



No. 12 - OCTOBER 2008

TAXAND QUARTERLY

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LEGAL DEVELOPMENTS

LEGISLATION

1. ARGENTINA

Limitation on tax benefits for financial trusts and mutual funds

Executive Order No. 1207/2008, published in the Official Gazette on 1 August 2008 (the "Executive Order"), abolished the practice of deducting profits from mutual funds provided for by the second paragraph of Section 1 of Law No. 24,083¹ (the "MF") and financial trusts included in Sections 19 and 20 of Law No. 24,441 (the "FT"). Exception was made for financial trusts related to certain infrastructure projects.

Section 70.2. of the Regulatory Executive Order implementing Income Tax Law No. 1344/98 ("Section 70.2") allowed MFs and FTs to use a special method for assessing their tax base for income tax purposes if certain requirements were met. This method allowed profit distributions to be deducted from the tax base. As a result, in general neither MFs nor FTs generated taxable profits. In other words, although these entities were liable for income tax, in practice they could end up with taxable income equal to zero. This was the main tax incentive associated with MFs and FTs and one of the reasons why both structures were widely used in recent years.

Pursuant to the Executive Order, the tax benefit provided for in Section 70.2 is no longer applicable to MFs and FTs, with the exception of FTs for infrastructure projects related to public services. However, it is worth pointing out that this type of infrastructure trust rarely fulfills the requirements set out in Section 70.2.

The Executive Order may also have consequences for the Tax on Debits and Credits on Argentine Bank Accounts ("TDC"). The decree implementing the TDC establishes an exemption for FTs and MFs if the requirements provided for in Section 70.2 are met. However, the Executive Order gives no guidance about whether the TDC applies to accounts used exclusively by the FTs².

In light of the foregoing, the National Tax Direction, dependent of the Subsecretary of Public Revenues of the Ministry of Economy, held, under Memorandum No. 853/2008 dated on August 14, 2008, that the amendments introduced by the Executive Order do not affect the exemption provided for by regulatory executive

¹ MFs generally correspond to closed-end mutual funds (i.e., mutual funds that issue units up to a certain amount), except for those investing in publicly listed securities and derivatives of futures and options, as well as instruments issued by financial entities, etc.

² In our opinion, the exemption is no longer applicable to MFs because despite a remission to Section 70.2 for MFs continuing to exist, the Executive Order eliminated all references that made the exemption applicable to the MF. By contrast, the exemption regarding the TDC is still applicable to mutual funds concerned by the first paragraph of Section 1 of Law No. 24,083 (i.e. the open-end mutual funds and closed-end mutual funds for securities), because the exemption for those mutual funds has never been conditional on meeting the requirements included in Section 70.2.

order of the TDC for the accounts exclusively used for the development of the activity of the FTs, as long as they fulfill the requirements provided for in Section 70.2. Thus, in the opinion of the National Tax Direction, the TDC exemption is still in force for the FTs in general.

The Executive Order came into effect on 1 August 2008. Accordingly, the Executive Order affects income tax for the fiscal year ending 31 December 2008 (even for FTs and MFs existing before the effective date of the Executive Order).

Termination of the Argentina-Austria tax treaty

In accordance with the Official Gazette of Argentina dated 22 July 2008, Argentina gave written notice of the termination of its tax treaty with Austria on 26 June 2008. As a result of such notice, the Argentina-Austria tax treaty shall cease to have effect in both countries as from 1 January 2009.

The Argentina-Austria tax treaty was executed in 1979 and granted tax exemptions for both countries. From an Argentine perspective, this meant that (i) dividends, interest and royalties arising from Austria were not subject to income tax in Argentina, and (ii) shares held in Austrian companies or in bonds issued by Austria were not subject to Argentine wealth tax or asset tax.

The treaty was terminated by the Argentine government mainly because Argentine taxpayers had been taking advantages of this exemption for tax planning purposes. Surprisingly, the treaty was not bilaterally amended after negotiations between both countries, but unilaterally terminated by Argentina.

2. CHILE

On 30 April 2008, the Chilean Internal Revenue Service issued Ruling No. 27, which provided a definition of foreign financial institutions and international financial institutions eligible for a reduced 4% withholding tax on interest payments for loans granted by a nonresident or resident entity.

Prior to June 2001, in order to qualify for the 4% reduced withholding tax rate, the foreign financial institution had to be registered with the Chilean Central Bank. To do this, investors needed to comply with certain requirements established in the Foreign Exchange Regulations of the Central Bank. In June 2001, the Income Tax Law was amended and the Central Bank registration requirement deleted. From that date until the issuance of the aforementioned Ruling No. 27, neither the Chilean Income Tax Law, Chilean Central Bank Regulations nor case law of the Chilean Internal Revenue Service had established specific rules governing the eligibility of financial institutions in this area.

The aforementioned ruling provides the following definitions:

- (i) a foreign financial institution is an entity incorporated abroad, the purpose of which is to grant loans or financing;

- (ii) an international financial institution is an entity with the same purpose as set forth in (i) above, the capital of which is contributed by different Member States or institutions from different countries. In both cases, the paid-in capital and reserves must be equivalent to or higher than a quarter of the minimum required by the Chilean Banking Act to incorporate foreign banks in Chile.

Additionally, to grant absolute certainty to Chilean borrowers regarding the tax treatment applicable to interest payments abroad, the aforementioned ruling established a voluntary registry of foreign and international financial entities. This registry is regulated by Ruling No. 59 issued on 14 May 2008. If the foreign entity granting a loan is not registered, the borrower will be required to prove the nature of the lender.

3. DENMARK

Four tax agreements signed with The Isle of Man

On 3 June 2008, the Danish parliament adopted Bill no. 115 (Act no. 471 of 17 June 2008) proposing the adoption of a law to enact four tax agreements signed by four Scandinavian countries (Denmark, Sweden, Norway and Finland), with the Isle of Man. Bill no. 115 would make effective four tax agreements signed with the Isle of Man on 30 October 2007 and is as a package part of OECD's work to curb harmful tax competition. The agreements would not become effective until both Denmark and the Isle of Man had enacted commencement provisions.

The tax agreements are a part of the OECD's work to combat damaging tax practices, and the purpose of the agreements is to strengthen and broaden the economic and trading relationship between Scandinavian countries and the Isle of Man.

4. FRANCE

Law on the modernization of the economy improves the tax situation of French expatriates and amends registration duties on the transfer of French businesses

The "*Loi de Modernisation de l'Economie*" published on 5 August 2008 improves French tax rules for individuals who transfer their tax residence to France ("expatriates"), by extending the scope of the expatriation premium personal income tax exemption, amending net wealth tax rules and adapting the tax shield mechanism.

Provided that they have not been French tax residents during the five previous years, individuals transferring their tax residence to France as a result of their taking up a salaried activity in France may benefit from a personal **income tax exemption during a six-year period**, on:

- an expatriation premium corresponding to:
 1. either the effective amount of the premium, up to certain limits, if they remain on the payroll of their foreign employer; or

2. a **lump-sum amount corresponding to 30% of their remuneration**, if they transfer their tax residence to France and simultaneously transfer to the payroll of a French employer after 1 January 2008.

However, the individual's remuneration should remain subject to personal income tax in France for an amount equal to the remuneration that would have been received by a "nonexpatriate" individual exercising similar functions.

- part of the remuneration for assignments performed abroad for ELC Europe, up to certain limits;
- 50% of the following foreign-source passive income: dividends, capital gains on shares and income deriving from intellectual property.

In addition, individuals who transfer their tax residence to France may exclude their foreign assets from their French wealth tax base during a six-year period as from the date of their transfer to France, provided that they have not been French tax residents during the five years preceding their transfer to France.

Finally, the French tax shield mechanism ("*bouclier fiscal*") which allows French tax residents to request a refund if the total French tax paid, including income tax, wealth tax, the 11% social surcharge and local taxes on their home, exceeds 50% of their worldwide income, is adapted to expatriates:

- for the year in which their tax residence is transferred to France, the tax shield is determined taking into account the expatriates' foreign-source revenues only as from the date of the transfer;
- for the following years, the expatriates' foreign-source revenues are taken into account net of foreign tax.

The law also amends registration duties on the transfer of French businesses occurring after 5 August 2008:

- the transfer of shares in French limited partnerships ("*SARL, sociétés civiles*", etc.) is subject to a reduced registration duty of 3% on the portion of the sale price which exceeds EUR 23,000;
- the transfer of shares in a French unlisted corporation is subject to a 3% registration duty, up to a new higher maximum amount of EUR 5,000;
- the transfer of a French going concern is subject to a reduced registration duty of 3% on the portion of the sale price which is between EUR 23,000 and EUR 200,000. The registration duty remains 5% on the portion of the price which exceeds EUR 200,000.

The transfer of shares in French unlisted real estate companies (more than half of whose assets relate to French real estate property or shares in French real estate companies) remains subject to a 5% registration duty.

5. GERMANY

Decree on the application of article 42 of the Fiscal Code (AO) – abuse of the tax design option

On 17 July 2008, the Federal Ministry of Finance published an amendment to the decree on the application of the Fiscal Code. It included a new administrative directive regarding the application of article 42 of the Fiscal Code on the abuse of the tax design option.

The amendment states that if there is a special provision regulating the prevention of abuse of the tax design option, this special regulation overrides article 42 of the Fiscal Code. In the event of abuse, the legal consequences of this separate regulation are therefore applicable.

If no such provision exists, article 42 of the Fiscal Code continues to apply, leading to the establishment of a tax claim as if the structure ultimately chosen had been a regular, rather than a fiscally motivated one.

The decree comprises a comprehensive list of legal structures deemed abusive, e.g. cases in which the legal structure chosen is not appropriate for the underlying business or where the procurement of tax advantages is not intended by the respective law.

This new provision leads to a reversal of proof, meaning that taxpayers themselves are now required to prove that economic or personal reasons were behind the choice of a certain legal tax structure and that the underlying intent was not tax savings. Prior to the publication of this amendment, the tax authorities were required to prove that the taxpayer intended to circumvent the respective tax laws.

This decree is applicable as from 1 January 2008.

Tightening of loss trafficking rules

On 4 July 2008, the Federal Ministry of Finance published a decree on the application of tightened loss trafficking rules in the new article 8c of the German Corporation Tax Code (KStG). The purpose of this regulation is to prevent abusive loss trafficking, by limiting the loss carry forward in the case of share capital transfers.

The most important changes compared with the “old” loss trafficking rules are as follows:

Indirect and direct acquisition of shares

The direct acquisition of shares is deemed harmful even if it does not indirectly lead to a change in the percentage interest of the ultimate shareholder.

Automatic forfeiture of loss carry forwards

If more than 50% of a company's share capital is transferred within a five-year period all loss carried forward are forfeited. Limited pro rata forfeiture of loss carry forwards applies if 25%-50% of the share capital is acquired within the aforementioned period.

The acquisition of less than 25% of the share capital does not affect the loss carry forward, although it might become relevant if additional shares are acquired within the five-year monitoring period.

Groups of shareholders

If a group of shareholders carries out several acquisitions within a 12-month period, which taken as a whole, result in a change of more than 25% in the shareholding, a harmful overall plan is deemed to exist and an acquisition presumed to have taken place within the meaning of article 8c of the German Corporate Tax Code. However, this presumption is rebuttable.

A group of shareholders may also be presumed to exist when there is no contractual basis but there is a joint decision-making process or when a corporation is jointly controlled.

Acquisition of shares during the financial year

The decree states that in the case of a harmful acquisition of shares during a given financial year, losses up to that date are also subject to the limitation of the loss carry forward.

Losses from prior years shall not be offset against profits until the acquisition.

Transitional rules

The decree published by the Federal Ministry of Finance stipulates that the “old” loss trafficking rules are to be applied in parallel to article 8c of the Corporation Tax Code, in the event that:

1. more than 50% of the shares of a corporation are transferred within a period of five years, starting before 1 January 2008; and
2. the loss of economic identity occurs before 1 January 2013.

Decree on the relocation of functions

On 18 August 2008, the decree on the relocation of functions drafted by the Federal Ministry of Finance was published after having been adopted by the German Federal Council on 4 July 2008.

The decree has a wide scope of application, as it defines a “function” as any kind of business activity that consists of an aggregation of similar operational tasks, carried out by specific departments or positions in a company.

The duplication of functions, where a function is set up at a second foreign entity and reduced or cut back in a German entity within five years, is not deemed harmful if the company is able to prove that the reduction of the function in the German entity is not immediately and economically related to the function performed by the second foreign entity. It is currently unclear what this proof would consist of in practice.

Due to the decree's wide scope of application, cases of double taxation are expected to increase. There is also a lack of practical experience with regard to the application of the decree by the tax authorities. However, an additional statement by the German Ministry of Finance providing further details on the relocation of business functions is expected to be published by the end of 2008.

As a possible alternative to the relocation of business functions, intercompany secondments and contract/toll manufacturing are being discussed.

Earnings stripping rules

In the context of the 2008 Business Tax Reform Act, a new interest deduction limitation was introduced for corporations. It stipulates that a taxpayer will only be able to immediately deduct net interest expenses up to 30% of income before interest, taxes, depreciation and amortization (EBITDA).

The respective decree on the application of the earnings stripping rule was published on 4 July 2008 by the Federal Ministry of Finance.

A business within the meaning of the aforementioned regulation is defined as:

- any business that generates earnings from agriculture and forestry, trade and self-employed work, even if profit is computed by aggregating net receipts;
- any partnership that has a trade or is deemed to trade by virtue of its governance structure;
- all tax groups ("*Organschaften*"). As a rule, tax groups are treated as a single business.

Interest within the meaning of the aforementioned provision includes:

- compensation received for the lending of money;
- compensation for profit-participating loans;
- yields on typical silent partnership agreements;
- profit-sharing bonds;
- yields on participation rights.

Exceptions to the interest limitation rule

The limitation does not apply:

- if the net interest expense is less than EUR 1 million (de minimis threshold);
- if the taxpayer is not part of a corporate group (no group affiliation);
- if the equity ratio of the borrower is at least equal to or higher than the equity ratio of the whole group, a tolerance of 1% being allowed (escape clause in the event of group affiliation).

Calculation of EBITDA

- EBITDA is calculated on the basis of the respective applicable regulations. The EBITDA reported by corporations is increased by the addition of hidden distributions, for example, and reduced by dividends and capital gains.
- In the case of partnerships, the interest deduction limit is calculated on the basis of the business. It is to be attributed to every partner according to the profit distribution key, even if the interest expenses relate to the separate business assets of one of the partners.

