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 YOUR GLOBAL NETWORK OF LEADING TAX ADVISORS



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LEGAL DEVELOPMENTS

LEGISLATION

1. ARGENTINA

Tax Regularization, Promotion and Protection of Registered Employment with Priority in Medium and Small Size Companies, and Declaration and Repatriation of Funds Regime

On 24 December 2008 was published in the Official Gazette the Law No. 26,476 that established a Tax Regularization, Promotion and Protection of Registered Employment with Priority in Medium and Small Size Companies, and Declaration and Repatriation of Funds Regime (hereinafter, the "Regime").

The Regime is structured as follows:

1. Title I. Tax Regularization;
2. Title II. Promotion and Protection of Registered Employment; and
3. Title III. Declaration and Repatriation of Funds.

1. Title I. Tax Regularization

Title I of the Regime grants a partial tax amnesty for taxpayers who fail to comply with their federal taxes and social security charges due 31 December 2007, as well as infringements committed until such date.

The benefits set forth in Title I are available only once from 1 March 2009 to 31 August 2009, and the filing has to be made by means of, among other documents, a sworn statement to be filed before the AFIP.

The Regime includes all obligations pertaining to federal taxes and to social security charges whose application, collection and auditing falls within the scope of the Federal Tax Authority ("AFIP" as per its acronym in Spanish). Some duties are excluded from Title I such as, among others, payments and contributions to health insurance systems, debts and infractions related to custom duties and value added tax due to import of services.

The provisions of the partial amnesty allow taxpayers to satisfy overdue federal tax debts and social security charges for an amount that is significantly lower than the original assessment, even in cases where the non-fulfillment or failure to pay has been already disputed by the AFIP (Title I includes those liabilities under administrative or judicial dispute).

In all cases, the taxpayer's allowance involves a voluntary dismissal of the claim and the assumption of the costs of the proceeding, including legal expenses and fees¹.

¹ Resolution 2,537 contemplates the possibility of paying legal fees -but not legal expenses- through up to 12 monthly installments (without interests).

Taxpayers who comply with Title I requirements will benefit from:

- (i) A significant reduction in the corresponding interest charges.
- (ii) A waiver of civil penalties to the extent that no final sentence in relation thereto has been already pronounced.
- (iii) A suspension of any outstanding criminal proceedings provided that no final sentence in relation thereto has been already pronounced. Once the debt is totally cancelled the extinction of the criminal action will occur.

The settlement of amounts included in Title I can be made in cash or through an installment plan which shall satisfy the following conditions: an initial down-payment of 6% of the relevant debt and up to 120 monthly installments bearing a monthly 0.75% interest.

2. Title II. Promotion and Protection of Registered Employment

In addition, Title II promotes the regularization of unregistered employment or the correction of the commencement date of the existing labor relations, releasing employers from infringements, fines and sanctions of any nature, related to the lack of or incorrect registration of employees under a labor relationship.

Employers who register newly existing labor relations or regularize a pre-existing one shall enjoy a reduction in their contributions in force on certain social security subsystems for a 24-month period. This reduction consists in paying only the 50% of said contributions within the first 12 months, and the 75% of said contributions for the following 12 months. The contributions to the National Health Insurance System and those installments to the Workers' Compensation Insurance Companies are not included.

A condition to maintain the tax benefits of Title II is that employers may not reduce personnel for a period of two years.

3. Title III. Exteriorization and Repatriation of Funds

As an incentive to repatriate foreign earnings to Argentina, Title III of the Regime contemplates a special treatment applicable for taxpayers that decide to exteriorize the tenancy of assets (including currency) held in Argentina and/or abroad under certain conditions.

Assets benefited by the special treatment are the following: Argentine pesos, foreign currency, real estate assets, and movable assets subject to registry (cars, crafts, among others), machinery and non fungible goods.

The exteriorization of the tenancy of the assets has to be done between 1 March 2009 and 31 August 2009 under conditions set forth in the Regime.

Instead of paying 35% income tax, among other taxes, plus interest and penalties, Title III provides various flat tax rates for companies and for individuals that exteriorize their tenancy of assets. Assets exteriorized shall be subject to a special flat tax that varies between 1% and 8% according to the purpose to which said funds are destined.

Also, Title III grants a waiver of any civil, commercial, administrative, professional and tax criminal actions that would correspond to individuals or companies that exteriorize their assets (including currency) and pay the special flat tax.

Moreover, Title III of the Regime sets forth that individuals or companies that exteriorize their assets (including currency) and pay the special flat tax will not be required to exteriorize the date of acquisition of the funds or the origin of the funds acquired. This waiver does not cover issues related to money laundering and has to be construed in accordance with Section 4(i) of the present summary.

4. General Provisions

The following general provisions are applicable for Titles I, II and III of the Regime:

- (i) Money laundering, drug and weapons trafficking, and other blacklisted activities. None of the provisions contemplated in the Regime waives the duties of financial entities -and other responsible agents- in connection with money laundering, financing of terrorism or other criminal charges contemplated in non tax laws, save for the figure of criminal tax evasion or the figure of participation in criminal tax evasion. Amounts of money originated in money laundering are expressly excluded of the Regime.
- (ii) Waiver of claims intended to seek the application of adjustment proceedings. Those who agree to be included in the Regime must previously relinquish to promote or, in this case, discontinue with claims intended to seek the application of adjustment proceedings of any nature for tax purposes. In this case, legal expenses and fees shall be borne by each party, and the AFIP waives the collection of penalties.
- (iii) Suspension for a year of the statute of limitations. The statute of limitations applicable for federal tax debts and penalties has been extended for one additional year. The suspension for a year is applicable to all federal tax debts and penalties, even in situations not included in the Regime.
- (iv) Relation between Titles I, II and III. All benefits detailed in Titles I, II and III of the Regime may be enjoyed concurrently.

Amendments on the Stamp Tax in the City of Buenos Aires

On 9 January 2009, Laws No. 2997 and No. 2998 were published in the Official Gazette of the City of Buenos Aires which introduced major changes in the Fiscal Code.

The most significant change relates to the stamp tax levied on formal execution of instruments and monetary transactions (hereinafter, the "Stamp Tax").

