



BDO International

# BDO World Wide Tax News

Issue No. 2 / 08 • August 2008

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**BDO World Wide Tax News**  
**Issue No. 2 / 08 - August 2008**

Welcome to Issue 2008 No. 2 of BDO *World Wide Tax News*, which summarises important recent tax developments of international interest across the world. If you would like further information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. BDO *World Wide Tax News* is published quarterly by BDO Global Coordination BV in Brussels. If you have any comments or suggestions concerning BDO *World Wide Tax News*, please contact the editor, Zigurds Kronbergs, by e-mail at [zkronbergs@bdoglobal.com](mailto:zkronbergs@bdoglobal.com) or by telephone on +32(0)2 778 0141.



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## European Union

# Germany did not have to allow foreign branch losses

Overriding the contrary Opinion of the Advocate-General, the European Court of Justice (ECJ) has held that Germany did not have to recognise a foreign branch loss where the possibility still existed for the loss to be offset in the home state of the branch.

The case concerned the German low-cost supermarket chain, Lidl, and its German limited partnership (KG), Lidl Belgium KG. The partnership had a branch in Luxembourg, which incurred a loss in 1999. Under the double tax treaty between Germany and Luxembourg, Germany does not tax the income of a German entity's Luxembourg branch, but neither does it allow the losses of a Luxembourg branch to be offset against the German tax liability of the principal entity.

Lidl's argument in this case was that the denial of the loss was in breach of the freedom of establishment guaranteed by the EC Treaty, because a loss incurred by a German branch would have been deductible when computing German tax liability (and of course a profit would have been taxable).

The Court agreed that this treatment was indeed discriminatory and thus a breach of the EC Treaty. However, it recognises that such discrimination may be justified if it pursues a legitimate objective and is not disproportionate. In previous cases, it has been established that the ECJ regards the following objectives to be justified in this respect:

- Preserving the allocation of taxing powers among the Member States concerned
- Preventing the risk that losses may be used twice
- Containing the risk of tax avoidance

In its judgment, the Court observed that not all three objectives need to be present in any particular case in order for the infringement of the freedom of establishment to be justified. Here, it found two of the objectives to be satisfied. The denial of foreign branch losses was capable of preserving the allocation of taxing powers, as it maintained symmetry between the right to tax profits and the right to deduct losses. It also served to prevent a double loss deduction – once in Luxembourg and once in Germany – which in Lidl's

circumstances would otherwise have been impossible to rule out.

A second condition for an infringement to be justified is that it not go beyond what is necessary to attain the objective being pursued. In this respect, the ECJ regards the denial of a loss deduction to be disproportionate if it results in a definitive exclusion of the right to deduct altogether. Here, however, the Court observed that deduction of the loss had not been definitively excluded. Under Luxembourg law, a branch loss could be carried forward and, indeed, Lidl had been able to deduct its 1999 Luxembourg loss against its 2003 Luxembourg profits.

Whereas the Advocate-General had concluded that the German rule was disproportionate, the Court held that it was both proportionate and served a legitimate objective.

The Lidl case confirms the landmark judgment of the ECJ in *Marks & Spencer* on the use of cross-border losses. In that case, the ECJ held that a Member State must allow a resident company to deduct a loss incurred by a foreign subsidiary resident in another Member State if, but only if, the possibility that the loss might be deductible in the foreign subsidiary's home state was definitively excluded. It also confirms that the principle applies equally to branches (permanent establishments) as to subsidiaries.

However, the judgment takes no account of the potentially significant cash flow disadvantage that may arise if the taxpayer has to accept an indefinite delay before the loss becomes deductible. It also leaves open whether it is sufficient for only one of the three objectives to be present for an infringing measure to be justified (here there were two). It also fails to clarify in what circumstances and when a loss can be considered as definitively no longer deductible. In this respect, we can expect further litigation before the European Court.

In the meantime, companies and other entities that have made claims for cross-border losses made by their foreign branches, on the basis of the Advocate-General's Opinion, should not withdraw them, unless the loss in question has actually been used or could still be used in the branch's home state.



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## North America and the Caribbean Canada

# Taxpayer wins in ‘beneficial ownership’ case

The Tax Court of Canada has released its long-awaited decision in the *Prévost* case. This case was an attack by the Canadian tax authorities on what they perceived was tax treaty shopping – the Canadian government argued that favourable withholding tax rates on dividends available under the Canada-Netherlands tax treaty were not available to a Netherlands holding company resident in the Netherlands because this company was not the ‘beneficial owner’ of the dividends paid by *Prévost Car Inc.*, its Canadian subsidiary. However, in a very clear decision of the Tax Court, the judge ruled in favour of the taxpayer.

The facts of the case are relatively straightforward. *Prévost* was a Quebec corporation that manufactured buses and related products in Quebec and had parts and service facilities throughout North America. In 1995, the shareholders of *Prévost* sold 51% of its shares to Volvo Bus Corporation, a company resident in Sweden, and 49% to Henlys Group plc, a company resident in the United Kingdom. This purchase was made through a Netherlands holding company, *Prévost Holding BV (PHBV)* – therefore after the purchase *Prévost* was a wholly owned subsidiary of PHBV, which in turn was owned 51% by Volvo and 49% by Henlys. At trial, the taxpayer testified that there were good business reasons for making the purchase through a Netherlands BV, which included that Volvo and Henlys wanted to use the holding company to pursue multiple North American projects (which never happened due to financial difficulties for Henlys). However, tax was a consideration as the withholding tax on dividends under the Canada-Netherlands tax treaty was lower than the

withholding tax on dividends under both the Canada-United Kingdom and Canada-Sweden treaties. Volvo and Henlys entered into a shareholders’ agreement that provided, among other things, for not less than 80% of the profits of *Prévost* and PHBV to be distributed to the shareholders Volvo and Henlys – in part, due to the fact that Henlys required the payment of dividends to help service the debt it had taken out to finance the purchase of *Prévost*. In the years that followed, several dividends were paid by *Prévost* to PHBV – in fact, money was usually advanced to Volvo and Henlys before the dividends were actually declared.