Consequences

- Unlike the rules applicable until 2007, the disallowance of interest deduction under the earnings stripping rule will no longer trigger withholding tax.
- Nondeductible interest expenses can be carried forward and be deducted in future years in compliance with the 30% EBITDA rule.
- Interest carry forwards will be lost in the event of harmful shareholder changes as defined in the recently amended loss trafficking rules. For more details, please consult the article on the tightening of loss trafficking rules.

6. GREECE

Reduced uniform real estate duty rate extended to properties under a financial lease arrangement

The Greek Ministry of Finance has issued a Circular (POL 1086/28.05.2008) regarding the application of the recently introduced uniform real estate duty (Law No. 3634/2008, see Taxand Quarterly Issue 10 dated April 2008 for more information). By virtue of the said Circular, the Greek Ministry provides, *inter alia*, that the reduced rate of 0.1% - previously applicable to properties self-occupied by corporate taxpayers for the purpose of carrying on their business activities - is extended to properties that are leased under financial leasing arrangements. Application of this reduced rate (0.1% instead of the generally applicable 0.6%) is conditional on the leased properties being used as production plants, or for the conduct of other business activities of the lessee company, for as long as the financial lease arrangement remains in force. However, as a general rule although the uniform real estate duty is payable by the owner of the property, under financial leasing arrangements the lessee is liable for such tax over the lease term.

New Greece-Saudi Arabia tax treaty

On 19 June 2008, Greece entered into a tax treaty with Saudi Arabia. However, the treaty has not yet been ratified by law and therefore is not yet effective.

7. INDONESIA

Amendments to Income Tax Law

In an attempt to attract foreign as well as domestic direct investments, and to increase the number of taxpayers, the Indonesian parliament recently approved the amendment to the Income Tax Law. The new law will take effect on 1 January 2009.

Below are some of the important amendments to the Income Tax Law:

1. Reduction of income tax rates for individual taxpayers from a maximum rate of 35% to 30%. The taxable income level subject to the maximum tax rate is also increased from INR 200,000,000 to INR 500,000,000.
2. Reduction of corporate income tax from a maximum of 30% to a flat rate of 28% in 2009 and 25% in 2010.

3. Publicly listed companies that have 40% of their stock traded on the Indonesian stock exchange and that fulfill other requirements to be set out at a later date in a government regulation will obtain an additional tax rate reduction of 5%.
4. Small- and medium-sized enterprises will be eligible for a corporate income tax rate reduction of 50% on their taxable income from revenues up to INR 4,800,000.
5. Another unique feature of the amended law designed to force taxpayers to obtain a taxpayer identification number is to increase the withholding tax rates for those taxpayers who do not possess such a number. The tax rate would be 20% higher for employees and 100% higher for service providers.
6. Individual taxpayers who have a taxpayer identification number and their families will no longer have to pay the exit tax of INR 1,000,000.
7. Donations are currently nondeductible for corporate income tax purposes. The amendment defines certain kinds of donations as deductible expenses, including donations for national disasters, donations for research and development performed in Indonesia, development costs of social infrastructures, donations for educational facilities, donations for sports development and scholarships.
8. Provisions for bad debts that have hitherto only been applicable to banks and leasing companies will be extended to all finance companies.

The amendment also included some anti-tax avoidance rules, as follows:

1. The Director General of Taxation is authorized to determine the actual taxpayer who buys or sells shares or other assets through a special purpose vehicle that has a special relationship or where there is an unrealistic transaction.
2. The Director General of Taxation is entitled to determine a transfer of shares between a conduit company domiciled in a tax haven country that has a special relationship with a company domiciled in Indonesia or a permanent establishment in Indonesia, as a transfer of shares in a company domiciled in Indonesia.
3. The Director General of Taxation is entitled to recalculate the amount of income received by a domestic individual taxpayer from an employer which has a special relationship with another company, in the event the employer redirects all or part of the individual taxpayer's income through another channel.
4. The tax residency of the foreign taxpayer is considered to be the country that actually receives the benefit of the income ("beneficial owner").

8. ITALY

Decree No. 112 of 25 June 2008 (the "Decree") has introduced a number of relevant changes regarding both personal income taxation (i) and corporate income taxation (ii).

(i) Personal income tax

Stock option plans – The decree abrogated the special tax regime for stock option plans offered to selected employees. The previous rules, under which the difference between the value of the shares received by the employee and the option exercise price was exempt from taxation, has been abolished. Therefore, any future capital gains are fully taxable as employment income.

(ii) Corporate income tax

- Robin tax – The decree introduced an additional 5.5% corporate taxation (IRES nominal tax rate: 27.5%, plus additional tax rate of 5.5%) for companies generating revenues in excess of EUR 25 million in the fiscal period concerned and involved in the following types of business: exploration and exploitation of hydrocarbon; oil refining; production and sale of oil, gasoline, gas, lubricating oil, and liquefied natural gas; production and sale of electricity.
- Interest deductibility – Article 96 of the Italian Tax Code has been amended to allow banks and insurance firms to deduct 96% of interest expenses as from fiscal year 2009. The allowed percentage for fiscal period 2008 is 97%.
- Deemed residence – The decree added paragraph 5-ter to article 73 of the Italian Tax Code and introduced a rebuttable presumption pursuant to which a foreign company is deemed to be fiscally resident in Italy if the following requirements are fulfilled:
 - ✓ the majority of its corporate assets are invested in units of an Italian real estate investment fund;
 - ✓ it is directly or indirectly controlled by Italian resident persons.

The decree also enacted the following modifications to the real estate funds (REIF) tax regime:

- the withholding tax levied on income distributed by REIFs is increased from 12.5% to 20%;
- a wealth tax of 1% is levied by the SGR on certain types of REIF principally incorporated through contributions of real estate properties (so-called "family real estate funds").

Company Law amendments - cross-border mergers. Legislative Decree No. 108 of 30 May 2008 implements Directive 2005/56/EC of 26 October 2005 concerning the cross-border merger of limited liability companies

From a Company Law perspective, this provision supplemented domestic tax rules on cross-border mergers implemented by Directives 90/434/EC and 2005/19/EC.

9. JAPAN

2009 tax reform proposed by METI

In Japan, METI (Ministry of Economy, Trade & Industry) recently announced their plan to push ahead with amending the international tax rules and repeal the taxation to which a Japanese parent company is liable on dividend income from overseas subsidiaries. Currently, a Japanese parent company is subject to Japanese corporate income tax of around 40% on dividend income received from overseas subsidiaries and is allowed to claim tax credits for the foreign corporate income tax paid on the profits of overseas subsidiaries out of which dividends are paid to the Japanese parent company. Accordingly, if the foreign corporate income tax rate is less than 40%, a Japanese parent company is liable for taxes at the rate of 40% minus the foreign corporate income tax rate when it receives dividend distributions from its foreign subsidiary. According to the survey conducted by METI, profits generated by overseas subsidiaries of Japanese companies are mostly retained by the overseas subsidiaries. Japanese tax on dividend income is viewed as the obstacle to remittances directed to Japan. METI views the remittance of overseas profits to Japan as a stimulus for Japanese economic expansion and will attempt to include this amendment in its 2009 tax reform.

Japanese National Tax Agency (NTA) is in the process of partially revising Transfer Pricing Operational Guidelines

The currently proposed revision focuses on services. The NTA published a draft revision for public comment. The process will be finalized in due course. The proposal and the business community's reaction are summarized below:

1. *Determining whether intragroup services have been rendered*

One of the key issues in the analysis of transfer pricing for intragroup services is whether intragroup services have in fact been provided. The NTA basically follows the approach adopted by the OECD and the draft describes the same approach: i.e.,

determining whether intragroup services have been rendered depends on whether the activity provides a respective group member with economic or commercial value. The NTA draft proposes the following two tests as measures to determine whether the activity should be considered as an intragroup service under the arm's length principle.

(1) an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise;

or

(2) if the respective group member had not performed the activity, it would have been recognized that said member needed to perform the same activity.

Test (1) above is the same as its counterpart in the OECD guidelines, but (2) is obviously different from its OECD counterpart, which is set out below:

"An independent enterprise in comparable circumstances would have performed the activity in-house for itself."

An independent enterprise in comparable circumstances is not referred in (2) above as proposed by NTA. This difference is raising concerns among the business community.

2. *Types of activities that would normally be considered intragroup services*

The OECD guidelines prescribe the following activities as those that would normally be considered intragroup services, being activities that independent enterprises would have been willing to pay for or to perform for themselves:

- administrative services such as planning, coordination, budgetary control, financial advice, accounting, auditing, legal, factoring, computer services;
- financial services such as supervision of cash flows and solvency, capital increases, loan contracts, management of interest and exchange rate risks and refinancing;
- assistance in the fields of production, buying, distribution and marketing;
- services in staff matters such as recruitment and training.

The NTA draft contains a similar list but includes specifically "advertising" as an independent item separate from "marketing".

This is raising concerns in the business community because generally speaking, advertisements are often designed to directly enhance the brand image of headquarters in Japan and are not necessarily focused on local markets in foreign jurisdictions.

3. Shareholder activity vs. Intragroup services

The NTA draft contains a provision for “shareholder activity” and states that such an activity would be performed solely because of an ownership interest in one or more other group members in its capacity as shareholder, and would not therefore be regarded as an intragroup service. The NTA draft cites the following two activities as shareholder activities:

- activities relating to the legal structure of the parent company itself, such as meetings of shareholders of the parent and issues of shares in the parent company;
- activities relating to the preparation of the annual security report in accordance with the Financial Products Transaction Law.

While the OECD guidelines list similar activities as examples, the NTA draft adopts a more prescriptive tone and seems to define shareholder activities by the list provided.

It also states that managerial and control activities relative to the management and protection of investments in subsidiaries fall within the definition of intragroup services.

The OECD guidelines are not so decisive: “whether these activities fall within the definition of shareholder activities or intragroup services would be determined according to whether, under comparable facts and circumstances, the activity is one that an independent enterprise would have been willing to pay for or to perform for itself”.

However, the NTA draft is construed to mean that the two tests mentioned above will not apply to the managerial and control activities related to the management and protection of investments in subsidiaries.

The business community appears strongly concerned about these narrow definitions of shareholder activity and the clear indication of managerial and control activities as intragroup services.

The NTA is currently reviewing the public opinions compiled and will finalize its revision in due course.

New Japan-Pakistan tax treaty

A new income tax treaty signed between Japan and Pakistan was approved by the Japanese Diet in June 2008. This new treaty should enter into force and become effective in 2009 and will replace the existing 1959 tax treaty.

New Japan-Australia tax treaty

A new income tax treaty signed between Japan and Australia was approved by the Japanese Diet in June 2008. This new treaty should enter into force and become effective in 2009 and will replace the existing 1969 tax treaty.

10. LUXEMBOURG

0.5% capital duty abolished as from 2009

Following the announcement made by the Prime Minister in May of this year, a draft law has been released abolishing the 0.5% capital duty as from 2009.

The main aspects of the draft are summarized hereafter:

- The 0.5% capital duty is abolished as from 1 January 2009.
- The same applies to the fixed capital duty applicable to UCIs within the meaning of the Law of 20 December 2002, and also relates to SIFs, SICARs, ASSEPs, SEPICAVs and securitization vehicles.
- The commentaries to the law specifically mention that no claw-back applies to transactions based on article 4-2, even if the said transactions took place before 1 January 2009.

Article 4-2 deals with the so-called share-for-share merger exemption. Based on this article, a company receiving a contribution-in-kind consisting of shares in another EU company, in consideration for the issuance of new shares in its own capital, would be exempt from the capital duty under certain conditions. These include the requirement to hold the shares received for at least five years, otherwise the capital duty becomes due. Based on the commentaries to the draft law, as from 2009 companies having benefited from this capital duty exemption in the past will no longer be required to keep the shares after 1 January 2009.

- A fixed registration duty of between EUR 50 and EUR 100 (depending on the type of company) is introduced for several transactions involving Luxembourg companies: incorporation, transfer of headquarters from another country to Luxembourg, and amendment of the bylaws.

Contributions of real estate assets located in Luxembourg to a Luxembourg company will be subject to the following regime:

- contributions remunerated by shares will be subject to a 1.2% registration duty plus a 0.5% transcription tax;
- contributions remunerated other than by shares will be subject to a 6% registration duty plus a 1% transcription tax;
- transfers made in the context of a corporate restructuring process (i.e. contributions of all assets and liabilities in exchange for shares and contributions of one or more businesses in exchange for shares) will be exempt under certain conditions.

11. MALAYSIA

2009 Malaysian Budget highlights

The 2009 Malaysian Budget was announced on 29 August 2008. We highlight below some of the more significant developments arising from the 2009 Budget.

■ Corporate tax

Transfer pricing and thin capitalization

Transfer pricing guidelines were first introduced in Malaysia in 2003 and took effect under the general anti-avoidance provision in Section 140 of the 1967 Income Tax Act (ITA). Recognizing weaknesses in the use of Section 140 in dealing with transfer pricing situations, a new provision, Section 140A, will be introduced in the ITA to specifically address transfer pricing, focusing on the "supply of property or services". In the absence of a definition of "property or services", the question of whether this would include interest-free loans remains uncertain.

In connection with the new transfer pricing provisions, the ITA now provides that Advance Pricing Arrangements (APAs) may be sought in relation to cross-border transactions between associated persons.

The new Section 140A also heralds the introduction of thin capitalization rules in Malaysia, whereby a deduction for interest will be denied in respect of interest payments made to associated companies in respect of 'financial assistance', subject to certain criteria and conditions. It is understood that the Inland Revenue Board (IRB) will be issuing guidelines before the end of the year setting out the rules in relation to the application of the thin capitalization provisions.

Withholding tax

There have been several changes in relation to withholding taxes that warrant attention.

Firstly, an unexpected change has been introduced whereby nonresidents will now be subject to withholding tax of 10% in respect of 'gains or profits' under Section 4(f) of the ITA. Section 4(f) is a 'catch all' provision which covers 'gains or profits' that do not fall within the other classes of taxable income derived from Malaysia. This would include commission fees, guarantee fees and introducer's fees paid to nonresidents.

Secondly, to make investments in Real Estate Investment Trusts (REITs) more attractive, the rate of withholding tax on REIT distributions to foreign institutional investors will be reduced from 20% to 10%, while distributions to noncorporate investors (which would include resident and nonresident individuals) will be reduced to 10% from the current rate of 15%. Distributions to nonresident companies will continue to attract withholding tax at the prevailing corporate tax rate.

Group relief

The group relief provisions have been enhanced to allow 70% rather than 50% of losses to be group relieved.

