voluntary disclosure. Based on their findings, recommendations will be made.

What if you reported all your taxable income but recently learned that you should be filing foreign bank account reports (Form TD 90-22.1) (FBARs)? Should you use the Voluntary Disclosure Program?

According to IRS guidance, if you reported all taxable income from all accounts, you should not use the voluntary disclosure process. Instead, delinquent FBARs should be prepared in accordance with the instructions and should be filed with a statement attached explaining why the forms are being filed late, together with a copy of the tax returns for all relevant years. The forms should be sent to IRS Philadelphia Offshore Identification Unit by 23 September 2009. If these steps are followed, the IRS has stated that no penalties will be imposed for the failure to file FBARs.

What if, in addition to delinquent FBARs, additional taxable income needs to be reported?

Summary of IRS Proposed Settlement

IRS announced that the tax liabilities related to offshore issues of taxpayers that make “voluntary disclosure requests” will be settled as follows:

... Taxes and interest due going back six years will be assessed. The taxpayer must file or amend all returns, including information returns, and FBARs.

... IRS will assess either an accuracy or delinquency penalty for all years (no reasonable cause exception will be applied).

... In lieu of all other penalties that may apply (including FBAR and information return penalties), IRS will assess a penalty **equal to 20% of the amount in a foreign bank account or entity** in the year with the highest aggregate account or asset value.

The penalty is reduced to 5% if, with respect to the accounts or entities formed: (a) the taxpayer did not open them or cause them to be opened or formed; (b) there has been no activity during the period the accounts/entities were controlled by the taxpayer; and (c) all applicable US taxes have been paid on the funds in the accounts/entities (where only the earnings have escaped US taxes).

The above terms will apply only to taxpayers that “fully cooperate with IRS both civilly and criminally”. The terms will remain in effect only for six months from 23 March 2009 (the date that IRS released its voluntary disclosure offer).

Illustration of how settlement would work as described in IRS FAQs.

In FAQ 12, a taxpayer deposits \$1 million in a foreign account in 2003. It is assumed this amount is not unreported income. The account earns \$50,000 of income each year, and the account balance in 2008 is \$1.3 million.

Year	Amount on Deposit	Interest Income	Account Balance
2003	\$ 1,000,000	\$ 50,000	\$ 1,050,000
2004		50,000	1,100,000
2005		50,000	1,150,000
2006		50,000	1,200,000
2007		50,000	1,250,000
2008		50,000	1,300,000

The taxpayer is in the 35% bracket, files a return but does not report the foreign account or the interest income on it, and the maximum applicable penalties are imposed. If the taxpayer takes advantage of IRS voluntary disclosure offer he would pay a total of \$386,000 plus interest. This sum consists of:

... tax of \$105,000 (six years at \$17,500 [$\$50,000 \times .35$] plus interest;
... an accuracy-related penalty of \$21,000 (ie, $\$105,000 \times .20$); and
... an additional penalty, in lieu of the FBAR and other potential penalties that may apply, of \$260,000 (ie, $\$1,300,000 \times .20$).

If the taxpayer does not come forward and the IRS discovers his offshore activity, he would face up to \$2,306,000 in tax, accuracy-related penalty, and FBAR penalty. The taxpayer would also be liable for interest and possibly additional penalties, and an examination could lead to criminal prosecution.

The civil liabilities potentially include:

- Tax and accuracy-related penalty, plus interest
- Penalties totaling up to \$2,175,000 for willful failures to file complete and correct FBARs (2003 - \$100,000, 2004 - \$100,000, 2005 - \$100,000, 2006 - \$600,000, 2007 - \$625,000 and 2008 - \$650,000)
- The potential of having the fraud penalty (75 %) apply, and
- The potential of substantial additional information return penalties if the foreign account or assets is held through a foreign entity such as a trust or corporation and required information returns were not filed.

Who is eligible and ineligible for relief under the voluntary disclosure initiative?

The offer is open to all taxpayers that comply with IRS's terms, including corporations, partnerships and trusts (FAQ 19), and those taxpayers that have an offshore merchant account (FAQ 8). The offer does *not* apply if IRS has initiated a civil examination of the taxpayer, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities. (FAQ 7)

What happens at the end of six months? Will you get a better deal if you wait to see what the IRS does at the end of six months?

Taxpayers should not wait until the end of the six-month period to make their voluntary disclosures as there is no guarantee that the taxpayer will still be eligible or that the current penalty terms will be available after six months.

Taxpayers who wait until the end of the six-month period run the risk that they will be disqualified from the Voluntary Disclosure Program. The IRS has stepped up its enforcement efforts, including the use of John Doe summonses, to identify taxpayers using offshore accounts and entities to avoid tax. In addition, the IRS continues to receive information from whistle blowers and other taxpayers making voluntary disclosures. If the IRS receives specific information about a taxpayer's noncompliance before the taxpayer attempts to make a voluntary disclosure, the disclosure will not be timely and the taxpayer will not be eligible for the criminal and civil penalty relief available under the voluntary disclosure program. Finally, taxpayers run a substantial risk that the uniform penalty structure described in the internal guidance will not be available past the six-month deadline or that the terms will be less beneficial to taxpayers.

Should taxpayers make a "quiet disclosure" to become compliant?

IRS says it is aware that some taxpayers are attempting "quiet disclosure" by filing amended returns and paying any related tax and interest for previously unreported offshore income without otherwise notifying IRS. In FAQ 10, IRS strongly encourages such taxpayers to come forward under the voluntary disclosure offer. Those who do not come forward run the risk of being examined and potentially criminally prosecuted for all applicable years. IRS says it has identified, and will continue to identify and closely review, amended tax returns reporting increases in income.

PKF Recommendations

INTERNATIONAL TAX ALERT



All taxpayers should review their financial matters to ensure they have not omitted income from foreign financial bank accounts and to determine whether all foreign bank accounts have been disclosed. Financial

account reporting includes any financial interest in or signature authority over any foreign financial accounts including bank, securities or other types of financial accounts in a foreign country.

PKF tax advisors have begun the process of voluntary disclosure for their clients. In many cases, PKF works in conjunction with tax attorneys especially in cases where criminal sanctions are possible. If you have any questions on IRS voluntary disclosure, please contact us.

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