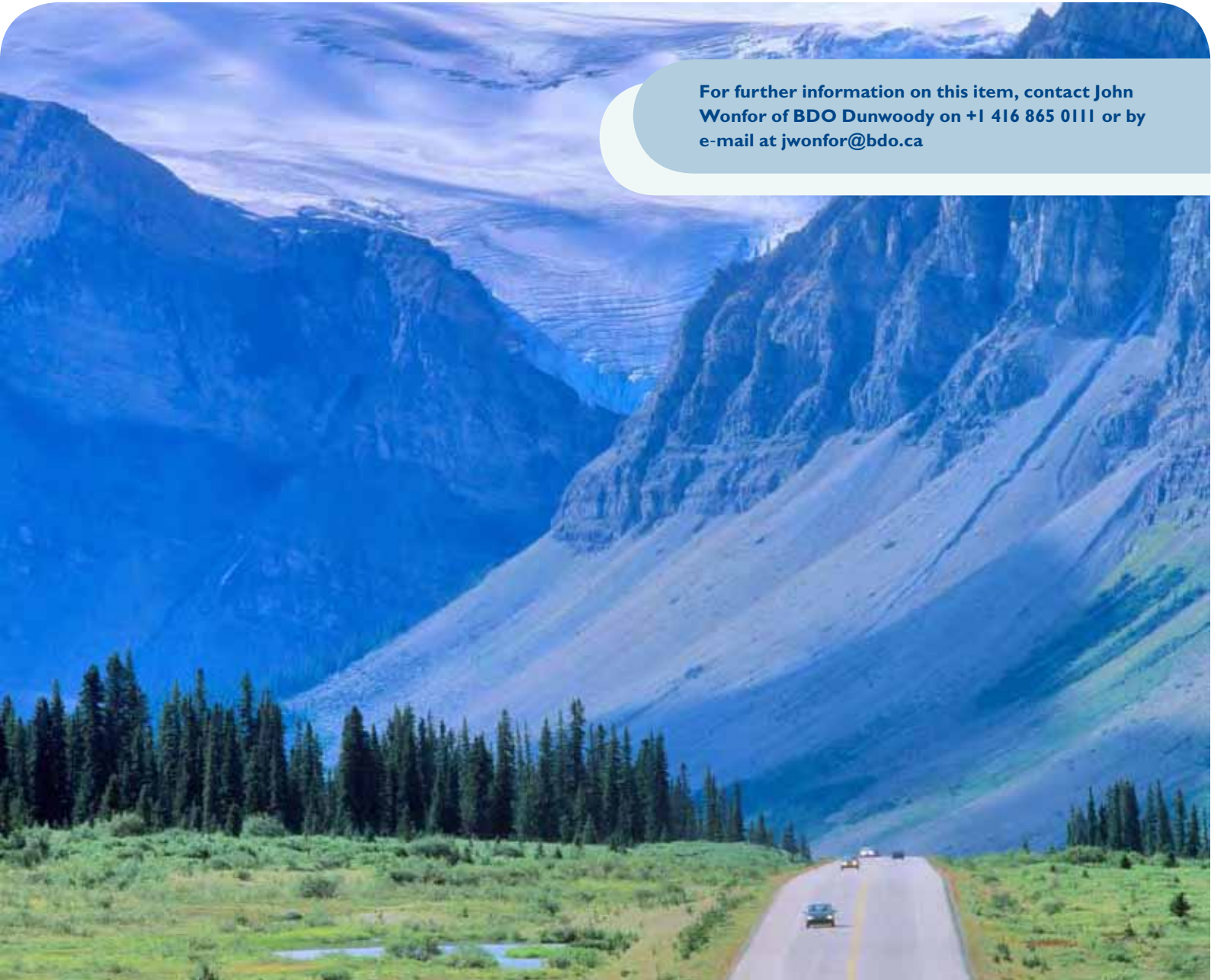
The Canadian tax authorities argued that the beneficial owner of the dividends was not PHBV, but rather its shareholders, Volvo and Henlys. Under Article 10(2) of the Canada-Netherlands tax treaty, reduced withholding tax on dividends only applies if the ‘beneficial owner’ of the dividends is resident in the Netherlands. The Canadian tax authorities argued that PHBV was not the beneficial owner of *Prévost* and was merely a conduit, pointing out that PHBV had no employees and no office in the Netherlands and that Volvo and Henlys advanced all funds required to pay the expenses of PHBV.

At trial, the taxpayer called expert witnesses who testified that under Netherlands law, PHBV was the beneficial owner of *Prévost* shares. It was noted that despite the existence of the shareholders’ agreement between Volvo and Henlys, PHBV was not contractually or otherwise required to pass on the dividends it received from its Canadian subsidiary, *Prévost*. In all cases, dividend payments had to be authorised by

PHBV's directors in accordance with Netherlands law and practice.

The Tax Court in its decision clearly agreed with the taxpayer's expert witnesses in ruling in favour of the taxpayer that PHBV, and not Volvo and Henlys, was the beneficial owner of the dividends. The judge ruled that there was no evidence that PHBV was a conduit for Volvo and Henlys. With respect to the shareholders' agreement between Volvo and Henlys that documented their agreement that dividends would be distributed from PHBV to the shareholders, the judge stated that he could not find any obligation in law requiring PHBV to pay dividends to its shareholders on a basis determined by the shareholders' agreement and that dividends must be paid in accordance with Netherlands law.

This is another significant loss in Canada's attempts to attack tax treaty shopping. The first attempt to use the Canadian general anti-avoidance rules in this regard was unsuccessful in the *MIL Investments* case. Now Canada has lost in its first attempt to use the concept of beneficial ownership to deny treaty benefits. The recently negotiated Fifth Protocol to the Canada-United States tax treaty contains a very comprehensive limitation of benefits (LOB) clause that will act as a barrier for a resident of a third country to get benefits under this treaty. It can be expected that, as a result of the *MIL* and *Prévost* decisions, Canada will look to negotiate these type of LOB provisions into tax treaties in the future. In the meantime, the tax authorities have appealed against the Tax Court's decision, so the matter has still some way to run.