According to these new laws, the Stamp Tax levies written instruments of an economic value that, among other cases, are executed in, and/or produce effects, within the City of Buenos Aires.

Stamp Tax also applies to monetary transactions that represents deliveries or receptions of money and generates interests, performed by financial entities under Law No. 21,526 located in City of Buenos Aires.

Law No. 2997 contains a long list of exemptions. Law No. 2998 established a general rate of 0,80% to be applied on the amount of the instrument but it also contemplates other rates for specific transactions. In case of monetary transactions, there is a special calculation to estimate the stamp tax to pay.

2. AUSTRALIA

Australian Parliament about to enact comprehensive regime for financial arrangements

Introduction

In early December 2008, the Australian Government introduced into Parliament a Bill to enact the promised regime for taxing gains and losses from dealings with financial arrangements, including debt, equity, hybrid instruments, derivatives and foreign currency. In general terms, the regime is intended to accomplish two key outcomes:

- to change the character of gains and losses made on transactions with certain kinds of financial instruments; and
- to codify the timing rules applicable to the recognition of gains and losses from the instruments.

Character

So far as character is concerned, the regime will generally require a taxpayer to account for gains and losses arising under a financial arrangement as assessable income or an allowable deduction rather than as a capital gain or loss. The principal exception to this is the hedging regime which allows a taxpayer to align gains and losses made on hedges with the tax character of gains and losses made on the underlying asset or liability.

Timing

So far as timing is concerned, the rules require taxpayers to record amounts of income or deduction using one of five regimes:

1. a residual method which taxes gains or losses using either a compounding accruals method or on realisation – this rule is mandatory if none of the elective regimes apply;
2. an elective method which taxes gains or losses on certain financial arrangements on a fair value basis;
3. an elective method which taxes gains and losses on foreign currency on a retranslation basis;
4. an elective hedging regime which allows a taxpayer to align the timing of gains and losses made on hedges with the realisation of gains and losses on the underlying asset or liability; and
5. an elective method which allows certain kinds of taxpayer to report for tax purposes the same amounts they have recorded in their audited financial statements.

Commencement

The new regime will start on 1 July 2010, although taxpayers do have an option to start applying the new rules as from 1 July 2009.

Australian Parliament proposes Investment Allowance as part of economic stimulus package

Introduction

On Wednesday 25 February 2008, the Treasurer released a draft of the legislation to enact an investment allowance which the Government announced as part of its economic stimulus package.

Details of the incentive

The tax incentive is delivered in the form of an additional allowable deduction for qualifying expenditure. The incentive is available in the year in which a qualifying asset is installed ready for use or money on improving an existing asset is spent. The amount of the deduction is 30% or 10% of the expenditure depending on when the expenditure is incurred and the asset installed. The incentive is available for both the cost of acquiring and constructing additional assets and for the cost of making non-deductible improvements to existing assets. The deduction does not affect the taxpayer's depreciation or the computation of a balancing adjustment if the asset is sold or scrapped.

Conditions

The incentive is available for expenditure on tangible depreciating assets (including cars) which qualify for depreciation, and is given to the taxpayer entitled to claim depreciation, including equipment lessors. Assets must be new.

For large businesses – in general terms, businesses with an annual turnover over \$2m – the amount spent on acquiring or improving the asset must be \$10,000 or more to qualify for the incentive, and the relevant asset must have been acquired under a contract entered into, or the construction or improvements must commence, on or after 13 December 2008.

The incentive is available only to taxpayers carrying on a business; investors do not qualify.

3. CANADA

2009 federal budget tax proposals

In these times of economic turmoil, the 27 January 2009 Federal Budget (the "Budget") tax proposals are measured and modest. The Budget's focus is at home and on individuals, with only modest and targeted measures benefiting corporations (particularly, Canadian-owned private corporations). From a tax policy perspective, the Budget refers to the Report of the Advisory Panel on Canada's System of International Taxation and indicates that the Government is studying the Report, released in December of 2008, and will provide a response in due course, on which consultations will be held. Our prior commentary on the Report can be found at www.gowlings.com through the Resource Centre (Canadian Tax @ Gowlings Newsletter).

The recommendations of the Report did prompt one response in the Budget, being the proposed repeal of section 18.2 of the Income Tax Act (Canada) (the "ITA"). Section 18.2 was enacted in response to certain perceived abuses in the financing and structuring of foreign subsidiaries of Canadian corporations and is often referred to as an "anti double-dipping" provision. This provision, which would have resulted in the denial of interest deductions for Canadian parent corporations where the related borrowed money was used to finance foreign subsidiaries in certain circumstances, was not to be effective until 2012. We have previously commented that we felt that this provision was ill-conceived and not good tax policy. Its repeal, officialised on March 12, 2009, is a welcome measure.

New rules on dispositions of taxable Canadian property

Nonresident vendors may be subject to Canadian income tax on the disposition of "taxable Canadian property" ("TCP"). The definition of TCP is quite broad and includes numerous types of property interests including, in particular, most shares in Canadian corporations. Canada's Income Tax Act has withholding tax rules for the enforcement of such tax obligation of nonresidents.

Until recently, these rules required a nonresident vendor to notify the Canada Revenue Agency ("CRA") of the disposition of a TCP, to obtain a clearance certificate from the CRA and to pay the required tax. If no clearance certificate was obtained, the purchaser was required, in general terms, to remit to the CRA 25% of the purchase price, and could withhold that amount on closing. One of the greatest complaints of nonresident investors into Canada is in respect of the requirement to obtain such clearance certificates on each occasion, including on internal corporate reorganizations where no tax was payable because of particular tax "rollover rules", or where no tax was payable because Canada had ceded the right to tax the property disposed of under the terms of a tax treaty.

These rules were significantly relaxed as of 1 January 2009. Now, where, in general, a person purchases property from a nonresident vendor and: (i) the purchaser is satisfied, after reasonable inquiry, that the vendor is resident in a jurisdiction with which Canada has a tax treaty; (ii) the disposition of the property by the vendor would not be subject to Canadian tax by reason of that treaty; and (iii) the purchaser provides notice to the CRA, containing certain prescribed information, within 30 days after the acquisition of the property, no clearance certificate will be required of the vendor.