Reinvestment allowance (RA)

The RA has been an attractive incentive for investors considering expansion or diversification. The rules were somewhat liberal in certain areas and these have now been tightened quite significantly, with the RA:

- ✓ only available to companies which have been in operation for 36 months, rather than 12 months;
- ✓ no longer available in respect of assets acquired from related companies under the 'controlled transfer' provisions;
- ✓ clawed back for disposals within a five-year period, rather than a two-year period.

Small- & medium-sized enterprises (SMEs)

Under the ITA, SMEs are companies whose paid-up capital does not exceed MYR 2.5 million. Such companies are eligible for a 20% tax rate on the first MYR 500,000 of chargeable income and are not required to pay taxes via installments for the first two years of assessment. The definition of SMEs has been tightened in the Budget proposals to exclude companies where:

- ✓ more than 50% of the company (SME) is held by a company with paid-up capital in excess of MYR 2.5 million;
- ✓ the company holds more than 50% of any other company with a paid-up capital in excess of MYR 2.5 million.

SMEs will therefore be restricted to smaller stand-alone companies, rather than those which are controlled by a larger company or which are part of a larger group of companies. As an added benefit, to help SMEs cope with the increasing costs of doing business, they will now be entitled to accelerated capital allowances of 100% in respect of all plant and machinery purchased in fiscal years 2009 and 2010.

Capital markets

The Budget proposals provide for tax exemption on fees earned by approved institutions for arranging, underwriting and distributing non-ringgit Sukuk (i.e. Islamic bonds) issued in Malaysia and distributed outside Malaysia, as well as on profits earned on the trading of non-ringgit Sukuk in Malaysia.

Secondly, to attract foreign companies and foreign product listings on the Malaysian stock exchange (Bursa Malaysia), tax exemption will be given to corporate advisors on fees received from the primary listing, dual listing or cross-listing of companies with foreign-based operations, REITs with foreign-based assets, foreign listed securities and foreign financial instruments.

- **Personal tax**

Tax rates

Personal tax rates have only been marginally reduced with the top bracket and nonresident tax rates being cut from 28% to 27%. The tax rate for the chargeable income bracket of MYR 35,000 to MYR 50,000 has also been reduced, from 13% to 12%.

Benefits-in-kind

Several benefits-in-kind which were previously taxable are now exempt from tax. These include travel allowances for official duties of up to MYR 6,000 per year, allowances of up to MYR 2,400 for travel to and from work, provision of free services or services at a discount for employees (where the employer is in the business of providing the said services, e.g. where a private school provides discounted or free school fees to children of teachers), maternity medical benefits, and so on.

- **Indirect tax**

There were no significant developments in relation to indirect taxes. The Budget proposals include a reduction of sales tax and import duties in relation to several items. This is intended to relieve the burden of consumers but could also result in making domestic industries more competitive vis-a-vis foreign producers of these same products. Environmental concerns are reflected in the reduction of duties and taxes in relation to environmentally friendly items, such as hybrid cars, energy efficient equipment, and so on. Additionally, duties/taxes have been reduced/abolished in respect of items such as fertilizers and pesticides, certain heavy machinery and some basic food products.

Tax administration

On the tax administration front, changes have been proposed to allow taxpayers to amend their tax returns within six months from the deadline for filing returns. Where a taxpayer revises a tax return within the prescribed timeframe, penalties will not be imposed in respect of additional taxes. However, to prevent abuse, late payment penalties will be levied.

Another area of change relates to nonchargeability situations, whereby appeals will now be allowed. This may arise where taxpayers are dissatisfied with their tax loss positions, for instance. The procedure for such appeals requires notification of nonchargeability from the IRB which the taxpayer will then appeal against.

From a self-assessment perspective, the proposals are welcomed as the tax system progresses towards being more taxpayer-friendly.

New Malaysia-Qatar tax treaty

Malaysia and Qatar signed a tax treaty on 3 July 2008. The details of this treaty will be reported when this information is available.

12. MALTA

Treaty News

Malta continues to expand its treaty network: around 50 treaties are currently in force and a number of other treaties are in the pipeline, including with Ireland, Jordan, Russia, Serbia & Montenegro, Thailand, Turkey, Ukraine and the United Arab Emirates.

Malta signs tax treaty with the United States of America

In general, the treaty follows the pattern of the US model income tax convention, although there are a number of deviations from the model to accommodate Malta's status as a developing country.

In the treaty, business profits of an enterprise of one country may be taxed by the other country only if they are attributable to a permanent establishment in the other country. However, the definition of a permanent establishment is somewhat more broadly drawn in the treaty than in the model convention. Similarly, with respect to independent personal service income, an individual who is a resident of one State may be taxed by the other country on the income from personal services performed in the other State only if certain tests are met. However, the time threshold is shorter in the treaty than in the model, and a dollar threshold is added.

Maximum rates of tax are established for the taxation by the source country of dividends, interest and royalties. With respect to dividends, the rules for US taxation of US source dividends are the same as in the model (15% in general, but 5% for subsidiary dividends). The rule for Maltese tax on Maltese source dividends is different in order to take into account Malta's full imputation system. The treaty provides that the tax payable to Malta on such dividends shall not exceed that chargeable to the paying company, although it may be lower, depending on the Maltese tax status of the US shareholder.

Interest and royalties are both taxable at source at a maximum rate of 12.5%, with the exception of interest received by a Contracting State and cultural royalties which are exempt at the source. As with dividends, Malta's tax may be below the specified limits, depending on the tax status in Malta of the US income recipient. Indeed Maltese tax legislation provides that interest and royalties are exempt from income tax provided the recipient does not have a permanent establishment in Malta.

The treaty contains the usual rules relating to real property income, shipping income, capital gains, the treatment of entertainers, students, teachers, pensioners and government employees, non discrimination and administrative cooperation.

This treaty will be in force for at least three years and will remain in force thereafter unless terminated by one of the parties by giving at least six months' notice through diplomatic channels. The treaty would cease to have effect as of 1 January following such notification.

Malta publishes tax treaty with Singapore

Malta published the tax treaty which it had signed with Singapore way back in March 2006. The treaty entered in to force earlier on this year and is based on the OECD model tax convention with very little deviations.

The treaty recognizes that both countries adopt a full imputation system of taxation and therefore there is no final withholding tax on dividends (under article 10). The withholding tax on interest is 7% if it is received by a bank and 10% in all other cases. Royalties are also subject to a withholding tax of 10%.

The treaty also contains articles on non discrimination, mutual agreement procedure and exchange of information.

Malta and France sign protocol to the treaty

Details of the protocol amending the existing treaty between Malta and France will be given in the forthcoming issue of Taxand Quarterly.

13. PERU

Regulations regarding certificates of residence to claim benefits from tax treaties

Supreme Decree No. 090-2008-EF published on 4 July 2008 approves the document by which a person shall evidence his/her condition of resident of a Contracting State that has entered into a tax treaty with Peru ("the Contracting State").

According to the new regulations, the Peruvian withholding agent must request from the nonresident taxpayer a certificate of residence issued by the Contracting State in which he/she is a resident liable to tax, in order to certify that the benefits of the tax treaty are applicable to such taxpayer. If this is not the case, the withholding agent must not apply the tax treaty.

However, if the nonresident taxpayer subsequently obtains the certificate of residence, he/she will be entitled to apply to the Peruvian tax authorities for a refund of the excess withheld.

14. PHILIPPINES

Republic Act No. 9504

In the midst of rising food and fuel costs coupled with double-digit inflation in the Philippines, the Philippine Congress enacted a tax relief package to taxpayers in Republic Act No. 9504 entitled "An Act Amending Sections 22, 24, 34, 35 And 79 of Republic Act No. 8424, As Amended, Otherwise Known As The National Internal Revenue Code Of 1997", which came into force on 6 July 2008.

The salient provisions of the new law are as follows:

Exemption of minimum wage earners

Minimum wage earners shall be exempt from the payment of income tax on their taxable income. Holiday pay, overtime pay, night shift differential, and hazard pay received by minimum wage earners shall also be exempt from income tax. The term 'minimum wage earners'

refers to a worker in the private sector paid the statutory minimum wage (as fixed by the Regional Tripartite Wage and Productivity Board) or to an employee in the public sector with compensation income not exceeding the statutory minimum wage in the nonagricultural sector where he/she is assigned.

Minimum wage earners shall also be exempt from the requirement of filing an income tax return and will be exempt from the requirement of withholding taxes on wages/compensation.

Optional standard deduction ("OSD")

The new law raised the OSD from 10% to 40%. The OSD shall be claimed in lieu of the itemized allowable deduction in computing taxable income. An individual taxpayer subject to income tax other than a nonresident alien, may opt for an OSD in an amount not exceeding 40% of his/her gross sales or gross receipts. In the case of a domestic corporation and a resident foreign corporation subject to income tax, it may elect an OSD in an amount not exceeding 40% of its gross income as defined under Section 32 of the Tax Code. An individual who is entitled to and has claimed the OSD shall not be required to submit financial statements with the tax return. Nonetheless, taxpayers shall keep a record of their gross sales, gross receipts or gross income, whichever is applicable.

Increase in personal exemption

Each individual taxpayer shall be allowed an increased basic personal exemption ("BPE") of PHP 50,000. The new law abolished the BPE previously granted to individuals (PHP 20,000), heads of families (PHP 25,000) and married individuals (PHP 32,000). However, it should be noted that estates and trusts, which are taxed as an individual, are entitled to an exemption of only PHP 20,000 from the income of the estate and trust, since Section 62 of the Tax Code was not amended by the new law.

Increase in additional exemption for dependents

The new law increased additional exemption for qualified dependents from PHP 8,000 to PHP 25,000 for each qualified dependent. The number of dependents that may be claimed remains at a maximum of four (4) qualified dependents.

The Bureau of Internal Revenue is still finalizing the rules and regulations implementing the new law.

15. PORTUGAL

Developments regarding VAT refunds and VAT deductibility

Under article 22(9) of the Portuguese VAT Code, the Minister of Finance may authorize the tax administration to make VAT refunds under conditions other than those generally applicable to taxpayers, in specific sectors of activity. Under this article, on 2 June 2008 the Minister of Finance issued *Despacho Normativo* 31-A/2008 establishing that VAT refunds exceeding EUR 10,000 requested by Portuguese VAT taxpayers, whenever 75% of their supplies are made under the reverse charge

mechanism (namely taxpayers that provide construction services), should be paid by the Portuguese tax administration within 30 days from the presentation of such request. This regime is only applicable if the taxpayer is not submitting its first refund request, in which case the general rule is applicable, allowing the Portuguese tax administration a six-month period to refund the VAT incurred. The same deadline is applicable if the conditions for the reduced payment period are not met.

The Portuguese tax administration issued an internal instruction (Circular 14/2008) providing that the amount of VAT incurred by Portuguese taxpayers in another EU Member State and not recovered under the Refund Directive shall not be considered as tax deductible for Portuguese Corporate income Tax purposes. This position is essentially based on the argument not requesting a refund makes that cost as not indispensable for computing the taxable profits of the taxpayer (a prerequisite for its deductibility under Portuguese Corporate Tax rules).

16. ROMANIA

Amendments to the Romanian Fiscal Code

The Romanian Fiscal Code was recently amended by Government Emergency Ordinance No. 91/2008.

The recently adopted amendments are applicable as from 1 January 2009 and provide, *inter alia*, that tax losses incurred as from the 2009 financial year and recorded in the annual corporate income tax return may be carried forward for the following seven years, while tax losses incurred before 2009 may be carried forward for the following five years.

As per the provisions of the Emergency Ordinance, the Romanian tax treatment applicable to interest and royalties obtained by a beneficial owner, legal entity resident of an EU Member State under the EU Interest and Royalties Directive, also applies to beneficial owners who are legal entities resident in one of the European Free Trade Association ("EFTA") countries or permanent establishments of enterprises resident in an EFTA country (i.e., Norway, Liechtenstein, Iceland). Under these new provisions, interest and royalties obtained by tax residents of Norway, Liechtenstein and Iceland will be taxed at 10% until 31 December 2010 and tax exempt starting 1 January 2011, provided that the conditions laid down in the EU Interest and Royalties Directive are met at the date such income is paid (i.e., the beneficial owner of such interest or royalties holds at least 25% of the value/number of shares in the Romanian legal entity paying the interest/royalties, for an uninterrupted two-year period ending when the interest/royalties are paid).

Dividends paid by a Romanian legal entity to another legal entity resident in an EU Member State or in an EFTA country (i.e., Liechtenstein, Iceland, Norway), including dividends paid to a permanent establishment of an enterprise resident in another EU Member State or resident in an EFTA country, are taxed in a similar way to inbound dividends at a rate of 10% (the tax rate that applies to dividends paid to Romanian legal entities),

unless they are not subject to tax in Romania under the EU Parent-Subsidiary Directive. Additionally, starting 1 January 2009 the provisions of the EU Parent-Subsidiary Directive apply to dividends paid to tax residents of EFTA countries (i.e., Liechtenstein, Iceland, and Norway).

Amendments to the Government's Emergency Ordinance No. 196/2005 regarding the Environmental Fund

The Ordinance contains certain amendments to the Romanian Environmental Fund legislation regarding the contribution due to the Environmental Fund and the procedural requirements for collecting and using the Environmental Fund.

A new tax ("ecotax") for the Environmental Fund will be due starting 1 January 2009 by economic players introducing bags made of nonbiodegradable materials on the Romanian market. The contribution will be RON 0.2 per bag and should be declared and paid by the 25th of the month following the one in which the activity is carried out. The ecotax should be separately indicated on the sales documentation and its value displayed for the information of end consumers. Failure to display the value of the ecotax is sanctioned with a fine ranging from RON 2,000 (approximately EUR 570) to RON 2,500 (approximately EUR 715).

17. SWEDEN

Preview of tax proposals in the upcoming Budget proposal

Introduction

On 9 September, the Ministry of Finance issued a preview of tax reforms for companies which will be presented in the Budget Proposal on 22 September.

In short, the proposal includes the following:

- Reduction of the general social security tax from 32.4% to 31.4%.
- Reduction of the corporate tax rate from 28% to 26.3%.
- Marginally lower tax rate for owners of small closely-held companies.
- Reduced social security taxes for employees under the age of 26.

The proposed financing of the corporate income tax reduction is of particular interest, with two sets of tax planning restrictions being used for this purpose.

First proposed legislation restricting tax planning structures

The first restrictive legislation concerns two principal structuring opportunities: a) tax exempt step-ups in the tax base, and b) deductible writedowns of shares.