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## United States of America

# IRS simplifies late-filing procedures for certain real-estate transactions.

The Internal Revenue Service (IRS) has simplified the procedures for late filing by foreign taxpayers of claims for exemption from withholding tax under the Foreign Investment in Real Property Act (FIRPTA).

Foreign taxpayers transferring shares of US corporations are generally presumed to transfer US real-property interests (in the form of equity interests in a corporation holding US real property) and consequently are subject to withholding tax under FIRPTA of 10% of the proceeds. In order to invoke non-recognition treatment (and thus an exemption from FIRPTA withholding), the affected taxpayers must comply with extensive notice and filing requirements. In situations where a taxpayer has failed to file a timely notice or statement, the affected taxpayer is no longer required to file a costly private-letter ruling in order to obtain permission to issue the FIRPTA notice or statement retroactively.

Under the new Revenue Procedure 2008-27, the affected taxpayer need only file a statement or notice with the IRS describing why the failure to file on time was due to reasonable cause.

This simplified procedure, where applicable, will be available for late-filing relief requests submitted after 26 June 2008. Pending letter-ruling requests that were not determined by 27 May 2008 can be withdrawn and a refund of the user fees may be granted.

The following statements and notices are covered by the simplified procedure:

- A foreign shareholder's request for a statement from a domestic corporation that the transferred stock was not a US real-property interest as at the date of disposal.
- The statement/notice issued by the domestic corporation to the foreign shareholder and the IRS that the domestic corporation is (or is not) a 'United States Real Property Holding Corporation'
- The transferor's statement to the transferee that the transferred stock is not a US real-property interest
- The statement by the foreign taxpayer (transferor) that the transferor is not required to recognise gain with respect to the transfer of a US real-property interest because of a treaty provision or by reason of a non-recognition provision.
- In the event of a distribution by a foreign corporation or the disposal of an interest in a domestic corporation by a partnership, estate or trust, a statement or notice provided by the entity or fiduciary that no US real-property interest was transferred or that no gain is recognised under a non-recognition provision or a tax-treaty provision.

Before the application of Revenue Procedure 2008-27, a taxpayer who omitted to file any required statements had to request relief by applying for a letter ruling under Treas. Reg. §301.9100-3. As of 26 June 2008, taxpayers may file the omitted statement or notice with the appropriate person or IRS. The statement or notice must state "Filed pursuant to Rev. Proc. 2008-27". On some statements, the taxpayer must attach an explanation why the failure to file on time was due to reasonable cause.

By using this simplified procedure, the affected taxpayer will be able to avoid any of the user fees generally applicable to private-letter rulings.

## Regulations to curb Subpart F (CFC) abuses

New Regulations have been issued aimed at curbing what the tax authorities perceive to be abuses of the Subpart-F (controlled foreign company) provisions of the Internal Revenue Code.

Under section 956 of the Internal Revenue Code (IRC), when a controlled foreign company (CFC) makes an investment in US property, the transaction is normally viewed as a repatriation of foreign earnings and profits, giving rise to taxable income under Subpart F in the hands of the controlling US shareholder(s).

The transactions aimed at concern investments in US shares and securities. It has come to the attention of the IRS that certain CFCs are structuring certain tax-

free exchanges in return for shares or securities in a US corporation ('non-recognition exchanges') in ways that manipulate the tax base-cost of the acquired shares and securities so as to avoid section 956.

The principal effect of the Regulations is to amend the calculation of the adjusted base cost of the acquired securities, and hence the amount to be included in section 956, so that it is never less than the fair market value of the property transferred by the CFC.

The final Regulations apply to exchanges taking place after 23 June 2008.

## Partners, not partnership, must file Form 926

The IRS has concluded that in the case of property transfers made by a partnership to a foreign corporation, it is the ultimate US partner(s), rather than the partnership, who must report the transfer, on a Form 926.

In a generic legal-advice notice issued on 21 May, the IRS advises that by regulation, when a transfer of cash or property is made in exchange for shares within IRC section 351 or in some other non-recognition transaction (see above) by a partnership, the partners are treated as having transferred their respective shares of the cash or tangible property to the foreign corporation; consequently, it is the US partners, and not the partnership, that are required to file Form 926 or face non-filing penalties.

If a US partner in a transferring partnership is an estate or trust (other than a grantor trust), the transfer will be treated as it was made by the entity and not as an indirect transfer by its beneficiaries. In a grantor trust, the grantor is treated as owning the assets of the trust and thus the grantor is required to file Form 926.

If a US partner in a transferring partnership is either a C-corporation or an S-corporation, the filing requirement is imposed on the corporation itself, as both entities are included in the definition of US person and there is no special provision placing any filing requirement on the shareholders of these entities.

If a partner is a partnership itself, the look-through rules apply so that the filing requirement is again imposed on the partners, rather than the partnership.

## Change in tax-return extension procedures

On 30 June 2008, the Treasury Department published regulations intended to simplify procedures for obtaining automatic extensions of time for certain tax returns.

For individuals, corporations and certain other taxpayers, the period of automatic extensions is six months from the otherwise required due date. For partnerships and other pass-through entities, the length of time of the automatic extension period is five months. The regulations are effective for tax returns to be filed after 1 January 2009.

The changes will allow individual taxpayers to file one extension request only and not two requests (as was required in the past) to obtain the full six-month extension period for filing their individual income tax returns. For partnerships and trusts and estates, the temporary regulations provide for a five-month automatic extension period. This time difference in extension periods allows individual partners in partnerships (or beneficiaries of a trust or estate) one month between the date they receive their share of income/loss information (reported on Form K-1 from the partnership or trust) and the extended due date for filing their individual tax return.

## IRS substantially expands the jurisdiction of the APA programme

The Advance Pricing Agreement (APA) programme was conceived solely to resolve double taxation issues arising from transfer pricing under Internal Revenue Code section 482. The programme has now been formally expanded to consider determination of the proper amount of income from permanent establishments, income effectively connected with a US trade or business and income from US sources, with effect from 9 June 2008.