Although the purpose of these new rules is to simplify the procedure on disposition of TCP, the rules raise new legal issues, and may require additional contractual protection for purchasers. Indeed, an element of risk remains with the purchaser on the availability of treaty protection by the vendor and there is no due diligence defense for purchasers in making such determination.

In practice, if there is any uncertainty as to the residence of the vendor or the treaty-protected status of the property, it may be advisable to insist that the nonresident vendor still provides the purchaser with a clearance certificate and for the purchaser to withhold tax from the gross purchase price until a clearance certificate is received. Consequently, the effects of the new rules may well be less than had been intended and caution is required when dealing with such transactions.

4. CHILE

Tax measures to stimulate economy

A new Law temporarily reduces the Stamp Tax to 0% during the year 2009 and to 0.6% during the first semester of the year 2010. It will then rise to the normal rate of 1.2%.

5. CYPRUS

Ratification of the double tax treaty between the Republic of Cyprus and Qatar

In a nutshell, the Cyprus - Qatar double tax treaty was concluded during the period 22-27 May 2007, and subsequently approved by the Council of Ministers on 27 August 2008. The agreement was signed by the Cypriot Minister of Finance on behalf of the Cypriot Government on 11 November 2008, and countersigned by the Minister of Finance of Qatar upon ratification. Qatar ratified the said treaty on 26 January 2009.

6. DENMARK

Political agreement about Danish tax reform

Introduction

The Liberal-Conservative minority government has reached agreement with its parliamentary safety net, the Danish Peoples Party, on a tax reform. On 20 March the draft bills implementing the agreement was published and the actual bills are expected in April, whereas adoption in Parliament will take place before the summer break.

Corporate taxation of capital gains and dividends

In Denmark, taxation of capital gains and dividends are based on a rather complicated system, capital gains and dividends are taxed differently, a standing which now will be changed by harmonizing the corporate taxation rules for capital gains and dividends.

The tax reform introduces a distinction in taxation on gains and losses between companies that hold 10% or more of the shares, and companies that hold less than 10% of the shares in a subsidiary.

For companies that hold 10% or more of the shares in a subsidiary, the agreement implies:

- tax exemptions on all dividends and capital gains. The tax exemption is no longer limited by ownership period, which is a big change compared to today, where dividends are tax exempted after one year of ownership, and capital gains are exempted after three years of ownership. This is good news for international investors and multinationals.

For companies that hold less than 10% of the shares in a subsidiary, the agreement implies:

- that all dividends and capital gains are taxed at the full corporate income tax rate of 25% (irrespective of ownership period and percentage),
- taxation according to the mark-to-market principle.

Danish companies who own 10% or more of the shares will benefit from the Government's proposal of abolishing the present claims of ownership period and ownership percentage regarding taxation on dividends and capital gains. They will be tax-exempted from capital gains and dividends, but furthermore, the restructuring possibilities will be improved.

On the other hand, Danish companies that hold less than 10% of shares will face higher and more rigorous taxation. For those companies, the proposal is a step backward, practically as well as economically. This would affect many individuals with private holding companies and virtually all private equity fund structures.

Any legislation regarding corporate taxation of capital gains and dividends would be effective as of 2010.

Individual taxation of capital gains and dividends

The tax reform proposes that taxation of share income (capital gains and dividends) will be reduced to the following rates:

- 27% for income up to approximately EUR 6,500 and
- 42% for income between EUR 6,500-14,100
- 45% for income exceeding EUR 14,100

Today the taxation brackets of share income are:

- 28% up to approximately EUR 6,500
- 43% between EUR 6,500-14,100
- 45% exceeding EUR 14,100

7. FINLAND

Proposal for the amendment regarding the taxation of work-related dividends

The Ministry of Finance published a draft for the Bill on 3 February 2009 regarding the taxation of dividends based on work contribution.

The proposal is based on the ruling of the Supreme Administrative Court 2008:6. In this case, the rights of the company's different share series for the company's assets were determined on the basis of the operating income of the share series. According to the viewpoint adopted in the decision of the Supreme Administrative Court, dividends were taxed in accordance with the provisions related to the normal taxation of dividends. On the basis of the ruling, the Ministry of Finance states that in such cases the dividend is to be considered as remuneration received for the contribution of his or her work, which should be taxed as earned income. According to the Ministry of Finance, the said ruling will increase the tax avoidance in order to exploit the moderate dividend taxation.

According to the currently published draft, the dividend received from any non-listed company would be considered as a salary, which will be taxed as earned income or as a remuneration of work, if the dividend is based on the provisions of the articles of association, the decision of the board of directors, shareholders' agreement or any other agreement concerning the work effort of the receiver or of a person belonging to his or her interest group. The dividend will be treated as an earned income of the person, whose work contribution is in question.

According to the proposal, the corresponding taxation treatment would also be applied to the dividends paid for the personnel in superior or liable position if the distribution of the dividend will be based, for example, on a factor defined by the result of a certain scope of liability which is comparable to a bonus system.

The proposed dividend taxation based on work contribution would only apply to cases where the distribution of the dividend is based on the value of the work contribution. Thus, it cannot be applied in situations where the distribution of the dividends is based on the number of shares owned.

Considering the dividend as a salary or a remuneration of the work would mean that the payer of the dividend could deduct such a dividend in his own taxation.

It has been proposed that the Act should enter into force as soon as possible and also that it should be applied for the first time to those dividends which can be drawn from 1 January 2010 onwards. The proposal draft is currently in circulation for comments. Taxpayers and especially companies, whose distribution of dividends is partly based on the value of the shareholders' work contribution, should evaluate their fiscal status and the possible measures required in their business on the basis of the proposal draft.

Depreciation allowances of the production investments to double for two years

The Government has introduced a bill to double the maximum amount of the depreciation allowances concerning the acquisition costs for the fiscal years 2009 and 2010 arising from the introduction of new buildings, devices and equipment on production activities in 2009 and 2010.

The amendment would apply to new factories and workshops as well as to new devices and equipment of the current factories and workshops used in productive activity. The government agreed on the alleviation in liaison with the first supplementary budget hearing of 2009.