In short, the **step-up possibility** concerns the particular rules on taxation applicable to Swedish partnerships and their owners. A partnership is not a taxable entity in Sweden; instead, the partners are liable to pay tax on the partnership's profits. As a result, the tax base for shares in a partnership varies; any income that is taxable in the hands of the partner will increase the partner's tax base relative to the share. An additional motivation behind exempt step-ups is the fact that capital gains on

partnership shares realized by a non-Swedish company under certain circumstances are taxed neither in Sweden nor in the partner's home country. The final set of rules enabling step-up structures are those concerning asset transfers below market value: in certain situations these transfers can take place without triggering any taxation.

The structure typically used is a Swedish group which sets up a partnership with a foreign company, often a Dutch BV, as the general partner. Assets – often property – are subsequently transferred from one of the Swedish companies at a price equal to the tax base (“tax book value”) to the partnership. Consequently, the foreign company has sold the share in the partnership at market value. Any Swedish corporate buyer of the partnership share is then able to transfer the assets out of the partnership at market value and achieve a step-up. This step-up is exempt from tax as the gain upon transferring assets out of the partnership is set off against a corresponding loss upon liquidation of the partnership.

In a key scenario regarding **deductible writedown structures**, a company engaged in contracting or property trading must account for shares in subsidiaries owning investment properties as inventory for tax purposes. This means that such shares are outside the scope of the Swedish participation exemption regime. Therefore, a writedown on such shares triggered by a decrease in value is generally deductible. In some cases a decrease in value has been “constructed” as follows: assume that a company engaged in property trading acquires a property investment company at market value. The fair market value of the properties held by the subsidiary – which is reflected in the purchase price of the shares – is substantially higher than the tax book value of those properties. The next step is to transfer the properties out of the subsidiary at tax book value (which is possible in some cases, as discussed above). Owing to this transfer, the value of the shares in the subsidiary decreases, and the property trading company must take a writedown on the shares. Arguably, the writedown is tax deductible.

On 17 April, the Swedish government issued a notice stating that it intended to introduce legislation to prevent the structures described above. As this relates to special anti-abuse legislation, it will come into effect as from 18 April if enacted.

Second proposed legislation restricting tax planning structures

While the above described anti-abuse legislation was both expected, and subject to very limited debate, the other restrictive proposal for financing the reduction of the corporate tax rate has stirred intensive debate among practitioners, Swedish-based MNEs and scholars alike.

In the previous issue of *Taxand Quarterly*, we reported about the so-called *Industrivärden* case, which more or less confirmed the status of Sweden as a “leveraged acquisition paradise”. We also mentioned that we expected lobbying towards stricter legislation. Now a memorandum proposing such legislation exists. The memorandum issued by the Ministry of Finance is an amended version of a previous memorandum issued by

the tax authorities. The amended version follows widespread criticism of the tax authorities’ memorandum.

In short, the memorandum proposes severe restrictions on the deductibility of interest expenses arising on debt owed to a related legal entity.

The restrictions will mainly apply to related companies. Companies will be considered as related if:

- the companies are parent company and subsidiary or have principally the same management; or
- one of the companies directly or indirectly has a controlling influence over the other company. The controlling influence may be upheld through shareholding or by other means.

The restrictions are the following:

1. A limited liability company or an economic association may not deduct interest expenses arising on debt owed to a related company to the extent the debt is linked to an acquisition of shares or similar assets from a related company.
2. Additionally, under the proposal the restrictions will apply to debt owed to a nonrelated company to the extent a related company is owed money from that unrelated company or from a company related to it. This rule is designed to prevent circumvention through back-to-back loan financing with unrelated parties, and may be avoided if the borrower can prove that its dealings with the external party are “primarily” (around 75% or more) motivated by business reasons.
3. The proposed restrictions may also apply to debt owed to a related company when this debt has replaced “temporary debt” owed to a nonrelated company, if the restrictions on interest deductibility according to the description above would have applied had the debt originally been owed to a related company.

In reference to items 1 and 2 above, the following two exceptions which allow for deduction are available:

1. If the beneficial owner of the interest on the receiving end would have been subject to at least 10% corporate income tax had its only income been the interest in question. If the beneficial owner is allowed to deduct dividend distributions, the interest income is always considered to be below 10%.
2. Both the underlying acquisition and the debt that gives rise to the interest in question are “primarily” (around 75% or more) motivated by business reasons.

Since we expect a formal proposal to be sent to the Swedish parliament in the near future, we will provide a thorough analysis in the next *Taxand Quarterly* Issue.

18. THE NETHERLANDS

Important proposed changes to Dutch tax laws

On 16 September 2008, the traditional "Third Tuesday of September", the Dutch Ministry of Finance announced its Budget for 2009. In addition, just before the date of publication of this report, the Dutch Parliament passed a number of other tax laws which may be of interest from an international perspective.

Budget

The Budget contains a large number of modifications that have a bearing on domestic issues as well as technical amendments of certain recently introduced tax laws such as packaging tax, air transport tax and wage tax. From an international perspective, the following matters are of interest.

Corporate income tax

The corporate income tax rate for fiscal year 2008 will be 20% on the first EUR 250,000 and 25.5% on the excess. The previous rates were 20% on the first EUR 40,000; 23% on amounts between EUR 40,000 and EUR 200,000 and 25.5% on the excess.

VAT

The Ministry of Finance has confirmed that for the time being, it will not increase the standard VAT rate from 19% to 20%.

Social security

It has also been confirmed that the unemployment insurance premium deducted from employee salaries will be abolished.

Gift tax

The Dutch gift and inheritance tax is shortly to be amended. Rumors are that contrary to the current rules, gifts received from nonresidents will become taxable in the hands of Dutch resident beneficiaries.

Other recent changes

In addition to the above issues resulting from the Budget, the Dutch Parliament recently dealt with the following tax laws:

- On 5 September, the Dutch senate agreed to modify the Law on Gaming Taxation. Winnings on (allegedly illegal) foreign internet gaming activities are – subject to possible relief for the avoidance of double taxation – considered taxable in the Netherlands at a rate of 29%, assuming the income is not (business) income. The taxpayer is either the (foreign) provider of the (access to) gaming or, if access is not directly available from the Netherlands, the person cashing in on the gains. The tax base is the difference between the bets placed and the gross winnings paid. There are plenty of questions pending about how the new law should be interpreted. In addition, in this particular case the tax legislation is not only motivated by tax principles but also by a wish to stem participation in games of chance. The new law will become effective the day after its publication in the Dutch Official Gazette.

- On 9 September, The House of Representatives adopted an important Bill regarding taxation of excessive remuneration (the Bill is still subject to review by the Senate). The Bill contains three pillars. The first two pillars relate to employees earning EUR 500,000 or more per annum. Firstly, the employer has to pay an additional wage tax of 30%, which cannot be recovered from the employee (and which the employee cannot credit against his/her income tax), on termination indemnities exceeding one year's annual salary. Secondly, the employer is required to pay an additional 15% wage tax on the back-service premium, which cannot be recovered from the employee (and which the employee cannot credit against his/her income tax), in case due to e.g. a salary increase the employee has a final pay pension scheme based on a base salary exceeding EUR 500,000. The third pillar, and certainly the most far-reaching, relates to so-called carried interest. This includes shares, bonds and similar rights intended as remuneration for services (to be) rendered by an employee (or in certain cases by related persons such as management companies) as well as shares owned as a result of management buy-outs, and can therefore relate to prior employment. While the current law in many cases allows these rights or the income thereon to be treated as income from net wealth or substantial shareholdings, the new rules will bring this income within the scope of the substantially higher taxed income from employment.

19. UKRAINE

Termination of Ukraine (USSR)-Cyprus tax treaty

On 4 June 2008, the Ukrainian Parliament voted down a draft law ("Draft Law") terminating the tax treaty between the former USSR and Cyprus. The Parliament was short of just three votes (223 of the 226 required) for the Draft Law to be adopted.

According to the Ministry of Finance of Ukraine, the author of the Draft Law, the effective Ukraine-Cyprus tax treaty "...created favorable conditions for residents of Ukraine to legally transfer abroad substantial amounts of funds free of tax. The provisions of the treaty are also used by many companies to establish various tax minimization schemes."

Ukraine and Cyprus started negotiating a new tax treaty ("Draft Treaty") in April 1997. In the course of the two recent rounds of negotiations Cyprus proposed several amendments to the Draft Treaty, which, in the opinion of the Ministry of Finance of Ukraine, "...in fact have blocked further negotiations as they [amendments] are absolutely unacceptable for Ukraine."

In particular, Cyprus proposed excluding from the Draft Treaty a provision granting Ukraine the right to tax capital gains earned by Cypriot companies from the sale of shares in Ukrainian real estate companies. Cyprus also proposed to reduce the rate of withholding tax from 10% to 0% for interest income and from 10% to 5% for royalty income.

Given the rejection of the Draft Law, it can be expected that the tax treaty will remain in force at least until 31 December 2008. The termination procedure set forth in Article 20 of the tax treaty states that notice of termination shall be given not later than six months before the end of any calendar year. If the termination notice is given within this six-month period, the tax treaty will cease to apply to taxes assessed in respect of periods starting from 1 January of the year in which the termination notice has been given.

VAT on the supply of legal services to nonresident customers

Under article 6.5.d) of Ukraine VAT Law, the place of supply of legal, consulting, auditing, engineering and other similar services shall be the place where the customer or its permanent establishment is registered or the place where the customer has its permanent address or usually resides. This means that if a Ukrainian company registered as a taxable person for VAT purposes provides such services to a customer registered outside Ukraine and who has no registered permanent establishment in Ukraine, the provision of such services falls outside the scope of Ukrainian VAT.

However, according to a recent ruling (Letter No. 7104/7/16-1517-26 of 8 April 2008) published by the State Tax Administration of Ukraine ("STAU"), the provisions of article 6.5.d) of the VAT Law shall not apply to supplies of legal, consulting, auditing, engineering and other similar services until such services are explicitly listed in the law. Therefore, the STAU considers that the provision of such services is subject to 20% VAT in Ukraine.

In practice, many Ukrainian consulting services providers do not charge 20% VAT on the value of their services provided to nonresident customers. Taking into account STAU's foregoing position, it is likely that it will attempt to assess VAT liabilities for Ukrainian companies which did not charge VAT on their services. As a result, numerous tax disputes may arise.

20. VENEZUELA

Repeal of the Decree with Rank, Value and Force of Law on Financial Transactions Tax

A Presidential Decree was published in Official Gazette No. 38.951 dated 12 June 2008. This Decree repealed the Decree with Rank, Value and Force of Law on Financial Transactions Tax for Legal Entities and Economic Entities without Legal Personality, published in a special issue of the Official Gazette No. 5852 dated October 5, 2007, and reprinted in Official Gazette No. 38797 dated October 26, 2007. The repealed regulation had been in force since 1 November 2007 and established a tax of 1.5% for all financial transactions carried out by legal entities and economic entities without legal personality. The Decree also repealed all implementing regulations.

Presidential Decree with Rank, Value and Force of Law on the National Institute of Training and Social Education

Presidential Decree No. 6068 with Rank, Value and Force of Law on the National Institute of Training and Social Education was published in Official Gazette No. 38958 dated 23 June 2008 and reprinted in Official Gazette No. 38968 dated 8 July 2008. The Decree regulates the aforementioned institute as an entity of the Ministry of People's Power Responsible for the Communal Economy, and establishes in detail the purpose of the institute, its functions, address, competencies, organization, duties of contributors and the penalties applicable for noncompliance.

Law of Partial Reform of Decree No. 363 with Force and Rank on Stamp Tax Law

Official Gazette No. 38958 dated 23 June 2008 published the Law of Partial Reform of Decree No. 363 with Force and Rank on Stamp Tax Law. This law included cash payments made directly to the Recipient Office of National Funds as a branch of income from stamp tax; limited the items comprising the branch of income from stamp tax; and amended rates related to acts and/or identification, and/or migration documents, which must be paid in cash to the Recipient Office of National Funds.

Decrees published in Official Gazette No. 38.984 dated 31 July 2008

Official Gazette No. 38.984 dated 31 July 2008 published a list of 26 Decrees with Rank, Value and Force of Law issued by the President of Venezuela, which introduced important reforms in the Venezuelan legal system, particularly as regards employee matters and employer social contributions, the Venezuelan social system, the economic and financial sector, and matters related to the public administration system.

The National Integrated Service of Customs and Tax Administration (SENIAT) issued Regulation No. 257 establishing general rules for invoices and other documents.

The regulation (*Providencia*) establishes general rules for invoices and other documents and repeals Regulation No. 591. The regulation sets out the method for issuing invoices and other documents, and the requirements that must be fulfilled by taxpayers and other users.

RULINGS

1. INDIA

Ruling on taxability of intangibles in India

In a landmark Ruling, the Authority for Advance Rulings (AAR) has laid down important principles relating to the taxability of intangibles in India. The applicant (Foster), an Australia-based company, had entered into an agreement with SAB Miller UK ("SAB Miller") for the sale of trademarks, Foster's brand intellectual property ("marketing intangibles") and Foster's brewing intellectual property ("brewing intangibles"). The intangibles transferred to SAB Miller had previously been licensed by the applicant to Foster's India Limited ("Foster's India").

In determining the taxability of the sale transaction, the AAR held that marketing intangibles had been licensed and commercially exploited by Foster's India for its marketing activities in India and hence, had their 'tangible presence' in India. Accordingly, the consideration received on the transfer of such intangibles, being situated in India, would be liable for Indian capital gains tax.

The applicant had filed an appeal against the AAR Ruling before the Supreme Court. The Court directed the applicant to file the appeal before the High Court, which is the appellate authority before the Supreme Court in the Indian judicial hierarchy. This was an interesting move by the Court, because appeals against AAR Rulings (such as the Morgan Stanley decision on Service PE) had previously been directly admitted by the Supreme Court.

Foster's Australia Ltd vs CIT (AAR)

2. ITALY

Ruling No. 345/E of 5 August 2008 – transfer of company headquarters – calculation of the value of corporate assets

Alfa SA, a Luxembourg resident company incorporated as a "1929 holding company", and which had applied for the exemption provided by the *millionnaire* regime, relocated to Italy.

The Italian tax authorities took the view that Alfa SA had been resident in Italy for tax purposes since the beginning of the financial year when its legal headquarters, place of management or main business activity had been located in Italy for the greater part of that year.

According to the Inland Revenue, since the company moved its headquarters to Italy without going into liquidation, it is entitled to benefit from the exemption on capital gains realized on the sale of its shareholdings provided for by the domestic participation exemption regime. This exemption is conditional on subjective and objective requirements for the participation regime being met: i.e., the shareholding has been held at least from the first day of the 12th month preceding the transfer; the shareholding is classified as a financial asset in the first post-acquisition balance sheet; the company in which a shareholding is acquired has been engaged in a business activity at least since the beginning of the third financial year preceding the relocation).