This Revenue Procedure will only apply to situations where a US tax treaty is in place, which is also a precondition for resolving double tax issues arising from transfer pricing.

This revision is a welcome development as previously these areas have been outside the APA's authority and thus required taxpayers to seek additional relief in other advance-determination programmes such as the pre-filing agreement programme. This will facilitate more efficient resolution of all the issues now encompassed by the APA programme.



For further information on any of these items, contact Bob Pedersen of BDO Seidman on +1 212 885 8000 or by e-mail at [rpedersen@bdo.com](mailto:rpedersen@bdo.com)

## Europe and the Mediterranean European Union

### Germany need not recognise foreign branch loss

See the lead item.

### Belgian treatment of foreign dividends may be struck down

See 'Profits rule under dividends-received deduction' under Belgium below.

## Bar on company migration rule may be ruled out

Company-law rules within the European Union that prevent 'export' of the place of effective management to another state may be ruled unlawful if the European Court of Justice follows the Opinion of the Advocate-General in the *Cartesio* case.

*Cartesio* (*Cartesio Oktató és Szolgáltató bt*) was a Hungarian limited partnership, with both partners resident in Hungary. It wished to relocate its operational headquarters to Italy while remaining an entity subject to Hungarian law. Under Hungarian law, partnerships are for this purpose treated as if they were companies. Hungarian company law adheres to the so-called 'real seat' theory, under which companies incorporated in Hungary must have their 'real seat' (their operational headquarters, where the place of effective management is located) in Hungary if they are to be governed by Hungarian law. A Hungarian company that wishes to transfer its real seat abroad must therefore first be dissolved and then reconstitute itself under the company law of the country of destination. On these grounds, *Cartesio's* application to transfer its real seat was refused. Some other Member States, such as the United Kingdom, adhere to the 'incorporation

theory', under which a company incorporated in that State is *ipso facto* governed by the law of that State, wherever its management and control is located. Under this theory, therefore, it is perfectly possible for a company to 'export' its 'real seat' without needing to be dissolved.

*Cartesio's* appeal against the refusal of its application was referred to the ECJ, which has now released the Opinion of the Advocate-General in the case. *Cartesio's* argument was that the Hungarian law was a restriction on its freedom of establishment, since, by contrast, there was nothing to prevent a relocation of its operational headquarters within Hungary. In 1988, the ECJ held, in the *Daily Mail* case, that companies (unlike natural persons) were the creatures of national law and existed only by virtue of that law. The United Kingdom, as the country of incorporation, was therefore not in breach of Community law in imposing certain conditions on UK companies wishing to move their place of effective management (management and control in the UK context) (and as the law stood at that time therefore ceasing to be resident in the United Kingdom for tax purposes) abroad.

In his Opinion, however, the Advocate-General in *Cartesio* considered that Community law had moved on since *Daily Mail* and that that case no longer accurately reflected the position the ECJ had taken in more recent decisions. National company law, in his view, could no longer be regarded as falling outside the scope of the principle of freedom of establishment. The Hungarian rule in dispute was clearly an infringement of that freedom and the absolute prohibition on company migration that it imposed was out of proportion to any legitimate objective it was aimed at satisfying. Although the European Court usually follows the Opinion of the Advocate-General, it is not bound to do so (see the *Lidl* case above), and we have some reason to believe that in this case the chances of a contrary decision are somewhat higher than normal. Nevertheless, if the Court does agree with the Advocate-General, Member States will no longer be able to operate rules such as Hungary's, and cross-border migration of the place of effective management will be unrestricted. In such an eventuality, the lawfulness or otherwise of exit taxes on company migrations will again come up for review. Another consequence may be that the chief justification for the European Company (*Societas Europaea*), which was partly designed precisely to allow a cross-border transfer of a company's seat without the legal and tax consequences of a dissolution and reincorporation, would fall away.



For further information on the European aspects of these items, contact **Andrea Bilitewski**, Chair of the BDO European Union Direct Taxes Centre of Excellence, on +49 40 302930 or by e-mail at [andrea.bilitewski@bdo.de](mailto:andrea.bilitewski@bdo.de). For the Belgian, German and Hungarian aspects, respectively, see under the respective countries below.

# Input VAT on overheads must be limited to proportion of taxable activity

The European Court of Justice has held that where a taxable person carries on both economic activities and non-economic activities, the recovery of input VAT on overheads must be limited to the proportion attributable to the taxable person's economic activity.

It is a fundamental principle of VAT that where a person carries on both economic activities (which are taxable) and non-taxable activities (such as non-economic activities), only the input tax (VAT incurred on purchases) attributable to the taxable activities may be deducted.

In the *Securix* case, a German company acquired, managed and sold properties but also held and sold participations and other investments. It acquired the capital for this by issuing shares and entering into atypical silent partnerships (*atypische stille Gesellschaften*). It claimed to recover input VAT on the entire costs of the share issues, on the grounds that these issues increased its financial resources as a whole

and were thus for the benefit of its economic activity in general. The German tax authorities allowed only a proportion of the input VAT, disallowing the amount allocable to non-business activity, viz. the acquisition of participations.

The Court upheld the position of the authorities, holding that that part of the input VAT attributable to non-economic activity was not deductible. It further held that it was at the discretion of Member States how the split between economic and non-economic activity was to be determined. The method of calculation had, however, objectively to reflect the part of the input expenditure actually attributable to the two types of activity.

For further information on this item, contact Dr Ulrich Grünwald, Chair of the BDO VAT Centre of Excellence, on +49 30 885 7220 or by e-mail at [vat@bdo.de](mailto:vat@bdo.de)



## Belgium

# Belgium under European hammer

Belgium's tax system has recently been found to be in breach of European Community law in no less than three separate cases.

We reported on the first case, involving interest payments to a foreign parent company that is also a director of the subsidiary, in the last issue of *BDO World Wide Tax News* (see 'Interest recharacterisation rule struck down', under Belgium in Issue 2008 No. 1). Two further cases are reported below.