According to the bill, a taxpayer pursuing business activities could make a double depreciation allowance of the acquisition costs arising from the introduction of a factory and a workshop during the calendar year 2009 or 2010 in no more than two fiscal years. The duplication of the depreciation allowance would mean that, instead of the regular 7% write-off, a maximum of 14% write-off can be made from the depreciable acquisition costs of the building. The increased depreciation allowance would also apply to new devices and equipment used in

productive activity. Thus, the annual maximum depreciation allowance of the devices and equipment provided by the law would be 50% instead of 25%.

The bill will enter into force when the European Commission has accepted the alleviation. The date of entry into force will be provided by the decree of the Council of State. The law will be applied to the taxations for the fiscal years 2009 and 2010.

8. FRANCE

Support measures for companies within the reviving scheme framework

As many other countries in Europe and throughout the world, France has recently implemented various tax measures in order to bolster up companies. These measures which concern both direct and indirect taxes primarily aim to improve the cash flow situation of the companies, by notably enabling them to accelerate the discounting and the use of tax receivables.

The main measures carried out are detailed hereunder:

- Monthly refund of deductible and non-allocable VAT credits. When the amount of the deductible VAT exceeds the amount collected on the monthly return, the companies concerned can formulate an immediate refund claim –on a monthly basis - for each monthly return. This accelerated refund method concerning VAT credits replaces the former quarterly refund procedure. The companies which do not declare their turnover monthly can now opt for a monthly reporting system enabling them to accelerate the discounting of their receivables.
- Immediate refund of research tax credit receivables. Until the implementation of this immediate refund procedure, the research tax credit receivables were charged on the corporation tax amount and the balance, possibly non-charged, was carried over for three years. A refund claim could then be formulated should there be, at the end of the three-year period, a tax receivable balance. The new procedure implemented enables the companies, which benefit from balance receivables carried-over for the 2005, 2006 and 2007 accounting periods, to ask for their anticipated refund. A refund claim can also be formulated with regard to the 2008 expenditures after estimating the receivable by deducing the corporation tax amount from the research tax credit amount.
- Reimbursement of excess corporation tax installments. When the amount of corporation tax installments is higher than the amount of tax due for the 2008 accounting period, a refund before due date claim concerning excess installments can be formulated between the day following the closing of the fiscal year and the settlement of the tax balance. However, should the estimate of the tax amount due for the 2008 accounting period deviate more than 20% from the amount really due, it would entail a mark-up of the overpayment refund by the taxpayer.

- Immediate refund of carry-back receivables. The carry-back receivables, born from the loss carry-backs of the accounting periods closed in 2004, 2005, 2006 and 2007, and not yet used as of 1 January 2009, can be the subject of a refund before due date claim with the tax authorities.

9. GERMANY

Campaign against tax fraud - Draft tax bill issued

Early 2009, the German Federal Ministry of Finance issued a draft tax bill in relation to a campaign against abusive tax practices and tax fraud.

The general aim of the draft law is that taxpayers' requirements to justify the deduction of expenses paid to certain countries shall be stricter than they currently are.

According to the current draft, specific tax regulations shall not apply if an entity or an individual tax resident in Germany has business relations with entities or individuals resident in countries which do not accept and fulfill OECD standards for exchange of information in tax matters (Art. 26 of the OECD master convention). These countries shall be blacklisted. Mainly, the finance centers of Europe as well as those of the rest of the world shall be affected. Based on first rumors, countries such as Austria, Belgium, Luxembourg or Switzerland shall be on this black list. However, there is no official statement available on this point yet.

The consequences in case the draft law would be enacted would be e.g.:

- No reduction of WHT rates according to double tax treaties or the EU Parent Subsidiary Directive for dividends to these blacklisted countries;
- Dividends from blacklisted countries would be fully subject to taxation (usually dividends to German corporate shareholders are 95% tax-exempt in Germany);
- Restriction of the deduction of expenses paid to entities / individuals resident in a blacklisted country. In a worst case scenario, the deduction shall even be denied completely.

Currently, the draft law is controversially discussed in the German parliament. Furthermore, it is uncertain whether the draft bill is in line with EU regulations. Therefore, at the moment it cannot be foreseen to what extent the draft bill will actually be enacted.

Accounting Law Reform Act – Implementation delayed

With the German Accounting Law Reform Act ("Bilanzrechtsmodernisierungsgesetz"), the most important German accounting reform since 1985 is expected. The major goal of the draft law is to enforce the information value of the German accounting rules in comparison to international rules such as IFRS. The national accounting rules shall thus become more attractive.

At first, it was intended that the German Accounting Law Reform Act be enforced in 2008 and would apply as from 2009. However, at the moment the draft is still under discussion in parliament and is also still subject to changes. Current discussions concern the evaluation of financial instruments. Further debates shall take place in March and April 2009. Currently, it is expected that the draft bill will be enforced before the summer and will apply as from 2010.

10. GREECE

Introduction of market control rules on transfer pricing

Pursuant to article 26 of Law 3728/2008, new market control rules have been adopted for the substantiation of transfer prices agreed in the context of transactions between associated enterprises. The new rules are based on the provisions of the EU Code of Conduct on transfer pricing documentation for associated enterprises, adopted by the Council of the European Union in 2006 (2006/C 176/01), along with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (for further details regarding Law 3728/2008, please refer to our November 2008 Commercial & Tax Alert).

Pursuant to the new provisions, domestic enterprises, including branches of foreign enterprises, engaged in transactions with associated enterprises are required to substantiate intra-group transfer prices, by preparing a complete and standardized transfer pricing study. To this end, the Greek Ministry of Development has recently issued a relevant Decision, setting out the minimum required content of such studies. Furthermore, domestic enterprises should submit annually to the Ministry of Development a list setting out information concerning their intra-group transactions (particularly the volume and value thereof) performed during the previous fiscal year.

The new transfer pricing documentation rules apply with respect to intra-group transactions performed in the course of fiscal years ending after 18 December 2008. An exemption applies in the case of (i) domestic enterprises, whose annual turnover does not exceed EUR 1,000,000, and (ii) intra-group agreements of a value that does not exceed EUR 200,000, annually.