Moreover, the Italian tax authorities observed that where a company's headquarters are transferred without any assets being sold and the country which the company is leaving did not levy any exit tax on the deemed capital gains, then the values of the shareholdings for tax purposes are determined on the basis of their acquisition cost.

3. JAPAN

Guidelines issued by the FSA on the "independent agent exemption" under the 2008 tax reform

Nonresident persons or companies conducting business or investing in Japan may be assessed for income taxes according to whether or not their business activities constitute a permanent establishment ("PE"). Under Japanese tax law, PEs can arise in connection with (i) a branch; (ii) a construction project; or (iii) an agent. In the 2008 tax reform, independent agents will no longer cause an offshore principal to have a PE in Japan (hereinafter, "independent agent exemption").

Prior to the introduction of the independent agent exemption, if an offshore investment fund residing for tax purposes in a country that did not have a tax treaty with Japan, entered into a discretionary investment agreement with a Domestic Investment Manager ("DIM"), there was a risk that the DIM's activities could be treated as a PE. Under the independent agent exemption which came into force on 1 April 2008, the risk of a DIM's activity being treated as a PE was substantially decreased.

The application of the independent agent provision is basically consistent with the commentaries to the OECD's Model Tax Convention on Income and on Capital. To be considered an independent agent, the agent must have "legal independence", "economical independence", and must only be acting in the "ordinary course of business". To clarify the application of the aforementioned requirements, the Financial Services Agency of Japan ("FSA") recently published "Reference Cases" and "Q&A", which define the meaning of an independent agent when applied to domestic investment managers acting under a discretionary investment agreement with an offshore fund. The FSA documentation states that a DIM will be treated as an independent agent of the partners of the offshore fund as long as none of the following situations exist:

- "Detailed instruction"

The investment decisions delegated to a DIM are extremely limited (for example, instructions concerning the selection or timing of the purchase/disposal of individual investments are considered to be detailed instructions, but asset allocation decisions are considered as an 'extremely limited instruction'.)

- "Shared officers"

At least one half of the officers of the domestic DIM concurrently serve as officers or employees in the offshore fund.

- “Remuneration”

The DIM does not receive remuneration relative to the total assets to be invested.

- “Diversification capacity”

Where a DIM exclusively deals with the offshore fund or foreign manager, it does not have the capacity to diversify its business or to acquire other clients without either (i) fundamentally altering the way that a DIM conducts its business or (ii) losing its economic rationale for conducting business.

This legislation and subsequent clarification by the FSA is expected to have a positive effect on the PE treatment of offshore funds with investment managers in Japan (especially for offshore funds resident in countries which are not signatories to the tax treaty with Japan).

The English translations of the “Reference Cases” and “Q&A” published by the FSA can be found at the following website:

<http://www.fsa.go.jp/en/news/2008/20080627-3.html>.

4. PERU

Conflict between domestic law and tax treaties regarding the definition of a permanent establishment

The definition of a permanent establishment (“PE”) in tax treaties entered into by Peru, such as those with Chile and Canada, includes certain cases that are not considered to be a PE by Peruvian domestic law. This is the case, for example, with the rendering of technical assistance services in Peru by a nonresident entity for a certain period (six to nine months).

According to domestic law, a nonresident entity that does not have a PE in Peru is subject to a withholding tax of 15% on the gross income derived from technical assistance services provided in Peru.

However, if under domestic law it was deemed that such an entity had a PE in Peru, the PE considered to be a resident entity and the Peruvian-source net income attributed to the PE would be taxed at a rate of 30%. Accordingly, the PE’s taxable income should be determined by deducting expenses incurred for the purposes thereof, including executive and general administrative expenses.

The Peruvian tax authorities issued Revenue Ruling No. 039-2006-SUNAT, which holds that if a nonresident entity qualifies as a PE under the definition established by the tax treaties but not under domestic law, the nonresident entity will be taxed as a PE and considered as a resident in Peru for tax purposes.

The tax authorities’ opinion implies that a tax treaty can modify domestic law, in this case incorporating new definitions of permanent establishments that are considered and taxed as resident entities. Even though it is accepted that the concept of a PE is included in the tax treaties to allow the source country rather than the country of residence to fully tax the profits of the nonresident entity obtained through the PE, this definition cannot determine whether a taxpayer qualifies as a resident or nonresident entity for domestic law purposes.

In contrast, there is a position which holds that a PE under a tax treaty, but not under domestic law, must be taxed at the rates applicable to nonresident taxpayers (in the technical assistance example, at 15%), but on its Peruvian-source net income rather than on its gross income. However, there are no domestic regulations regarding the application of withholding tax to a nonresident entity’s actual net income.

In any event, it should be noted that no case law exists in connection with this issue and that uncertainty persists as to the rules that withholding agents should apply in these cases.

5. PORTUGAL

APA guidelines introduced in Portugal

Following the introduction of Advance Pricing Agreements (“APA”), the Portuguese tax administration have recently issued guidelines setting out the terms for applying and negotiating an APA. These new guidelines have been applicable since 17 July 2008.

Taxpayers may now apply for unilateral or bilateral/multilateral APA, the latter only being available for countries with which Portugal has a tax treaty that allows for a mutual agreement procedure. Basically, an APA may not exceed a three-year renewable period and is subject to a filing fee ranging from EUR 3,150 and EUR 35,000, depending on the taxpayer’s average turnover (reduced by 50% for renewals). If a bilateral/multilateral APA is not agreed, the taxpayer may request that it be converted into a unilateral APA subject to the taxpayer relinquishing any correlative adjustments following potential primary adjustments by foreign authorities.

Annex I to the guidelines sets out the specific information and documentation to be included in the APA proposal. Under said guidelines, taxpayers must provide all the information (even if confidential) requested by the tax administration, which agrees not to disclose such information to third parties with the exception of foreign authorities. Upon the implementation of an APA, taxpayers are required to file an annual report on the execution of the agreement, in addition to the general obligation to comply with local transfer pricing documentation rules. Failure to comply with this requirement may render the APA invalid. Lastly, it should be noted that an APA will not prevent the tax administration from conducting an audit of the taxpayer for transactions covered by the APA; in this case the audit will only verify that the terms and conditions of the APA are being complied with.

COURT CASES

1. EUROPEAN UNION

Case C-48/07 – Government of Belgium – SPF Finances v Les Vergers du Vieux Tauves SA – Directive 90/435 – usufruct over shares

In an opinion delivered on 3 July 2008, the Advocate General concluded that “Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States requires Member States to grant the advantageous tax treatment of dividends received by a parent company from a subsidiary which is enjoined by article 4(1) in a situation where ownership of the shares in the subsidiary has been severed, so that dividends are received by one company by virtue of a right of usufruct while legal ownership remains with another company”.

Case C-418/07 – Papillon vs French tax authorities – French tax consolidation

In an opinion delivered on 4 September 2008, the Advocate General concluded that the French tax consolidation rules – under which a French parent company can only form a tax consolidated group with a sub-French subsidiary if said subsidiary is held by a French rather than a foreign subsidiary – constitutes a restriction to the freedom of establishment principle.

Such restriction can be justified by the need to ensure the cohesion of the tax system, especially if it helps avoid double use by the tax consolidated group of the sub-subsidiary’s tax losses, but could be reached by less restrictive measures.

The Advocate General concluded that the national jurisdiction is responsible for assessing whether the objective can be reached by less restrictive measures.

2. COUNTRIES

2.1 GREECE

Supreme Court Ruling on the withholding tax treatment of fees for technical assistance

The Greek Supreme Court recently confirmed, by virtue of Ruling No. 1177/2007, that fees paid to a foreign enterprise (Dutch tax resident) for the provision of technical assistance, do not involve the transfer of knowledge, and therefore do not fall within the scope of “royalties” for Greek withholding tax purposes. The Court accepted that a key element distinguishing royalty payments from technical assistance service fees is that in the latter case, the service provider uses special knowledge, skills, or expertise for the purpose of providing services to the recipient, without however transferring such knowledge, skill, or expertise to the service recipient. Therefore, in accordance with relevant provisions of the Commentary to article 12 of the OECD Model Tax Convention on Income and on Capital, the Supreme Court ruled that in order for a fee to be

classified as a royalty for withholding tax purposes, it should be paid as consideration for the knowledge of the service provider, which is imparted to the service recipient.

In practice, Greek tax authorities commonly take the view that fees relating to the provision of technical assistance qualify as royalties for Greek withholding tax purposes. Therefore, the above position of the Greek Supreme Court strengthens the arguments of Greek taxpayers in challenging such erroneous classification.

2.2 INDIA

Attribution of profits to a dependent agent permanent establishment

In a landmark case, the Mumbai High Court overturned the order of the Mumbai Income Tax Appellate Tribunal (“the Tribunal”) and upheld the principles laid down by the Supreme Court in its landmark Morgan Stanley decision regarding the calculation of profits attributable to a dependent agent permanent establishment (DAPE).

The taxpayer, a Singapore-based company, was engaged in marketing operations in India for the sale of advertisement slots through its dependent agent (DA), Sony Entertainment Televisions India Private Limited (SET India). The taxpayer contended that it was not liable for tax since the dependent agent was remunerated on an arm’s length basis.

The assessing officer (AO) held that the taxpayer had a DAPE in India and was therefore liable to pay taxes in India. However, the Commissioner of Income tax (Appeals) [CIT (A)], the first appellate authority, held that remuneration paid to the DA on an arm’s length basis would extinguish the taxpayer’s liability in India.

The Tribunal observed that the DA and DAPE were two distinct taxable entities. Accordingly, where the functions performed, assets utilized and risks assumed (FAR analysis) for the DA and DAPE produced different results in terms of profit attribution, arm’s length remuneration paid to the DA would not extinguish the DAPE’s tax liability in India.

On further appeal, the Court, basing its decision on the Supreme Court’s Ruling in the Morgan Stanley case, held that if the service fee paid to the DA was at arm’s length, no further profits were required to be attributed to the DAPE. The Court did not place reliance on the principles laid down in the OECD Model Commentary, which does not rule out the possibility of attributing additional profits to the DAPE where the agent has been remunerated at arms’ length. Further, though the above principles were laid down by the Supreme Court in the context of a service PE, the High Court applied these principles to an agency PE.

*SET Satellite (Singapore) Pte Ltd vs DDIT
(Mumbai High Court)*

Taxability of offshore supplies where activities relating to such supplies are entirely undertaken outside India

In a landmark Ruling, the Delhi Tax Tribunal (Delhi) laid down important principles for determining the taxability of a contract involving offshore supply and onshore services.

In this Ruling, a South Korean company entered into an agreement for the offshore supply of equipment and the rendering of certain offshore services. A separate agreement was entered into for rendering onshore services which consisted of testing and commissioning activities. Onshore services were rendered through a project office (PO) in India and offshore supplies were undertaken entirely outside India. The AO and the CIT(A) observed that the responsibility of the taxpayer did not end at the moment the equipment was delivered, but continued until such equipment had been assembled and commissioned. Accordingly, it was held that the offshore supply of equipment would be taxable in India since the contracts for supplies, assembly and commissioning were interconnected.

The Tribunal observed that all of the activities relating to the supply of equipment – namely the transfer of property, payment of consideration, etc. – were undertaken outside India. Also, the equipment supply and assembly/commissioning activities were undertaken under two distinct contracts with separately identifiable revenue streams. Accordingly, the two contracts were not interconnected. Further, even in the case of a consolidated contract involving a distinct scope of work, the taxability of each scope is required to be separately determined. Accordingly, it was held that if all the activities in relation to offshore supplies are undertaken outside India, then the income from such activities will not be taxable in India.

*LG Cable Ltd vs DDIT
(Delhi Tribunal)*

Allowability of withdrawal of application subsequent to AAR Ruling

In a landmark Ruling, the Supreme Court has allowed the taxpayer to withdraw its application filed with the AAR. The merits of the application had previously been examined by the AAR. The taxpayer was registered as a Foreign Institutional Investor (FII) in India and had approached the AAR to determine the nature of income earned from undertaking transactions in securities. The AAR did not find in favor of the taxpayer.

An appeal was filed by the taxpayer before the Supreme Court to withdraw the application previously filed with the AAR. The Court allowed the taxpayer to withdraw its application and therefore held that the AAR's Ruling would no longer apply.

This decision is important since Indian tax laws do not grant any express power to the Supreme Court or any other Revenue authority to allow the withdrawal of an application already dismissed by an AAR.

*General Electric Pension Trust vs DIT
(Supreme Court)*

Provisions of Production Sharing Contract prevail over normal provisions of the Act

In a recent Ruling, the Supreme Court laid down principles on the importance of the terms of a Production Sharing Contract (PSC) vis-à-vis the provisions of the Act. The taxpayer was engaged in the business of oil exploration and had entered into a PSC with the Indian government alongside other consortium members. The taxpayer claimed revenue deduction of foreign exchange losses arising on the translation of expenses incurred in foreign currency at the end of an accounting period. The AO held that the loss recognized by the taxpayer was notional and accordingly, did not allow tax deduction for such loss. The Tribunal and the High Court decided the issue in favor of the taxpayer.

The Supreme Court observed that the PSC established an independent mechanism for the treatment of costs, expenses, income, profits, etc. incurred or earned by the consortium members engaged in oil exploration. Accordingly, the accounting and tax treatment of expenditure/income provided for in the PSC prevailed over the normal provisions of the Act. The PSC was considered to represent a distinct, complete code which provided for specific accounting and tax treatment of income/expenses. In the case at hand, since the PSC provided that the loss arising on account of foreign currency translation could be claimed as a tax deduction in the same year, such expenses were deemed to be tax deductible.

*CIT vs Enron Oil & Gas India Ltd
(Supreme Court)*

2.3 LUXEMBOURG

Participation exemption regime applicable to call options on shares

A Luxembourg Court considered that the Luxembourg holder of a call option on shares in a Singapore company can benefit from the participation exemption regime for corporate income tax and net wealth tax purposes.

On 26 June 2008, decision No. 24061C of the Luxembourg Administrative Court overturned a decision of the Administrative Tribunal dated 31 December 2007 regarding the application of the participation exemption regime (exemption of dividends and capital gains on shares from corporate income tax and municipal business tax and exemption of the value of such shares for net wealth tax purposes) to call options on shares in a Singapore company.

The Court was called upon to decide what is understood by a holder of a participation within the meaning of Corporate Income Tax Law and Valuation Law, before ruling whether or not the holder of a call option on shares could benefit from the participation exemption regime.