### **Profit rule for dividends-received deduction**

Under the EC's Parent Subsidiary Directive, dividends received by a company within the European Union from a qualifying company elsewhere in the European Union must either be exempt from tax in the state of the recipient company or be taxable with credit for the foreign tax paid. Belgium adopts the exemption method, but in common with several other Member States, subjects 5% of the dividends received to tax, as is generally permitted by the Directive.

It does so by first including the whole of the dividend received in taxable income and then deducting 95%. What is unusual about the Belgian method, however, is that the 95% deduction can only be made to the extent that the recipient company has sufficient taxable income. No deduction at all can be made when the company has incurred a loss, and where the dividend deduction would exceed the taxable profits, the excess deduction cannot be made and may not either be carried forward.

It follows that a company which, excluding the dividends received, incurs a tax loss may not carry forward this loss to a subsequent tax period.

In a case brought against this restriction by a Belgian company, *Cobelfret NV*, the European Court has now heard the Opinion of the Advocate-General.

The Opinion concludes that the Belgian rule is not compatible with the Parent Subsidiary Directive, since it does not allow for exemption of qualifying dividends (subject to the 5% retention) in every case.

Although the final decision of the European Court can go against the Advocate-General's opinion (as was recently the case with *Lidl Belgium* – see the lead item above), this is unusual and unlikely in this particular case. Under the constitutional principle of equality, a possible judgment against Belgium will also have implications for dividend payments between Belgian companies. In any event, companies affected by this rule should consider claiming the full 95% deduction as well as the carry-forward of any resulting tax loss. They should also review the tax position in previous years and, if necessary, recalculate the tax loss in the light of the Advocate-General's Opinion. It is possible to enter an appeal at the time set-off of the loss is claimed, regardless of when the loss was incurred.

### **Failure to implement the Mergers Directive**

Cross-border mergers, demergers and other restructuring operations are only possible in very restricted cases under Belgian law. Under current legislation a cross-border merger or (partial) demerger, whereby a Belgian company is taken over or split within the European Union, is not a tax-free operation but usually results in a deemed liquidation of the Belgian company and taxation of gains and distributions in excess of paid-up capital. It is still also a condition that the purchasing or acquiring company be subject to Belgian corporate tax.

Nonetheless, as long ago as 1990, the Tax Mergers Directive (90/434/EEC) required generalised fiscal neutrality for various forms of cross-border restructuring within the European Union. In 2005, this was supplemented by the Company Law Mergers Directive (2005/56/EC), which requires Member States to amend their company law where necessary to enable certain forms of cross-border merger to be legally possible. Although Member States should have transposed these rules into national law a number of years ago, Belgium has neglected to do so. This delay has now been condemned by the Court of Justice.

Following this decision, Belgian companies should be able to claim tax neutrality for cross-border restructuring operations within the European Union under the terms of the two Mergers Directives. Yet they risk a long legal battle to prove their case. A Bill to provide for the implementation of the Mergers Directives is now once again under consideration by the Government.

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## Denmark

# Withholding taxes cut on outbound dividends, interest and royalties

We reported in Issue 2007 No. 4 of BDO *World Wide Tax News* that Denmark was intending to cut its rates of withholding tax on outbound dividends, interest and royalties. Those reductions have now taken place and have been in force since 1 April 2008.

With respect to dividends, non-residents who hold less than 10% of the Danish company paying the dividend now face a withholding tax on that dividend of 15%, compared to 28% previously. However, it is a condition of the lower rate that the country of which the recipient is a resident must be bound under the terms

of a double tax treaty or other agreement to exchange information with the Danish tax authorities.

The existing exemption from dividend withholding tax for foreign companies having a significant (10%+) holding in a Danish company is unaffected by the new rule, as are dividends exempt under the EC Parent Subsidiary Directive.

The withholding tax on interest and royalties has been reduced to 25% from 30%. Lower rates granted by Denmark's tax treaties or by the EC Interest and Royalties Directive are unaffected.

## Expatriate tax régime extended

Expatriate employees coming to work in Denmark for a limited period benefit from a special tax régime limiting their income tax rate on their employment income to 25% (or 31% when social security contributions are taken into account). This compares to a normal top marginal rate of income tax of 59%. The régime lasts for

a maximum of three years, after which the expatriate, if he or she remains in Denmark, is subject to ordinary Danish taxation for a further two years. If the total length of stay in Denmark exceeds five years, the advantages of the expatriate régime are clawed back. With effect from 3 June, expatriates can now choose

a 33% rate as an alternative to the 25% rate, but have it apply over a five-year period. When social security contributions are taken into account, the effective rate of tax is 38.36%. People currently within the 25% régime may opt for the 33% régime, but the change will be retroactive to the date of entry into the 25% régime, so extra tax would become payable. Otherwise, the choice of régime must be made at commencement, although it is in practice possible to defer the choice until the filing date of the first relevant tax return.

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## Gibraltar

# 2008 Budget Changes

Gibraltar's 2008 budget was announced on 3 June. Key changes include:

### Lower tax for companies

The Government's commitment to lower corporate taxation was confirmed with a 6% cut in the standard rate of tax for companies from 33% to 27% with effect from the start of the 2008-09 tax year i.e. from 1 July 2008. A further cut in the rate is expected from 1 July 2009 and a new rate will be introduced in 2010 of between 10% and 12%, the Government preferring the lower end of this range.

Given the local-source basis of taxation that generally operates for Gibraltar-resident companies and the absence of withholding tax on dividends and royalties, these changes increase Gibraltar's attractiveness as a tax-efficient base for international businesses.

### Broadening of pension provision

Currently proprietary directors and certain shareholders of Gibraltar companies are restricted from becoming members of Gibraltar-approved occupational pension schemes. It was announced that this restriction will be removed from 1 July 2008.

In addition the Government has announced that an approved personal-pension régime will be introduced. This will provide a more flexible and portable pension product. Since 2006, pension income from approved Gibraltar schemes is generally taxed at 0%. In addition there is no taxation of pension lump sums in Gibraltar. This can result in a very favourable position because the member can receive a 25% tax-free lump sum on retirement and the remainder either as a pension (taxed at 0%), or used to purchase an annuity, or paid out as an additional lump sum (not subject to tax).