Non compliance with the new rules constitutes a violation of the Greek Code of Market Regulations, leading to the imposition of administrative fines and criminal sanctions. Furthermore, upon detecting violations of the arm's length principle (i.e. in the context of reviewing relevant transfer pricing documentation), competent authorities of the Ministry of Development shall accordingly notify tax authorities, in order for the latter to assess the relevant enterprise's level of compliance with the provisions of the Greek Income Tax Code.

Capital gains taxation on listed shares postponed for 2010

The Greek Ministry of Finance has submitted to the Parliament a draft bill, proposing the further postponement of the date of entry into force of the new 10% income tax on gains from the sale of shares listed on the Athens Exchange or, when it comes to Greek residents, foreign exchanges, due to the currently adverse market conditions. Specifically, pursuant to the draft bill, the 10% income tax shall apply on gains generated from the sale of listed shares purchased as of 1 January 2010, instead of 1 April 2009, as was provided in Law 3746/2009 (for further details, please refer to Taxand Quarterly January 2009). Accordingly, it is also proposed for the currently applicable 0.15% sales tax to remain effective with respect to transactions on listed shares purchased until 31 December 2009.

Entry into force of tax treaties with Estonia, Iceland and Malta

The treaties for the avoidance of double taxation of Income and Capital with Estonia, Iceland and Malta ratified by the Greek Parliament by means of Laws 3682/2008, 3684/2008 and 3681/2008 respectively, have entered into force as of 1 August 2008, 7 August 2008 and 31 August 2008 respectively. The treaties are applicable on income arising as of 1 January 2009.

Ratification of revised tax treaty with Austria

A new treaty for the avoidance of double taxation of Income and Capital with Austria has been ratified by the Greek Parliament by means of Law 3724/2008. The said treaty substitutes the one previously in force (signed in 1970 and in force since 1972). The new treaty has not yet entered into force, as the ratification documents have not been exchanged so far.

11. INDIA

India passes Limited Liability Partnership Act, 2008

The LLP Bill was passed by the Indian Parliament and has become a law with the Presidential assent on 7 January 2009. The LLP Act will come into force at a date yet to be notified. An LLP is a hybrid corporate form entity combining features of the existing partnership firms and limited liability companies. LLP combines the benefits of limited liability for partners with flexibility to organize internal management based on mutual agreement among the partners. India's 1932 Partnership law only permitted partnership firms with unlimited liability.

Following are the salient features of the LLP Act, 2008:

- LLP shall be a body corporate and a legal entity separate from its partners. It will have perpetual succession, like a corporation.
- Provisions of the Indian Partnership Act, 1932 shall not be applicable to LLPs and there is no limit regarding the number of partners.
- While the LLP will be a separate legal entity, liable to the full extent of its assets, the liability of the partners would be limited to their agreed contribution to the LLP.

- The framework of LLP is not restricted to professional services alone. Several business activities can be undertaken using the LLP structure.
- Any individual or body corporate may be a partner in an LLP.
- An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs.
- The Act contains procedures for corporate actions like mergers, amalgamations, liquidation, etc.
- LLP must have two 'designated partners' who must be individuals. If a body corporate is partner of LLP, it can nominate a person as 'designated partner'. The designated partner is liable for all compliances as required under the Act and is liable to penalty for contravention of those provisions

The LLP Act contains provisions for conversion of a partnership firm or a private limited company or an unlisted public company into an LLP.

The LLP Act permits foreign residents (whether individuals or body corporate) to become partners in LLPs in India. It allows foreign limited liability partnerships to establish a place of business in India, in accordance with rules which are to be separately framed and notified by the Government.

12. IRELAND

Finance (No 2) Act 2008

Residency Test

Previously an individual was resident in Ireland for a day if the individual was present in Ireland at the end of the day (i.e. at midnight). The definition of what constitutes a day in Ireland has been amended so that from 1 January 2009 for Irish tax residency purposes an individual will now be present in Ireland for a day if he/she is present in Ireland at any time during that day.

VAT Rate Change

From 1 December 2008, the standard rate of VAT on goods and services was increased from 21% to 21.5%.

Air Travel Tax

From 30 March 2009, an air travel tax of EUR 10 per passenger (with a lower rate of EUR 2 per passenger for air journeys with a destination located not more than 300 km from Dublin Airport) will apply to all departures from Irish airports. Crew, infants, disabled persons and others are excepted. The tax will be collected and paid on a monthly basis to the Irish Revenue Commissioners by the airline operator (being the operator or registered owner of the relevant aircraft).

Interest Payments to Non Residents

From 1 January 2009, the exemption from income tax on payments to persons tax resident in EU Member States (other than Ireland) or in countries with which Ireland has a tax treaty has been extended to interest received on wholesale debt instruments and discounts on securities issued by companies or investment undertakings in the ordinary course of their trade or business.

Disclosure Requirements Regarding Offshore Settlements

New provisions have been introduced in respect of the delivery of information by professional advisers concerned with the establishment of a settlement/trust arrangement whereby the settler is resident in Ireland and the trustees are not resident in Ireland. Under the provisions the Irish Revenue Commissioners have power to make requests for information from certain persons in respect of such arrangements. This is an onerous obligation for professionals in particular because it is retrospective for a 5-year period prior to the passing of the Finance (No. 2) Act 2008 (i.e. 24 December 2008), which is likely to necessitate a consideration by professionals of their client files for this period to determine whether any disclosures are required.

The Remittance Basis of Taxation

From 1 January 2009, the remittance basis of taxation was extended in certain circumstances. The remittance basis applies to Irish tax resident but non-Irish domiciled individuals and to Irish tax resident and domiciled but non-Irish ordinary resident individuals. The extended relief will be given by way of refund although a number of requirements must be met by the individual:

- (a) the individual must be Irish resident for a period of at least 3 years, however, he must not be Irish domiciled;
- (b) prior to arriving in Ireland the individual must have been resident outside the European Economic Area ("EEA") but resident in a country with which Ireland has a double tax treaty;
- (c) the individual must be employed by a company established outside the EEA (but in a double tax treaty country) and must be paid from abroad; and
- (d) at the end of every tax year the individual will be taxed on the greater of his remittances of income into Ireland or EUR 100,000 plus 50% of any further emoluments.

A refund claim may be made annually from the commencement of the 3-year period of residency, although if the 3-year condition is not subsequently met by the individual, the refund can be reclaimed by the Irish Revenue Commissioners.