Since there is no clear definition of the term "holding" (*détention*) in Luxembourg Corporate Income Tax Law, reference was made to the general principles set forth in article 11 of the Tax Adaptation Law (§ 11, 4° *Steueranpassungsgesetz*). Based on these principles, the holder of the shares for tax purposes is the one who possesses the economic ownership over the said shares.

In the case at hand, the court decided that the holder of the option was the economic owner of the shares despite the fact that he was not the legal owner.

The following questions were considered by the Court in determining who had the economic ownership:

- Who can benefit from an increase in value of the underlying shares?
- Who bears the risk in the event that the underlying shares decline in value?
- Who holds the voting rights and other rights (including dividends) attached to the shares?
- Was there any kind of advance payment made on the acquisition price of the shares?
- Is the option more than likely to be exercised?

Since the holder of the option satisfied all of these five conditions, the Court decided that the economic ownership of the shares had been transferred to the holder of the call option. As a result, the participation exemption was applicable both to the dividends received by the option holder on the shares in the Singapore company and, for net wealth tax purposes, on the value of these shares.

This decision is in line with the opinion of the Advocate General of the European Court of Justice handed down in case C 48/07 on 3 July 2008. According to this opinion, the participation exemption regime (Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States) applies to dividends received by the holder of usufruct rights even when the holder is not the legal owner of the shares.

2.4 PERU

Income tax treatment applicable to satellite services and assignments for the use of international underwater wires rendered by nonresident corporations

The Peruvian Tax Court recently ruled on whether payments made to a nonresident corporation for the provision of satellite services and assignments for the use of underwater services qualify as Peruvian-source income and are therefore subject to withholding taxes.

According to Peruvian Income Tax Law ("ITL"), nonresident taxpayers are taxed only on their Peruvian-source income, which includes income produced by goods and rights physically located or used in Peru, as well as income derived from services rendered in Peru.

The Peruvian tax authorities considered that:

- (i) satellite services rendered by foreign entities to resident corporations are assignments for the use of intangible goods used within Peru, since they allow international communications with Peru; and
- (ii) assignments for the use of underwater wires located partially outside and partially within Peruvian territory are assignments of goods or rights used in Peru, since they allow the international transmission of signals with Peru.

Accordingly, the Peruvian tax authorities qualified the consideration for the abovementioned services as taxable Peruvian-source income.

In its Resolution No. 01204-2-2008, the Peruvian Tax Court established that the income derived from the satellite services represents consideration for services and not for assignments of intangible goods. Therefore, it ruled that the satellite services were developed entirely outside Peru and do not give rise to Peruvian-source income.

The Tax Court held that the income derived from the assignment for the use of underwater wires qualifies as Peruvian-source income for the part of the underwater wire that is physically located within Peruvian territory.

Based on these considerations, the Tax Court reversed the tax authorities' position as regards the taxation applicable to these international telecommunication issues.

2.5 SPAIN

Documentation supporting valid economic reasons in restructuring transactions

As a result of the transposition of Directive 90/434/EC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, the Spanish tax system provides for a special tax neutrality regime for transactions of this type, the main aim of which is to defer the taxation of any gains on such transactions by valuing the assets received by the transferee at the same value as they were previously recorded by the transferor. By way of limitation, the regime does not apply where the main purpose of the transaction is tax fraud or tax evasion. In particular, the regime does not apply where the transaction is performed not for valid economic reasons, such as restructuring or streamlining the activities of the entities taking part in the transaction, but solely in order to gain a tax advantage.

Two National Appellate Court judgments have recently been handed down in this area. In the related cases, two individual shareholders (of two different companies) became, by virtue of two successive exchanges of securities in 1996 and 1998, shareholders of a holding company which itself held shares in another holding company, itself the ultimate holder of the shares in the operating companies.

The transactions were reviewed by tax authorities, who took the view that there was no economic justification for them and that they were merely part of a corporate arrangement aimed at reducing taxation. Accordingly, the tax authorities issued a reassessment of the taxpayers' situation for both years. The taxpayers filed an appeal against the administrative decisions with the Central Economic-Administrative Tribunal, which upheld the proposed assessments, leading the plaintiffs to appeal to the National Appellate Court.

In its decisions, the National Appellate Court reversed the administrative decisions by the tax authorities to issue assessments against the two companies, basing itself on two reports produced by independent experts at the

taxpayers' request that were submitted in the course of the tax audits and, in particular, together with the appeals for reconsideration of the assessments. The two reports concluded that the dual holding company structure had a clear economic justification based among other reasons on the sustained growth of the group and on the need to develop an organizational structure that could be adapted to the group's operating requirements — an arrangement typically found within most Spanish and international companies today.

Lastly, the Court dismissed the adjustments made in the assessments and held that since the transactions were based on valid economic reasons, they had been properly performed under the tax neutrality regime provided for in Corporate Income Tax Law. This constitutes a new development as regards the importance of having supporting documentation for transactions of this type in Court proceedings.

Changes to tax legislation governing stock options for individuals

Under Spanish Personal Income Tax Law, certain types of income qualify for a reduction in the tax base if they are generated over a period spanning more than two years and are not obtained on a recurring or periodic basis. However, in the case of stock options granted by companies to their employees, the regulations implementing the Personal Income Tax Law introduced an additional qualifying requirement, whereby the options were only exercisable when more than two years had elapsed since the grant date.

On 9 July 2008 the Supreme Court handed down a judgment on the above requirement. In the case heard by the Court, an employee received certain company stock options in 1999 but did not exercise them until more than two years later. However, the tax authorities adjusted his tax situation by disallowing the above reduction on the grounds that he could have exercised the stock options earlier (in fact from the outset). As a result, the employee unsuccessfully appealed against this decision before the Administrative Tribunals and then the Courts.

The appeal to the Supreme Court was essentially based on the principle regarding the rank of different sources of Spanish law. According to this principle, legislation (such as regulations) that is subordinate to a statute (for example a law, which is primary legislation) can under no circumstances contradict the said primary legislation. Transferring this argument to the case at hand, if the Personal Income Tax Law restricted the right to claim a reduction by imposing certain requirements (namely, that the income in question is not received on a regular basis and is generated over a period spanning more than two years), the fulfillment of such requirements should entitle the taxpayer to claim the reduction. The fact that the options could have been exercised at an earlier date was in fact irrelevant, contrary to the requirement imposed by the regulations.

Accordingly, the Court held that the provision in the regulations introducing a requirement in addition to the requirements provided for in the Personal Income Tax Law in order to qualify for the reduction in taxable income was unlawful.

This ruling declaring the additional requirement in the Personal Income Tax Regulations unlawful undoubtedly opens the door to a fresh review of the tax treatment of stock option plans at many corporate groups in which such incentives are in place.

2.6 VENEZUELA

Constitutional Chamber of the Supreme Court of Justice (the "Court") clarifies the application of the interpretation of article 31 of the Income Tax Law

In decision 980 of 17 June 2008 (the "decision"), the Court ruled that the constitutional interpretation of article 31 of the Income Tax Law, established in decision No. 301 of 27 February 2007, and previously ruled in decision No. 390 of 9 March 2007, applies from the 2008 fiscal year. The Court also ruled that remuneration considered as regular and permanent is clearly defined by the second paragraph of article 133 of the Organic Labor Law, which defines normal salary as remuneration payable to the employee in a regular and permanent manner, excluding any one-off remuneration, income from the provision of pension contributions, and any other payments stipulated by the aforementioned Law.

Political-Administrative Chamber of the Supreme Court (the "Court"), modifies the criterion regarding the application of the Criminal Code on sanctions for the non-fulfillment of duties relating to VAT Law

In decision No. 00948 dated 13 August 2008, the Court modified the criterion regarding the implementation of the legal fiction of continued crime to the tax infringements arising from the failure to fulfill formal duties in relation to VAT. The Court ruled that the application of sanctions for the non-fulfillment of formal duties over several periods of monthly taxation did not violate the principle of double jeopardy, as such sanctions are calculated, levied and effective in various taxation periods, in this case every month. According to this new criterion, the non-fulfillment of formal duties relating to VAT over several different periods shall be punished independently and will not be considered as a single offence.

Political-Administrative Chamber of the Supreme Court (the "Court") ratifies criterion on late payment interest

On 6 August 2008, the Court, in decision No. 00915 (Case: Bolivarian Republic of Venezuela vs. Vepaco, C.A.) ratified the criterion upheld by the Constitutional Chamber regarding decision No. 1490 dated 13 July 2007, and ruled that late payment interest generated by tax debts was payable since the tax assessment was considered "final".

OTHER NEWS

1. COUNTRIES

1.1 MALAYSIA

Liberalization of rules in relation to Labuan offshore companies

The Labuan Offshore Financial Services Authority (LOFSA) has recently announced that it was to liberalize the rules pertaining to offshore companies (OCs). LOFSA has granted blanket approval to allow OCs to:

- i) carry on business with Malaysian residents;
- ii) invest in domestic companies (so long as the holding does not amount to a controlling holding); and
- iii) wholly own a domestic company to carry on an offshore business.

It should be noted however that where approvals are required from other regulatory authorities, such as Bank Negara Malaysia, the Securities Commission and the Foreign Investment Committee (FIC), such approvals must still be obtained. Further, LOFSA has issued a notification form which OCs are required to submit when undertaking (i) – (iii) above.

1.2 PORTUGAL

EC infringement procedure against Portugal – Mandatory tax representative

The Commission announced on 26 June 2008 that it had asked Portugal to amend its legislation concerning the tax rules requiring nonresident taxpayers to appoint a tax representative if they obtain taxable income in Portugal. The Commission believes that a general obligation imposed on nonresidents to appoint a tax representative goes beyond what is necessary to ensure objectives such as guaranteeing the payment of taxes and preventing tax evasion, and hence restricts the free movement of persons and capital as provided for in the EC Treaty and in the EEA Agreement.

This announcement follows a significant number of infringement procedures pending against Portugal dealing with direct taxation. These include for example infringement procedures on the discriminatory taxation of outbound dividends (IP/07/66), discriminatory taxation of dividends and interest paid to foreign pension funds (IP/07/616), discrimination against investments held abroad (IP/08/339) and the discriminatory 2005 tax amnesty legislation (IP/08/147). In addition, there is an important infringement procedure already pending in the ECJ, dealing with the discrimination of foreign banks on Portuguese-source interest income (C-105/08). Given the high number of infringement procedures pending, we believe that taxpayers should consider reviewing their tax position taking into account the current procedures or other discriminatory treatments under EC Law.

1.3 VENEZUELA

The Superintendence of Foreign Investments (SIEX) reiterates the obligation for companies that receive or provide technology import services to disclose the payments made under executed contracts

By official notice published in the press on 6 July 2008, the SIEX reminds all companies that receive or provide technology import services of their obligation to disclose, within sixty (60) days following the end of the fiscal year, all matters associated with contracts entered into by the company regarding trademarks, patents, licenses and royalties, and reminds companies that receive foreign direct investment of their obligation to update the respective registration within 120 days following the close of each fiscal year.

The National Anti-Drug Office of the Ministry of People's Power for the Interior and Justice published a notice stating the permanent nature of the extension of the tax collection process regarding the provisions set out in articles 96 and 97 of the Organic Law Against Illicit Traffic and Consumption of Narcotic and Psychotropic Substances.

In a notice published on its website on 5 June 2008, the ONA notified public and private companies subject to articles 96 and 97 of the Organic Law Against Illicit Traffic and Consumption of Narcotic and Psychotropic Substances, that the process of tax collection had been extended until further notice.

The National Integrated Service of Customs and Tax Administration (SENIAT) published a notice stating the new name that must be indicated when issuing checks for the payment of taxes.

In a notice published on its website, the SENIAT announced that from 1 July 2008, payments made with checks at banks for the collection of taxes must be issued in the name of the National Treasury.

New schedule of obligations for special taxpayers

Regulation No. 0251 dated 31 July 2008 published in Official Gazette No. 38.98 amended the schedule of obligations for special taxpayers and withholding agents, which came into force on 4 August 2008. The abovementioned schedule is published on the website of the National Integrated Service of Customs and Tax Administration.

2. OECD

On 17 July 2008, the OECD published the final version of its report on the attribution of profits to permanent establishments. This final report replaces all previous drafts of various parts thereof, including the interim versions published in December 2006 and August 2007.

The report, structured in four parts, systematically addresses the issue of determining profits which, under article 7(2) of the OECD Model Convention, are attributable to a PE in the host state by applying the "functionally separate entity approach".

According to this approach, profits must be attributed to a PE through a two-step analysis: first, the PE is assumed to be an independent entity, separate from the one of which it is a part; secondly, the PE's dealings with the parent company as well as with other related parties are priced by analogy with the OECD's Transfer Pricing Guidelines.

3. IFA

Congress in Brussels, 31 August – 4 September 2008

The yearly International Fiscal Association Congress took place in Brussels from 31 August to 4 September 2008. As usual, this Congress gave the opportunity to more than 2,000 participants including company tax executives, professors, consultants, and tax authorities, to share views about hot topics such as nondiscrimination, cross-border interests, tax risk management, EU common consolidated corporate tax base, taxpayer-tax authority relationships, and so on. These topics were discussed by selected panels in plenary or seminar sessions.

As usual, the presentations and discussions were particularly stimulating and stressed tax developments around the world, particularly convergence aspirations from the business community and persistent numerous national-based hurdles.

Among participants, more than 30 representatives of Taxand member firms from around the world attended the conference and joined the social events to increase networking and visibility with regard to the tax community.

SPECIAL FEATURES

CUSTOMS VALUATION: FIRST-SALE RULE STILL ALIVE BUT FOR HOW LONG?

According to article VII of the GATT, customs value is generally based on transaction value, which is the price paid or payable for goods when they are sold for export to the territory of import.

Since this article does not define when such sale shall take place, in case of successive sales prior to import (e.g. from the foreign manufacturer to the foreign middleman to the importer), some countries or customs territories such as the US, New Zealand and the EU allow customs valuation to be assessed based on the transaction value of a prior sale, usually once it is possible to demonstrate that:

- at the time of the prior sale, the goods were clearly and irrevocably committed for sale in the country of the importer;
- the middleman's selling price is at arm's length;
- the importer is able to substantiate and document that the sequence of transactions has economic substance.

This popular approach known as the "first sale rule", allows traders to reduce customs duties on the margin taken by middlemen and is often implemented for intragroup distribution flows, mainly when the parties to a transaction are afraid of giving away too much information about their margin.

In April 2007, the Technical Committee on Customs Valuation of the World Customs Organization adopted a nonbinding commentary, which concluded that the transaction value in the case of back-to-back sales shall be assessed on the basis of the last sale occurring prior to the introduction of the goods in the territory of importation.