These changes broaden the appeal of Gibraltar as a jurisdiction for pension provision. They also make it a more attractive jurisdiction for the transfer of pension rights that may have accrued overseas, e.g. under the United Kingdom's Qualifying Recognised Overseas Pension Scheme (QROPS) régime.

For further information, contact Lynette Chaudhary of STM Fidecs Advisory Ltd on +350 20 042686 or by e-mail at [lynette.chaudhary@stmfidecs.gi](mailto:lynette.chaudhary@stmfidecs.gi)

## Hungary

# Bar on company migration may be unlawful

See under European Union, above.

For further information on the Hungarian aspects of the *Cartesio* case, contact Zoltán Gerendy of BDO Forte on +36 1 235 3010 or by e-mail at [zoltan.gerendy@bdo.hu](mailto:zoltan.gerendy@bdo.hu)

## Israel

# Significant benefits announced for new immigrants

The Israeli authorities are proposing significant improvements to the tax benefits granted to new immigrants and returning residents.

The benefits proposed include an exemption from tax and from reporting requirements on all non-Israeli source assets held and income derived by the new immigrant and certain returning residents (former Israeli-resident individuals who have resided abroad for at least 10 years before returning to Israel – this may be reduced to five years for individuals returning to Israel in the tax years 2008 and 2009) for a 10-year period commencing from the individual's arrival. The tax exemptions will apply to all types of income, including, inter alia, interest and dividends from abroad, rental income from property located outside Israel, employment income, business income and capital gains on the sale of non-Israeli assets, including securities portfolios.

At present, tax exemptions are granted to both a new immigrant and returning resident for a five-year period and only on passive income derived from non-Israeli assets acquired prior to immigration (interest, dividends, annuities, royalties, and rent). Similar exemptions are granted solely to a new immigrant for

four years on business income should the business have been held by the new immigrant for at least five years prior to immigration. In addition a 10-year tax exemption is granted for capital gains on the sale of assets located outside Israel and acquired prior to immigration. It should be pointed out that at present the new immigrant is required to report all income in Israel whether or not ultimately exempt from tax.

A further tax mitigation to be offered is with regard to foreign companies managed and controlled by new immigrants and returning residents. These companies are not to be deemed Israeli-resident, under certain conditions, merely as a result of their being managed and controlled by the new immigrant or returning resident – this for a period of 10 years after the immigration.

This benefits package will undoubtedly enhance Israel's status as a jurisdiction attractive to high-net-worth individuals wishing to enjoy a low-tax régime.

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## Kazakhstan

# Material tax changes in prospect

Starting in 2009, material changes in the Tax Code of Kazakhstan are envisaged. In particular, these include:

- a reduction of the corporate income tax rate from 30% to 20%
- improvement of administrative procedures through a reduction of legal acts connected with the Tax Code
- simplification of the taxpayer-registration procedure
- possible refunds of excess input VAT (from 1 January 2010)
- elimination of all tax incentives;
- a significant reduction of tax return forms;
- setting of a single deadline for filing of tax returns and payment of taxes
- simplification of the procedure for applying double tax treaties, and removal of the requirement for non-residents operating a business in Kazakhstan to operate a conditional bank account as a condition for obtaining treaty relief
- an increase of the tax authorities' powers in certain spheres.

A moratorium on tax inspections of small and medium-sized businesses is to continue until the end of this year.

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## Luxembourg

# Reductions in corporate taxes planned

Luxembourg has announced that it plans to abolish entirely capital duty on the raising of share capital with effect from 1 January 2009. As we reported in *BDO World Wide Tax News* Issue 2007 No. 4, the original intention was to abolish the duty by 1 January 2010, and as a first step, the rate of duty was halved to 0.5% from 1 January this year.

A further step intended to enhance the competitiveness of the Luxembourg economy, a prospective reduction of the effective corporate tax rate is also planned.

Currently, the corporate tax rate is 22.88%. Businesses must also pay a locally set business tax, which in

Luxembourg City amounts to 6.75%. The total effective rate in Luxembourg City is hence 29.63%. The Government plans to decrease this total effective rate to 25.5% in a phased reduction to begin in 2009. This reduction may be accompanied by as yet unspecified base broadening (i.e. reduction of reliefs or the introduction of restrictions on deductibility).

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## Poland

# No withholding tax on software payments without clear words

A Polish court has held that cross-border payments by Polish businesses for the use of software do not have to be made under deduction of withholding tax, unless payments from software are explicitly included in the royalties article of the relevant tax treaty.

The case concerned a Polish company that made payments to the United Kingdom for the right to use particular software. The tax authorities maintained that the company should have deducted withholding tax under the royalties article of the double tax treaty between Poland and the United Kingdom.

The royalties article of the treaty in fact makes no mention of software as such. The court ruled that in the absence of a treaty definition, the term had to take its meaning from domestic Polish law. It noted that under Polish copyright law, software was mentioned as