Three-Year Tax Exemption for Start Up Companies

Start up companies that commence trading in 2009 are exempt from corporation tax (including capital gains tax) for their first three years of trading. This measure only applies to start up companies where their corporation tax liability does not exceed EUR 40,000 in each year, with marginal relief in respect of tax liabilities between EUR 40,000 to EUR 60,000. This measure is subject to EU state aid rules.

The relief does not apply to income from certain trades (for example, trades consisting of the provision of services by or to professionals (e.g. architects, accountants, doctors etc). It also does not apply to a "business" that is subject to corporation tax at 25%.

Capital Gains Tax Rate Change

From 15 October 2008, the capital gains tax rate increased from 20% to 22%.

Tax Deduction

For accounting periods ending on or after 20 November 2008, a tax deduction is no longer available for payments made as compensation for transfer pricing adjustments in other jurisdictions. Relief for such payments must be sought under the relevant tax treaty or under an EU Arbitration Convention Mechanism.

De Minimis Threshold for Stamp Duty on Share Transfers

From 24 December 2008, share transfers where the consideration is EUR 1,000 or less are exempt from stamp duty (normally 1% of the consideration paid or market value of shares, if higher).

Deduction for Equalisation Reserves

Finance Act 2008 introduced a tax deduction for equalisation reserves for reinsurance companies. These provisions were extended by Finance (No.2) Act 2008 to provide for a tax deduction to credit insurance companies that are required to maintain equalisation reserves under the Directive 2002/13/EC of 5 March 2002. This amendment is welcomed as it prevents Ireland from suffering a competitive disadvantage when compared with other EU Member States which already provide such a tax deduction.

Relief for investment in Research, Development and Innovation

A new relief has been introduced to encourage investment in companies established for research, development or innovation activities, meaning that the profits on the investment will be subject to tax at 15% for partnerships and 12.5% for companies. The investment must be for 6 years and be in unquoted shares or securities in a private trading company carrying on a business set up and commenced after 1 January 2009.

Tax Credit for Research and Development Expenditure

The research and development tax credit increased from 20% to 25% for expenditures that are incurred after 1 January 2009. This tax credit is allowed against a company's corporation tax liability for the current year and any unused balance may be offset against the previous years corporation tax liability or carried forward indefinitely against future corporation tax liabilities. In certain circumstances and subject to limits, the company may seek a refund of tax from the Irish Revenue Commissioners.

Stamp Duty on Commercial Property

From 15 October 2008, in an effort to kick-start the commercial property market, the maximum rate of stamp duty on transfers of non-residential property is reduced from 9% to 6% where the consideration exceeds EUR 80,000.

13. JAPAN

2009 Tax Reform in Japan

Under proposed tax reforms submitted to the Japanese Diet, foreign investors (nonresident individuals or foreign companies), who invest in Japanese companies through special funds structured as investment partnerships may be exempt from the capital gains tax. The proposed tax reforms provide that if the foreign partner of an investment partnership satisfies certain requirements, the foreign partner would be deemed as not creating a permanent establishment ("PE") and would therefore be exempt from the capital gains tax in Japan.

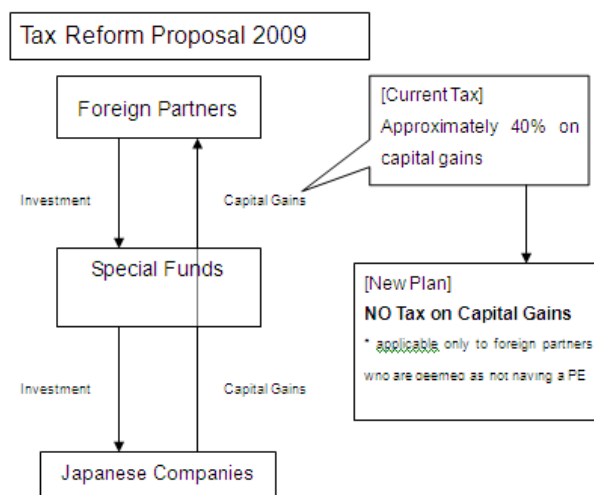
In Japan, foreign investors account for approximately 4% of fund investment. However, in other countries, the approximate rate of foreign investment into funds is significantly higher. For example, in the United Kingdom, foreign investors account for approximately 75% of fund investment. Further, in the United States, fund investment by foreigners is approximately 20%. Therefore, to promote investment into Japan, tax reforms in 2008 created, in effect, a safe harbor rule for certain "independent agents" whose actions would not create a PE. Under the 2008 reforms, a nonresident individual or foreign company will not be deemed to have a PE in Japan solely on the basis that a foreign partner invests in Japan through an independent agent acting in the ordinary course of the agents business.

To further stimulate foreign investment into Japan, the 2009 tax reform proposals ("Proposals") were presented to the Diet session in early January 2009. The Proposals include remarkable reforms to reduce the tax exposure of foreign partners of investment partnerships in Japan. One of the main proposals is to create a safe harbor under which a foreign partner, who satisfies specific requirements, will not be considered as having a PE in Japan and will therefore be exempt from the capital gains tax.

According to the Proposal, foreign partners of special limited liability investment partnerships ("*Toushi Jigyo Yugen Sekinin Kumiai*" in Japanese) or their foreign equivalents (collectively "Special Funds") will not create a PE and will therefore be exempt from the Japanese capital gains tax if the following conditions are met:

- 1) The foreign partner is a limited partner of the Special Fund;
- 2) The foreign partner is not involved in the operation of the Special Fund;
- 3) The foreign partner holds less than a 25% interest in the Special Fund;
- 4) The foreign partner is not a party related to the general partners (unlimited partners) of the Special Fund; and
- 5) The foreign partner does not have a PE in Japan with respect to any business other than the business carried out by the Special Fund.

This should create significant tax relief to a large number of foreign partners who currently are deemed to have a PE in Japan and are therefore subject to the Japanese capital gains tax on their Japanese investments.



If the proposal is enacted, the above-mentioned provisions will enter into force on 1 April 2009.