According to this interpretation, US Customs and Border Protection ("CBP") tried to challenge the first-sale rule – commonly practiced in the US for around 20 years – on the basis of judicial and administrative cases. Nevertheless, the US importers' lobby actively challenged its position, which some analysts believe could lead to a rise in average import duties, and hence in prices for consumers, from 8% to 15%.

Experts were anxious to learn about the outcome of this case, and it recently became known that CBP withdrew its proposal in August 2008 and created an interim rule requiring importers to declare on their import form the use of the first-sale rule for a one-year period. The practice will again be a topic of discussion based on the data collected by CBP in this respect, but cannot normally be changed before 2011.

In the EU, the possibility to benefit from such a mechanism is laid down in the implementing regulations of the Customs Code (article 147). There does not currently appear to be any active plan or study to amend customs regulations on this point. However, since these regulations will be overhauled in line with the publication of the Modernized Customs Code, it is still possible that article 147 will be amended in the coming years. In any case, these new regulations will not be in force before 2011.

While the Technical Committee's interpretation may comfort those countries that were reluctant to allow importers to apply the first-sale rule, it nevertheless appears that the rule is alive and well in the EU and in the US. Although its elimination became a real political issue in the US due mainly to its popularity and the ensuing lobbying efforts by various organizations, it is difficult to foresee what the business reaction would be in the European Union if the Commission tried to amend Customs Law on this point. It is impossible to determine with any accuracy whether or not the first sale rule is commonly used in all Member States. Consequently, the rise in average import duties at EU level is extremely difficult to calculate, notably due to the lack of figures. Nevertheless, the EU Commission should take into account the US withdrawal before making any decisions on this issue.

The first-sale rule is still alive, but it remains to be seen for how long.

THREE PROMINENT PROFESSORS LAUNCH PLAN TO REFORM ANTI-BASE EROSION RULES AND REINSTATE THE NETHERLANDS AS A LOCATION OF CHOICE FOR INTERNATIONAL HEADQUARTERS

Politicians and company representatives have embraced plans launched by professors Van Weeghel, Vording and Engelen to radically simplify the anti-base erosion rules, reduce the corporate tax rate from 25.5% to 20% and abolish the withholding tax on profit distributions. Although these plans do not have any official status, they are worth discussing, since Van Weeghel, Engelen and Vording are recognized and highly regarded academics and have already received tokens of support from government decision-makers.

The professors' most far-reaching proposal is to render intragroup interest nondeductible in the hands of the debtor and exempt in the hands of the recipient. Under the proposal, the same will apply to gains and losses on intragroup debt and receivables, such as forex gains and losses. The definition of interest will be broad so as to include payments which are akin to interest under contracts such as financial leases, hire purchase and annuities.

In the plan of the three professors, intragroup interest is defined as interest which is paid by one member to another member of a group. A group is formed by companies which are associated with each other. 'Associated' means that one company has a majority interest in the other company or vice versa, or that another person has a majority interest in both companies. The term 'interest' is broader than 'shareholding'. If two or more persons jointly have a controlling interest in companies and if these persons work together, as in the case of a joint venture or a family-owned business, the companies will be treated as associated companies (not unlike the UK concept of control).

Intragroup interest will, however, be deductible in the event that the group has financed the loan on which the interest is due by means of a loan from a third party.

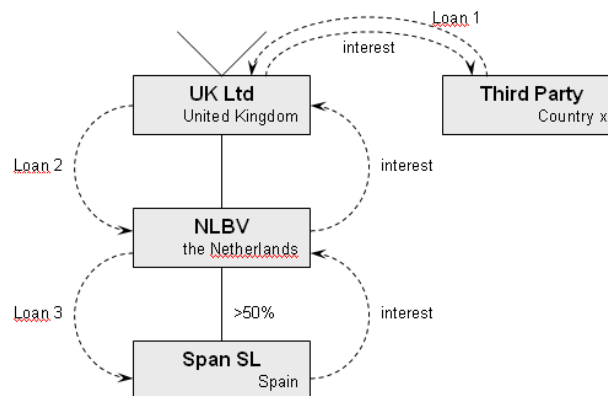
The professors hold that, as a result of the aforementioned proposal, almost all of the current provisions in the Corporate Tax Act restricting the deduction of interest can be scrapped. Examples of these provisions are the anti-base erosion rules of article 10a and the thin capitalization rules of article 10d. The professors also hold that there is no longer any need for the "Interest Box", a concession for group financing activities whose entry into force has been postponed pending a request for confirmation from the EC that it does not constitute incompatible State aid, which the EC is largely expected to reject. Finally, the professors propose abolishing the restrictions on the carry-over of losses from group holding and financing activities, introduced in 2004 in the wake of the ECJ's Bosal Decision in the Fall of 2003.

In the proposals put forward by the three professors, the exemption of intragroup interest receivable is achieved through a change in the participation exemption. The scope of the term 'qualifying participation' is extended to intragroup loans and war chests, i.e., short-term portfolio investments held with a view to financing takeovers. Intragroup loans are also treated as a qualifying participation if they have been financed with a third party loan. Conversely, the deduction of interest on third party loans of which the proceeds have been used to finance qualifying participations is restricted. To determine the portion of third party loans used to finance qualifying participations, companies have to compare their average equity with the average book value of their qualifying participations; the difference between these two amounts is treated as an equity surplus or deficit. The nondeductible portion of the third party interest is proportional to the equity deficit divided by the average total third party debt. The nondeductible part of the third party interest can be carried over to years in which the company has an equity surplus. Loans from associated companies and individuals are treated as equity for purposes of computing the nondeductible part of the interest on third party loans.

Under the current participation exemption, the subsidiary must not be a low-taxed passive investment subsidiary. The three professors propose dropping this rule. The scope of the existing requirement, namely that the subsidiary does not have the status of a qualifying mutual fund within the meaning of the Corporate Tax Act (in

Dutch: "*fiscale beleggingsinstelling*"), will be extended to all domestic and nonresident mutual funds. The expression 'mutual fund' will apply to companies engaging in portfolio investment which are not subject to taxation.

The changes in the Corporate Tax Act with regard to intragroup interest can be illustrated with an example based on the following structure chart.



Assume that NLBV has no equity; it has financed the acquisition of Span SL's shares and Loan 3 exclusively with the proceeds of Loan 2. Loan 3 will, pursuant to the professors' plan, fall within the scope of the participation exemption and the interest on Loan 3 will consequently be exempt from corporate tax in the Netherlands. Whether or not the interest on Loan 3 can be deducted for Spanish corporate tax purposes by Span SL is irrelevant. Since NLBV does not have equity, it must have exclusively financed the acquisition of the shares of Span SL and Loan 3 with the proceeds of Loan 2. Interest on a loan which has been used to finance the acquisition of assets qualifying for the participation exemption is nondeductible. Consequently, NLBV will not be allowed to deduct the interest on Loan 2, in spite of the fact that UK Ltd has financed Loan 2 with the proceeds of a third party loan, namely Loan 1. Whether or not the interest on Loan 2 is subject to UK taxation in the hands of UK Ltd has no bearing on the nondeductibility of that interest in the Netherlands.

The professors are convinced that their proposals do not risk being designated as incompatible State aid and harmful tax competition, because the measures they propose will apply to all corporate taxpayers, both residents and nonresidents. While the nondeductibility of intragroup interest would hamper highly leveraged private equity acquisitions of businesses in the Netherlands, preliminary comments on the proposals agree with the professors' views that the proposals will, on the whole, make the Netherlands a more attractive location for multinationals and encourage multinationals headquartered in the Netherlands to bring back their group financing to the Netherlands.

USA - THE PERILS AND OPPORTUNITIES OF ACQUIRED INTANGIBLE PROPERTY, OR HOW NOT TO TURN A BEVERAGE INTO A BOWL OF SPAGHETTI

When one multinational company acquires another, there are a variety of critical structuring, management and perhaps regulatory issues in multiple jurisdictions to be considered. Sometimes overlooked in the face of all this is the potential value in addressing head-on the issue of the acquired company's intangible property (IP). Valuable IP in an acquisition typically takes the form of patents, copyrights, trademarks, trade names or other similar items. Although often left to simply remain where it was pre-acquisition, a little up-front IP planning during an acquisition can yield significant tax and operational efficiencies.

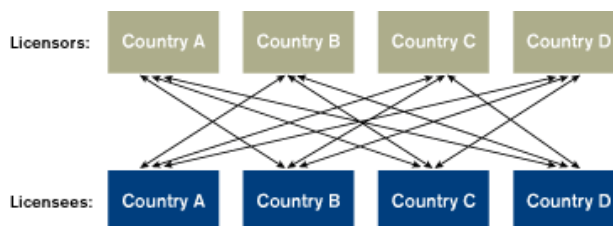
The opportunities can best be presented through a series of examples. All are based on the following basic acquisition scenario.

Scrumptious Co. ("Scrumptious"), a US-based multinational food company, produces a wide range of packaged food products. Scrumptious is seeking to expand its operations into the beverage industry. Refreshing Co. ("Refreshing") is a US-based multinational company that specializes in flavored beverages (bottled ready-to-drink and concentrated). Refreshing has a global brand as well as many local brands in specific markets around the world. In addition to the global and local brands, Refreshing owns US and non-US IP in the form of formulas and blending methods specific to each branded product. Scrumptious decides to acquire Refreshing through a stock acquisition of the US parent company.

Scenario 1 – Status quo

When Scrumptious acquires Refreshing, the status quo scenario is for the IP within Refreshing to remain in the countries where it currently resides. Since a primary purpose of the acquisition, however, is to expand the offerings of Scrumptious globally, the existing local Refreshing IP will be licensed to Scrumptious entities around the world. So, for example, the local Refreshing IP (brands and formulas) found in Country A would be licensed to entities in countries B, C and D for manufacture and distribution. Similarly, local Refreshing IP in Country B would be licensed into countries A, C and D, and so on. Agreements would be put in place for each license, and arm's-length royalties would be developed and documented. Very quickly a "spaghetti bowl" of licenses and royalties would develop (see Figure 1 below).

Figure 1 - The licensing "Spaghetti Bowl"



In addition to the transfer pricing issue of constructing arm's-length royalties for each transaction and the need for relatively complex local country documentation, this approach also quickly becomes an administrative burden and can be quite tax-inefficient. The following are some of the tax considerations associated with the status quo scenario:

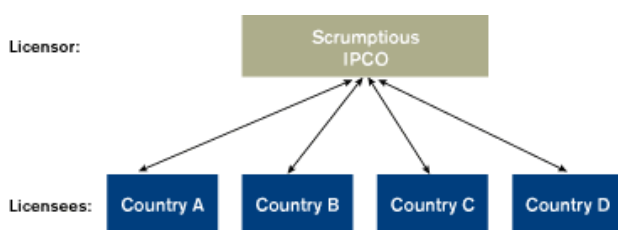
- There could be royalty income residing in a high-tax jurisdiction. For example, if IP located in Country A is deemed to be more valuable than the other products and Country A has an income tax rate of 40 percent, a large portion of the revenue from the international operations could be taxed at this relatively high rate.
- Each royalty stream must be analyzed from a withholding tax perspective. Specifically, the characterization as a royalty, the withholding tax rate, treaty eligibility and withholding tax formalities must be determined for each country relationship.
- The deductibility of the royalty payments must be confirmed for each jurisdiction.
- The local indirect tax implications (such as VAT) need to be considered.
- The US deemed dividend rules ("Subpart F rules") need to be reviewed to confirm that the intercompany royalty payments will not be subject to immediate taxation in the US. Although under today's rules, certain look-through rules (as well as certain other exceptions) might prevent the immediate taxation of the intercompany royalties, determining whether the exceptions apply could be cumbersome with these complex royalty streams.

Scenario 2 – Thinking about IP, a bit late

One way Scrumptious might address its spaghetti bowl of licenses is by consolidating all of its newly acquired IP into one entity. For example, after the acquisition, Scrumptious could establish a non-US entity in a tax-favorable jurisdiction to hold its IP ("Scrumptious IPCO"). This entity would acquire from the local entities any non-US IP intended to be shared globally. While the movement of the IP from the local entities to Scrumptious IPCO would involve valuations of this IP, once the migration was accomplished, the administration of the global licenses would be greatly simplified.

Specifically, Scrumptious IPCO would hold all the global non-US IP. As in Scenario 1, license agreements would be put in place between the licensor and licensees – in this case, however, there would only be one licensor, Scrumptious IPCO. Royalties would flow into Scrumptious IPCO from the local country licensees. As Figure 2 illustrates, however, the licensing transactions would be greatly simplified as compared with Scenario 1.

Figure 2 Licensing, simplified



While Scenario 2 has the advantage of relative simplicity, this structure gives rise to a different complication. To the extent that continued development related to local brands and formulas occurs in the local entities that originally owned each brand (“legacy entities”), the resulting IP from that development would need to be owned by Scrumptious IPCO in order to be included in its licenses to the other local entities. One way to do this, of course, is to enter into contract research and development arrangements with each of the legacy entities. In doing so, arm’s-length compensation for the local country R&D would need to be developed and documented.

In addition to the R&D complication, though, many of the tax issues discussed in Scenario 1 are also applicable here, including withholding taxes, deductibility, indirect taxes and Subpart F. Also, the migration of the IP to Scrumptious IPCO from the legacy entities can cause complexity and potential costly tax consequences in the legacy entity countries.

On the other hand, operational and tax issues may be greatly simplified in Scenario 2 because of the consolidation of IP into Scrumptious IPCO and the resulting reduction of the number of royalty streams. For example, the treaty network of potential Scrumptious IPCO jurisdictions can be reviewed to determine if one country is more advantageous than another in terms of withholding, based on the various countries that are making payments to Scrumptious IPCO. In summary, the advantages to Scenario 2 are the operational efficiencies gained and the possibility of earning royalty income in a tax-favorable jurisdiction.

Scenario 3 – IP planning as part of the acquisition

While Scenario 2 does eliminate the dreaded spaghetti bowl, it perhaps does not take advantage of the Scrumptious IPCO structure to the fullest. As an alternative, at the time of the Refreshing acquisition, Scrumptious could establish Scrumptious IPCO and concurrently have that entity purchase Refreshing’s non-US IP. By moving the non-US IP into Scrumptious IPCO

at the time of the acquisition, several tax complexities could be avoided, while leaving the transfer pricing planning unchanged. Specifically, using the same structure as shown in Figure 2, some of the taxable transactions related to migrating IP from the legacy entities might be avoided. (The extent to which this benefits Scrumptious depends on a variety of factors related to the tax profile of the Refreshing entities prior to the acquisition).