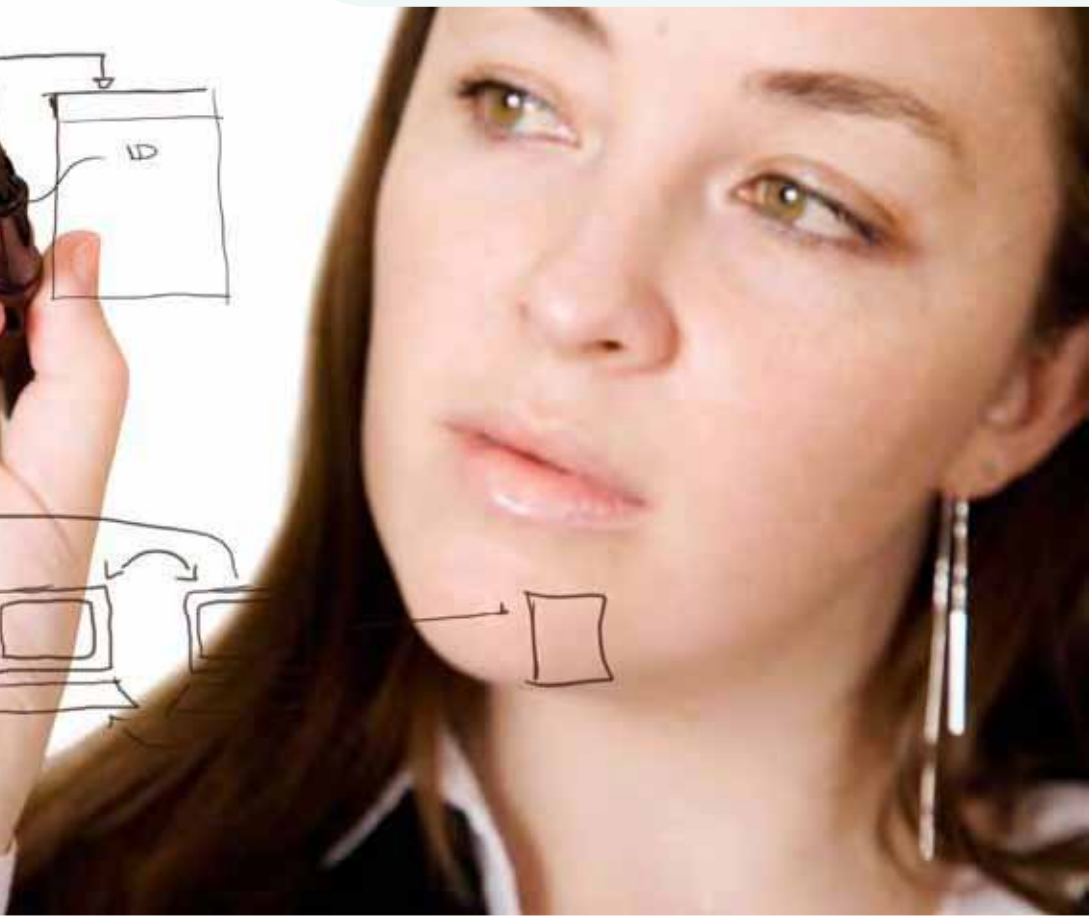
a separate subject of copyright protection. It concluded that software could not be classed as a literary, artistic or scientific work, payments for the use of which were subject to withholding tax under the treaty.

The court stressed that even though the OECD Model Convention makes it possible for software to be treated as scientific work, such an interpretation would have had to be permissible under domestic law.

This decision may be important in a number of cases where payments for software are paid from Poland to a foreign recipient. If there is no explicit mention of software in the royalties article of the relevant treaty, withholding tax is not due when making those payments.

The judgment may still be subject to appeal.

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## Spain

# Antilles no longer classed as a tax haven

Following the conclusion of an exchange-of-information agreement between Spain and the Netherlands Antilles, the Antilles has been removed from Spain's blacklist of tax havens.

This is the first agreement of this type to have been signed by Spain. It establishes a legal framework for facilitating the exchange of tax information and is seen as an essential tool in the fight against tax evasion. Spanish law provides that those jurisdictions that sign this type of agreement with Spain, or a double tax treaty with an exchange-of-information article are not to be considered as tax havens.

The content of the Antilles agreement follows the OECD Model. It allows for the exchange of banking information (and provides for consequences if the information requested is not delivered within six months), establishes cooperation in the notification of administrative decisions, and also allows for the supply of information in respect of tax years previous to the date of the agreement's entry into force and which are not yet barred by the statute of limitations.

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## United Kingdom

# Further implementation of EC Tax Mergers Directive

New Regulations were issued on 17 June with the aim of completing the transposition into UK law of the EC Tax Mergers Directive (90/434/EEC). The Regulations, which come into effect on 8 July 2008 complement and correct Regulations issued in November 2007. Taken together, the two sets of Regulations were necessary to align UK law with the amendments made to the Tax Mergers Directive by Directive 2005/19/EC. In particular, the law needed amendment to cater for a reorganisation by means of a partial division, for the inclusion in the Tax Mergers Directive of transparent entities, and for the merger of a subsidiary with its parent.

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## New legislation on VAT option to tax land

The UK legislation on the waiver of the VAT exemption on the transfer of a major interest in land (commonly known as the 'option to tax' legislation) is contained in Schedule 10 of the Value Added Tax Act 1994. Following public consultation, Schedule 10 has been comprehensively rewritten, and the new version takes effect on 1 July 2008.

Some of the changes are administrative, involving the mandatory use of new forms (e.g. to prevent a purchaser from being charged VAT on buildings to be converted to a residential use, to notify global options – now 'Real Estate Elections' – or to revoke an option during a new extended 'cooling-off' period of six months, etc). Others are more fundamental and include:

- removal of the possibility to waive exemption on a building without waiving exemption on the underlying land

- new rules for properties held within groups to prevent avoidance
- new arrangements for revoking an option to tax after 20 years
- no automatic lapse of an option to tax when a building is demolished
- the ability to exclude a new building on land in respect of which an election has been made from that election
- automatic cessation of an option where the taxpayer has had no interest in the subjects for six years
- new rights of appeal

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## Asia Pacific Australia

# Budget measures being enacted

The process of passing the measures announced in the first budget statement of the new Labour government has begun with the presentation to parliament of bills increasing the luxury car tax and making changes to fringe benefits tax and the income-tax treatment of employee share schemes.

The budget, announced in May, promised a comprehensive review of Australia's tax system with a view to creating a tax structure to assist Australia in dealing with the demographic, social, economic and environmental challenges of the 21st century. Among other specific measures was a phased reduction of the top marginal rate of income tax from 45% to 40%, a significant reform of the taxation of financial arrangements, and the imposition of a final withholding tax on distributions of income (other than dividends, interest or royalties) to foreign residents from Australian-managed investment trusts. In most cases, this involves a reduction in final taxation of the distribution.