Please note that even after this tax reform, the above-mentioned exemption from the capital gains tax for foreign partners without a PE will not apply if the following conditions are met (unless an applicable tax treaty stipulates otherwise):

- 1) The aggregate shareholding in the Japanese company of foreign partners and related persons which includes any partner of the Special Funds at any time during three fiscal years (including the fiscal year in which the shares were held) totals 25% or more of the total issued shares of the Japanese company; and

- 2) The foreign partners and related persons, including any partners of the Special funds who hold 5% or more of the total issued shares of the Japanese company during a single fiscal year.

Please note that the tax reform proposals may not be finally enacted in the form described above.

14. MALAYSIA

Economic Stimulus Package

In line with the many countries which have announced economic stimulus packages, Malaysia also announced a MYR 60 billion stimulus package on 10 March 2009 to resuscitate the shrinking economy and to build capacity for the future. The tax proposals arising from this are as follows:

Double Deduction

Employers who employ personnel who have been retrenched since 1 July 2008 will be given a double deduction for tax purposes on the amount of remuneration paid to such employees up to a maximum of MYR 10,000 per month per employee, subject to a limit of 12 months of the employee's remuneration. This incentive is applicable in respect of Malaysian citizens employed from 10 March 2009 to 31 December 2010. The incentive will take effect from the year of assessment 2009.

Tax Relief for Interest on Housing Loans

To stimulate the housing sector, tax relief will be given to individuals for interest costs on housing loans in respect of sale and purchase agreements executed between 10 March 2009 and 31 December 2010. The relief will amount to MYR 10,000 per year for three years. It should be noted that the relief is only available to Malaysian resident citizens and concerns one residential property only.

Tax Exempt Retrenchment Benefits

The current tax exemption of MYR 6,000 in relation to retrenchment benefits or compensation for loss of employment will be increased to MYR 10,000 for each completed year of service. This proposal is effective from 1 July 2008 for those retrenched under a voluntary separation scheme or mutual separation scheme.

Recognition of Interest Income for Financial Institutions

Financial institutions have agreed to allow retrenched workers to defer the repayment of their housing loans for one year. To support such licensed financial institutions in this regard, it is proposed that the interest income in relation to the deferment of housing loan repayments be taxed only when such interest is received (as opposed to on an accrual basis). This proposal is effective from the year of assessment 2009 in respect of deferred housing loans from 10 March 2009 to 9 March 2010. It should also be noted that the retrenched workers in this instance must be Malaysian citizens who have been retrenched from July 2008.

Accelerated Capital Allowances (ACAs)

Qualifying expenditure incurred on plant and machinery between 10 March 2009 and 31 December 2010 will be eligible for ACAs. The ACAs will result in the assets being written down for tax purposes over two years. Additionally, expenses incurred on renovation and refurbishment of business premises which are currently not deductible nor eligible for capital allowances will be given ACAs which can be claimed over two years. The expenditure on the renovation/refurbishment must be incurred between 10 March 2009 and 31 December 2010. The ACAs in this instance will be capped at MYR 100,000.

Carry Back of Business Losses

Current year losses of up to MYR 100,000 per year will be allowed to be carried back to the immediately preceding year. This tax treatment will be available for the years of assessment 2009 and 2010 to all businesses, including partnerships and sole proprietors.

Windfall Profit Levy

Currently, a windfall profit levy on oil palm is imposed when the price of crude palm oil exceeds MYR 2,000 per ton. The MYR 2,000 threshold will be increased to MYR 2,500 per ton for Peninsular Malaysia and to MYR 3,000 per ton for Sabah and Sarawak.

Finance Act 2009

The Finance Act 2009 was gazetted in January 2009 to enact the changes announced in the 2009 Budget proposals. (Note that the 2009 Budget is distinct from the Mini Budget). The most noteworthy of these changes is the introduction of Section 140A to the Income Tax Act, 1967 (ITA). Section 140A, which takes effect as from 1 January 2009 incorporates transfer pricing laws as well as a thin capitalization provision. In addition, Section 138C has been enacted to provide for Advance Pricing Arrangements (APAs). Transfer Pricing Rules and APA Rules will be gazetted shortly to clarify the scope of Section 140A and Section 138C. It is expected that the Transfer Pricing Rules will include the need to subject the provision of financial assistance between associated parties to the arm's length requirement, and to require contemporaneous documentation for transfer pricing purposes. As Section 140A applies to both domestic as well as cross-border transactions, it has far-reaching effects. All companies which undertake related party transactions should therefore reassess their pricing arrangements as well as their documentation policies to ensure that these are in line with the Section 140A transfer pricing provisions and documentary requirements.

Notwithstanding the inclusion of thin capitalization provisions in Section 140A, it is learnt that the introduction of thin capitalization rules may be deferred to a later date. The Ministry of Finance has indicated that any thin capitalization rules will be gazetted separately compared to the initial plan to incorporate thin capitalization rules within the Transfer Pricing Rules. It is hoped that the deferral of the thin capitalization rules will be sensitive to the current economic conditions.

Labuan

The Labuan Offshore Financial Services Authority has announced that the Ministry of Finance has granted an exemption to Labuan offshore companies from the requirement to withhold tax under Section 109F (in respect of Section 4(f) income) on payments to nonresidents. The exemption is expected to be gazetted in an exemption order pursuant to Section 127(3) (b) of the ITA.

Double Tax Agreements

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

15. MALTA

Tax Treaties

In January of this year, the Minister of Finance, the Economy and Investment, announced that an agreement has been reached with the State of Qatar on a tax treaty. This is in the process of being initialed for ratification by both Governments.

During December 2008 it was also announced that discussions between the Sultanate of Oman and Malta on the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income were held in Malta. Negotiations were conducted in a friendly atmosphere of mutual understanding, and agreement was reached on most proposals stipulated in the draft text. A number of other clauses remain open for further discussions. For this purpose, a follow-up meeting will be held in the near future.

Also during December 2008, Malta signed a tax agreement with Switzerland and another one with Libya. Both agreements will enter into force following ratification by the respective countries.

A complete list of tax treaties and the respective withholding tax rates may be found on <http://www.avanzia.com.mt>.