Alvarez & Marsal Taxand Says

Going further, Scrumptious could take the next logical step and, at the time of the acquisition, place all of Refreshing’s non-US IP (even that originally owned by Refreshing’s US company) in Scrumptious IPCO by establishing a cost sharing arrangement (CSA). The participants in the CSA would be Scrumptious IPCO and a US entity. While this arrangement has potential additional tax benefits, such as minimizing worldwide royalty income flowing into the US, the uncertainty of the current cost sharing climate and the costs of implementing CSAs have deterred many companies from pursuing this option. But as this example shows, many of the tax and transfer pricing benefits of CSAs, especially outside the US, can be achieved with some thought and attention given to IP at the time of an acquisition. In any case, with a little bit of forethought, there’s no reason to let a beverage become a bowl of spaghetti.

CYPRUS: TAX TREATIES UNDER NEGOTIATION

Cyprus has a considerable number of tax treaties with various countries. Set out below is a short status update of all new tax treaties which are under negotiation, revision, replacement and/or ready to be ratified.

EARLY NEGOTIATION STAGE	
ALGERIA	First round expected in Nicosia, 2008
BAHRAIN	Draft agreement exchanges in 2003 by both sides
BANGLADESH	Cyprus’ draft for negotiations submitted in 2005
BOSNIA & HERZEGOVINA	First round expected in Sarajevo, 2008
BRAZIL	Negotiations proposed after 1999 dialogues
GEORGIA	First round completed in Nicosia, 2007
INDONESIA	First round executed in Nicosia, 1997 and second in Indonesia, 2000
ICELAND	First round completed in Nicosia, 2006
JORDAN	Mutual interest in 2000. Draft agreement submitted by Jordan
LIBYA	First round expected, 2008
MALAYSIA	Draft agreement submitted in 1997
MOROCCO	First round expected in 2008
SRI LANKA	First round executed in 2000, second round expected in 2008
VIETNAM	Vietnamese draft agreement submitted, no date announced

ADVANCED NEGOTIATION STAGE	
ESTONIA, LATVIA, LITHUANIA	Two rounds: Nicosia 2000 & Riga 2006. Third round n/a
FINLAND	Second round 2006, Helsinki. Third expected in Nicosia
NETHERLANDS	Two rounds: 2003 & 2006 Amsterdam. Third round n/a
PORTUGAL	Two rounds: 2006 & 2007. Third round n/a
SPAIN	Two rounds: 2005, twice. Third round n/a

FINAL AGREEMENT STAGE	
CZECH REPUBLIC	First round Nicosia, 2007. Awaits ratification from Czech side
IRAN	Two rounds: Nicosia 2001 & Iran 2007, agreement initialed
INDIA	Renegotiations: 2006. Awaits ratification from both sides
LUXEMBOURG	First, final round: Nicosia 2007. Final text of agreement
MOLDOVA	First, final round: 2006. Final text of agreement
QATAR	First, final round: 2007. Final text of agreement
SLOVENIA	Replacement of Yugoslav treaty. Final text of agreement, 2007
YUGOSLAVIA (NEW)	Replacement of old agreement. New one not signed yet

RENEWAL OF AGREEMENTS	
SLOVAK REPUBLIC	Renewal of Czechoslovakian agreement, 1980.

NEGOTIATIONS FOR REPLACEMENT OR NEW AGREEMENT	
ARMENIA	Second round expected in Nicosia, 2008
DENMARK	Re-negotiations: second round in Nicosia, n/a yet
GERMANY	Negotiations for new: awaits ratification from German side
GREECE	Negotiations for new: expected in Athens, 2006. n/a yet
FRANCE	Re-negotiation: two rounds in 2003 & 2005. Third expected in Nicosia
ITALY	Re-negotiations: 2002, 2003, 2006. Forth round expected in Nicosia
KAZAKHSTAN	Replacement of USSR treaty. Negotiation proposal: 2001
NORWAY	Negotiations for new: first round 2007 & second round 2008
SOUTH AFRICA	Re-negotiations on dividend article: March 2008
UKRAINE	Draft Treaty: two rounds of negotiations. Current treaty still in force ³
UZBEKISTAN	Negotiations for new: n/a yet

³ See LEGISLATION – UKRAINE for more details

POSTPONEMENTS	
UNITED ARAB EMIRATES	First round in 2007 but postponed
IRELAND	Re-negotiation introduced 1999 but postponed by Cypriot side
PAKISTAN	First round in 2007 but postponed

NO PROGRESS MADE	
GABON	Interest by Gabon in 1999, no progress made by Cypriot side
MEXICO	Requesting information about Cyprus but no progress made

NO INTEREST SHOWN	
AUSTRALIA	Interest expressed by Cyprus but not a priority for Australia
ISRAEL	Interest expressed by Cyprus in 1994. No reply received
JAPAN	Interest expressed by Cyprus. Japan not interested
SWITZERLAND	Dialogues started in 1992, Swiss side not interested
TURKMENISTAN	Ex-USSR agreement ended by Turkmenistan. No further interest
YEMEN	Interest expressed by Cyprus in 1996. No reply received
ZAMBIA	Interest expressed by Cyprus in 1996. No reply received

Cyprus has entered into numerous tax treaties with a large list pending. The ultimate aim of these treaties is the avoidance of double taxation on income earned in any of the countries with which Cyprus has entered into agreement.

MEXICAN TAX TREATY NETWORK AT A GLANCE

Mexico has negotiated an extensive web of trade agreements and tax treaties with countries from all continents to increase its appeal for foreign investors. However, more than 80% of foreign direct investments in Mexico come from the United States of America, the Netherlands and Spain.

Even though Mexico is engaged with many countries in trade, transportation, tax agreements and other type of international agreements, it is clear that these legal instruments by themselves are not sufficient for attracting investments from other countries. For instance, the cumulative direct investments of the British Virgin Islands from 2005 to 2007, a country with which Mexico has not entered into any type of international agreement, are significantly higher than the investments made by France, the United Kingdom, Canada, Switzerland, Luxembourg and Germany. It is worth noting the case of Japan, which has a negative cumulative investment.

The following list of 29 countries, in which Taxand is present, shows the highest cumulative direct investment in Mexico from 2005 to 2007:

	Country	Accumulated 2005 - 2007**
1	USA	USD 32,343.00
2	Netherlands	USD 8,384.40
3	Spain	USD 7,718.70
4	France	USD 2,592.60
5	UK	USD 1,856.50
6	Canada	USD 1,826.60
7	Switzerland	USD 821.00
8	Luxembourg	USD 818.60
9	Germany	USD 795.50
10	Belgium	USD 567.20
11	Sweden	USD 336.60
12	Denmark	USD 313.10
13	Australia	USD 190.50
14	Chile	USD 180.20
15	Singapore	USD 170.40
16	Korea	USD 128.60
17	Brazil	USD 120.70
18	Finland	USD 100.90
19	Ireland	USD 88.30
20	Italy	USD 77.20
21	Norway	USD 41.20
22	China	USD 12.70
23	Poland	USD 1.50
24	Portugal	USD 0.80
25	Russia	USD 0.50
26	Greece	USD 0.10
27	Indonesia	USD -
28	Romania	USD -
29	Japan	USD - 1,074.70

** all amounts in millions of dollars

Based on the above, we see that encouraging the use of tax treaties can be a mechanism to develop not only trade between treaty countries, but also to attract direct investment.

However, investors from Argentina, Puerto Rico and Colombia, all of them Taxand countries with important direct investments in Mexico, do not currently benefit from the existence of tax treaties with Mexico. To the extent that such countries enter into or continue negotiations to sign a tax treaty with Mexico, they would have direct access to investment conditions similar to those enjoyed by direct investors from treaty countries.

PROPOSED CHANGES TO DUTCH CORPORATE LAW, INCREASING FLEXIBILITY FOR INTERNATIONAL STRUCTURES

The Dutch parliament is to vote on a Bill proposing substantial changes to the regime currently applicable to Dutch private limited liability companies ("BVs"). The changes aim at increasing flexibility of the rules governing the Dutch BV. Though the changes may not take effect until some time next year, the proposals warrant consideration at present. Existing BVs and those created prior to the effective date of the new rules will need to amend their bylaws if they want to benefit from said rules. If the bylaws are not amended, the current rules will apply.

The most important changes are discussed below.

Under the current law, a BV is required to have a minimum capital of EUR 18,000. The new rules would abolish this minimum capital requirement, with founders given the freedom to determine whether or not a minimum capital requirement should exist. As a result, the existing personal liability of directors linked to the funding of the minimum capital will also disappear, though certain other measures to safeguard the creditworthiness of the company, will be put in place, which could result in directors' liability. Obviously, this also has consequences on the denomination of shares and the minimum amount of capital that has to be paid up on the shares issued at incorporation. Another logical consequence is that BVs will no longer be required to produce a statement from a bank regarding minimum payment (which is currently required at the time of incorporation) or to have an external auditor report on any contributions-in-kind. Under the current law, any assets acquired by the newly incorporated company from its founders must be supported by an auditors' statement if such acquisition is made within two years of the date of incorporation. This requirement will be dropped. The change will greatly enhance the flexibility and especially the speed with which transactions can be completed.

Current legislation does not allow a BV to provide financial assistance to (third) parties in connection with the (indirect) acquisition of shares in the BV itself. However, such financial assistance will be allowed by the new regime, provided it does not go against the principles of good governance or conflict with the company's interests. The new provisions could be essential in takeovers, cross-shareholdings, or company-financed staff participation.

Similarly, the current limitation whereby BVs may only buy back up to 50% of their issued share capital will be abolished, again enhancing flexibility in the event of restructuring operations. At present, restructuring operations are often hampered by the fact that share buy backs are limited to 50% only. This obliges the parties to carry out transactions in stages subject to certain "waiting periods", often an issue when a quick solution is required. The only condition will be that after any capital restructuring, at least one voting share must remain

outstanding. All issues related to the buy back of shares will be governed by the same rules as those applicable to distributions of reserves by the BV: this means that distributions, buy backs, and financial assistance are allowed so long as they do not negatively affect the BV. However, under the new rules ill-judged changes to a company's capital and reserves can lead to the directors and shareholders being personally liable if the BV files for bankruptcy within a year of such a decision.

Many issues, which companies are currently required to set down in their articles of association (e.g. restrictions on transfers of shares and/or an obligation to offer shares to other shareholders), can henceforth be dealt with in shareholders' agreements. However, it remains possible to include such rules in the articles of association.

One of the most interesting developments is that the new rules would allow the creation of nonvoting shares and also increase the possibilities for creating shares with nonproportional profit participation. For instance, this will greatly enhance the possibilities for management or employee participation and for silent partners. Solutions to achieve similar objectives exist under the current law, but are often rather cumbersome.

The new rules would also alleviate the formalities for convening shareholders' meetings and in general provide much more flexibility for corporate governance. Currently, voting trusts are often used to achieve the level of flexibility required in daily business life. To a large extent, these structures will no longer be necessary because they can be dealt with at the level of the company itself or through a simple shareholders' agreement.

The proposed changes will certainly improve the Netherlands' appeal as one of the core countries for investment in Europe, while continuing to allow the "old regime" to apply for those who prefer the more restrictive rules currently in place.

TAXAND NEWS

TAXAND CLIENT CONFERENCES

On the 16th September our member firm in China hosted a client conference at the award-winning Pudong Shangri-La hotel in Shanghai. TAXAND speakers from our firms in China, Germany, Spain, Luxembourg, France, the USA and Venezuela presented to an audience of over 50 multinational clients based in China. To experience the insights shared on the day into the tax implications of investing & doing business in China, US, Europe & Latin America, please visit www.taxand.com/events.

On the 19th and 20th February our next annual global conference will be held in Miami. If you would like to join us, just let your nearest TAXAND advisor know.

TAXAND EXPANDS GLOBAL NETWORK

TAXAND is delighted to welcome two new members to its fast-growing network. Greenwoods and Freehills, recently merged with Shaddick & Spence, has taken over the TAXAND membership for Australia and William Fry tax advisors joins as the member firm for Ireland. The first global network of leading tax advisors now brings together independent firms in more than 40 countries giving multinational clients access to over 2,000 tax professionals across the world.

As our reputation has increased we are being approached regularly by independent firms wanting to join TAXAND. With one exclusive member firm per country making the right choice of firm is important for our multinational clients and for our tax advisors alike. William Fry Tax Advisors and Greenwoods and Freehills offer best-in-class tax advice and the quality of people we expect in TAXAND. Moreover by adding Ireland and confirming Australia TAXAND is more capable than ever to deliver high quality, integrated global tax advisory services.

TAXAND ACHIEVES FURTHER MARKET RECOGNITION

In the International Tax Review's Americas awards Taxand has been shortlisted for some 9 awards:

- Best Newcomer Americas
- Argentina Tax Litigation Firm of the Year
- Latin American Tax Firm of the Year

- Latin America Capital Markets Tax Transaction of the Year
- Mexico Tax Firm of the Year
- Peru Tax Firm of the Year
- Peru Tax Litigation Firm of the Year
- Venezuela Tax Firm of the Year
- Venezuela Tax Litigation Firm of the Year

Winners will be announced at the awards ceremony in New York on the 2nd October. These awards are determined by a panel of judges and ITR's editorial team following initial research canvassing the perspectives of tax executives, in-house counsel, tax advisors and private-practice lawyers. We look forward to celebrating success shortly!

TAXAND LAUNCHES NEW GUIDE

We are delighted to announce the launch of a new Guide which compiles local TAXAND knowledge across 15 key jurisdictions worldwide to give people operating in the sports sector informed insight into the key tax areas requiring consideration.

In a world where it is increasingly common for sportspersons to change team and country of residence, the decision on what offer to accept is no longer only down to questions of a sporting nature. The variation in tax rates applying to the same gross package can make one country, and thus one team, a far more attractive prospect than another.

The Guide, which has been coordinated by Felix Plaza Romero of Garrigues, TAXAND'S member firm in Spain and published by Thomson Aranzadi, delivers a brief description of the tax issues that will affect a sportsperson who is relocating to the most popular 15 jurisdictions. Designed as a source of reference for initial consultation, the Guide provides a framework outlining the key personal tax issues for exploration by advisors and sportspeoples' representatives alike. The rules on inbound expatriates, the tax treatment of image rights, the exploitation of such rights through corporate vehicles, the tax treatment of nonresidents and the concept of 'residence', are among the topics covered. Copies are available to purchase from www.aranzadi.es.

TAXAND UNVEILS NEW INTRANET

The Taxander portal has just been launched to help Taxanders share knowledge and access information for the benefit of our clients. www.taxanderportal.com

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