The luxury car tax is payable on the purchase of domestic or imported cars of a GST-inclusive value greater than AUD 57 123 (EUR 34 700; USD 54 800). As announced in the budget, the rate of the tax is being increased from 25% to 33%, with effect from 1 July 2008. Cars more than two years old, or imported more than two years previously, are exempt, as are most commercial vehicles and secondhand cars.

Fringe benefits tax (FBT) is a tax paid by employers on the provision of benefits to employees. Currently, there is an exemption for work-related items such as laptop computers and mobile phones. For some items, exemption is conditional on their use primarily for work purposes; for others, there is no such requirement. In

future, the requirement will apply across the board for FBT-exempt items, and it will no longer be possible for employees to claim depreciation for FBT-exempt assets that they receive from their employers.

The main change in relation to employee share schemes concerns shares or rights received at a discount. The discount may be assessed on the employee at the time the shares or rights are received, or in certain circumstances, deferred. Employees choosing to have the discount assessed immediately may qualify for an exemption for the first AUD 1000 of the benefit. It will now be a requirement that employees electing for immediate taxation of the discount do so in their tax return for the year in which the shares or rights are acquired. Failure to do so will lead to the automatic presumption that the employee has chosen the deferral method.

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## China

# Expense deductions for sole traders and partnerships

The Chinese tax administration has clarified the expense deductions available to sole traders and individuals carrying on business in partnership. The deductions are contained in Notice Cai Shui No. 65 of 2008, issued by the Ministry of Finance and the State Administration of Taxation.

Highlights are as follows:

- Sole traders and partners may claim a standard deduction of RMB 24 000 per year (or RMB 2000 per month) for the purposes of individual income tax, regardless of actual expenditure, with effect from 1 March 2008
- Expenditure on advertising and promotion may be deducted up to a limit of 15% of current annual turnover; excesses may be carried forward with effect from 1 January 2008
- Entertaining expenses are deductible to the extent of 60%, subject to a ceiling of 0.5% of current annual turnover, with effect from 1 January 2008.

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## Hong Kong

# No withholding tax on branch remittances

Following a request from the Thai tax authorities, Hong Kong has confirmed that, in conformity with the Hong Kong – Thailand double tax treaty, no withholding tax will be imposed by Hong Kong on remittances to Thailand of profits from the Hong Kong branch of a Thai company, effective from 1 April 2006 in Hong Kong. The confirmation took the form of an Exchange of Notes, which is now formally annexed to the treaty.

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## Taiwan

# Tax reforms announced

The new administration of President Ma Ying-jeou has announced planned reforms to business and personal taxation.

These reforms include:

- reduction of the corporate tax rate from 25% to 20%
- abolition of the 10% tax on retained earnings
- partial integration of the tax and benefits systems, whereby low-income families would receive benefits in the form of negative income tax.

The reforms are currently still aspirations and will be discussed by a tax reform committee. Whatever measures finally emerge will, it is expected, be implemented with effect from 2010.

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## Thailand

# No Hong Kong withholding tax on branch profits

See under Hong Kong.



## Sub-Saharan Africa South Africa

# Imminent change of treatment of old reserves on liquidation

Where a company liquidation is in prospect, changes to take place on 1 January 2009 to the tax treatment of certain accumulated reserves on a liquidation should be borne in mind.

The reserves in question are:

- Revenue profits earned before 31 March 1993 and
- Capital profits attributable to the period before 1 October 2001

Currently, where these reserves are distributed to shareholders in the course of a liquidation, the distribution is not treated as a dividend and the 10% secondary tax on companies (STC) is not due, but the distribution is treated as a 'capital distribution', liable to capital gains tax. From 1 January 2009, however, the position is reversed. On a liquidation on or after that date, distributions of these reserves will be treated as a dividend and the 10% STC will be payable, but the distribution will no longer be treated as a capital distribution liable to capital gains tax. Liquidations before 1 January 2009 may thus result in significantly different tax liabilities to those on or after that date. The circumstances will differ from company to company, but those companies which, for example, sold properties before 1 October 2001 and have not distributed the profits, should in particular review their tax position in good time. Bringing forward a liquidation to 2008 or postponing it to 2009 may result in significant tax savings.



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## Latin America

### Brazil

# Delaware listed as tax haven

New Brazilian legislation has changed the definition of 'tax haven' such that the transfer pricing rules will be applicable to all transactions between a Brazilian entity and an entity resident or located in Delaware (the US state) or Uruguay,

with effect from 1 January 2009. The legislation has also provided for excess credits relating to PIS and COFINS (social security taxes) to be offset against any federal tax liabilities with effect from 3 January 2008.

# Limited exemptions from social contributions tax maintained

On 4 June, Brazil's Superior Court of Justice (STJ) issued a landmark ruling on the social contribution tax on net profits (CSLL), holding that a taxpayer would be exempt from paying CSLL for the fiscal years covered by a judicially granted exemption.

In practice, the CSLL operates as a second income tax on companies. Enacted in 1988, it was immediately under constitutional attack and in August 1992, the Supreme Federal Court (STF), the second of Brazil's two superior courts, which together form Brazil's Supreme Court, ruled the tax constitutional.

The most recent decision by the STJ, however, may serve as a precedent for companies that have thus far successfully challenged the CSLL and have received CSLL exemptions.

Brazilian companies that managed to win judicial victories against CSLL between 1989 and 1992 have refused to pay it for that period. In most cases, they have included the tax in their expenses and

reserves, but have listed the value as 'contested'.

The tax authorities have tried to reverse these CSLL 'exemptions'.

The 4 June ruling involved the case of Brazilian food manufacturer, Cica. The STJ held that because the company had received a favorable court ruling between 1989 and 1992, it is exempt from paying the CSLL for that period of time. The case dealt only with the CSLL payments for 1991 and 1992, since Cica was later purchased by another firm, and according to Brazilian law, tax exemptions cannot be transferred to other companies.

In summary, the CSLL is a constitutional tax in Brazil, but Brazilian companies that were granted judicial exemptions before the STF ruling on its constitutionality may not be obliged to pay the tax for the specific period of time of the exemptions under the STJ ruling.

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