16. MEXICO

Recently, Mexico has renegotiated the Convention for the Avoidance of Double Taxation ("tax treaty") signed with Germany and the Protocol of the Convention entered with The Netherlands. Both agreements were renegotiated in almost identical ways. The main relevant changes which apply to both agreements are the following:

- The Flat Business Tax (the so-called "IETU") was recognized as a tax covered by the Tax Treaty,
- 5% WHT rate for interests derived from loans granted by banks, and 10% in other cases.
- Reduction from 15% to 10% of the withholding rate for royalties.
- Exchange of information is open to other taxes not covered by the Conventions.

- Both states shall lend assistance to each other in the collection of revenue claims. This assistance is not only restricted to the taxes covered by the Conventions.

With regard to the tax treaty signed by Mexico and Germany relative to capital gains, the alienation of shares and similar rights deriving more than 50% of their value directly or indirectly from immovable property situated in one of the contracting states will be taxable by the latter state. The amendments to the Mexico-Germany Tax Treaty will enter into force on 1 January 2010.

With regard to the Protocol of the Convention entered by Mexico and The Netherlands, the highlights are the following:

- Only resident persons subject to taxation in their corresponding residence country will benefit from this Convention. This amendment may directly affect structures with Dutch Holding companies enjoying the participation exemption regimes.
- A "short" definition of interest income is included, but a wide range of concepts has been added to said definition.
- Maximum tax rate for capital gains from the sale of shares is now 10%, and the "source" country may - in all cases - subject the sale to tax, with the exception of:
 - Sales between related parties (new requirements are included).
 - Gains obtained by an insurance company.
 - Alienation of shares in a stock market.
- Important amendments in the corporate restructure provision have been established to control and defer taxation of such transactions.

It is expected that the text of the new Protocol will soon be published in the Mexican Official Gazette, and should enter into force on 1 January 2010.

Finally, on 11 March 2008, Mexico signed a tax treaty with Iceland, which entered into force on 1 January 2009. Some of the most important characteristics of the said Convention are: (i) IETU tax is included within its scope, (ii) WHT rate for dividends is 5% when the beneficial owner of the dividend participated at least in 10% of the capital of the payer and 10% in all the other cases; (iii) WHT rate for interest is 10% with a wide definition of interests; (iv) WHT rate for royalties is 10%, and (v) both contracting states can tax capital gains derived from the sale of shares issued by entities resident therein.

17. NORWAY

Amendments to the participation exemption system

On 12 December 2008, Stortinget (the Norwegian parliament) adopted changes in the corporate tax rules with possible negative effect for corporate shareholders.

As a part of the 2009 National Budget, the Government proposed an amendment in the participation exemption rules implying that 3 % of the tax exempt income from dividends and capital gains from shares should be included in the tax base and taxable at the ordinary corporate tax rate at 28 %.

The amendment results in a 0.84 % effective tax rate on the previously tax exempt income. Losses incurred from shares can offset gains and dividends earned in the same fiscal year, but are otherwise not deductible.

In the last corporate tax reform in 2004/2005, income from shares was made fully tax exempt for corporate shareholders to avoid chain taxation, while private individuals would be liable for a 28% tax on the same income.

There have been few limitations in the participation exemption rules and they remained mainly unchanged until 2008. They apply to the most common forms of legal entities such as Norwegian private and public limited companies and foreign equivalents. They do not apply to income from shares in companies residing in low tax countries outside the EEA, or from portfolio investments in companies' residing outside the EEA.

With effect as from 2008, the participation rules were changed so as not to apply to income from companies residing in low tax countries inside the EEA without an actual establishment and which do not carry on genuine economic activities in such a country.

As a consequence from the tax exemption, corporate shareholders cannot as a main rule deduct capital losses from the sale of shares. As from 2004, costs incurred in relation to exempted income were not deductible, but this was soon changed, allowing corporate shareholders to deduct such costs in other sources of taxable income.

The rationale behind the last adopted amendment is the deductibility of costs incurred in relation to tax exempt income. By including 3 % of the tax exempt income in the tax base, the Government intended to bring a better balance into the participation exemption rule. As group contributions are not included in the bases for calculating 3 % of the income, other tax efficient ways of distributing profits are still available within groups of companies.

18. PERU

Simplification of custom procedures

Pursuant to the Peru-US Free Trade Agreement (FTA), both countries agreed to simplify their custom procedures. Accordingly, Peru has recently modified the Customs' law and its regulations in order to adjust such procedures to the requirements of the FTA.

Among the amendments introduced, it is important to highlight the following: (i) goods can be released from customs within 48 hours of their arrival, (ii) goods can be released at the point of arrival, directly from customs without being transferred to customs' warehouses or other facilities, and (iii) importers are allowed to withdraw goods from customs before the import procedure is completed.

This simplification of the Peruvian customs' procedures not only allows Peru to comply with the FTA celebrated with the US, but also enhances the negotiation possibilities of FTA's with other important countries.

Modification to the Drawback Regime

Due to the adverse conditions caused by the international financial crisis, the Peruvian Government has recently introduced a set of regulations to ensure economic stability with regards to trade with foreign markets.

This is the case of the Supreme Decree No. 018-2009-EF of 30 January 2009, which introduces a temporary amendment to the drawback regime. Pursuant to this special regime, any Peruvian producer-exporter company can fully or partially recover the customs' duties paid on the import of raw materials and spare parts which are incorporated or consumed in the production of the exported goods. Up to 30 January 2009 the recovery was equivalent to 5% of the FOB value of the exported goods. After the publication of the above-mentioned Decree and up to 31 December 2009 the recovery will be equivalent to 8% of the FOB value of the exported goods.

The 8% rate will be applicable to the recovery applications filed as of 31 January 2009.

19. POLAND

Changes in the law

As from 1 January 2009 numerous changes in the tax law came into force – important amendments in the tax procedure, as well as VAT, corporate income tax, personal income tax and tax on civil law transactions regulations.

Starting from 24 January 2009 in the transactions between Polish domestic entrepreneurs, settlements may be made in any changeable currency chosen (the special permit obtained from the National Bank of Poland is no longer required). You will note, however, that tax settlements still need to be made in PLN.

As from 1 March 2009 the new Excise Duty Act was introduced. Among the most important changes are the following:

- change of taxation rules with regard to electricity – generally, subject to taxation is now the supply of electricity to the final consumer (by distributors or redistributors);
- taxation of coal (until 1 January 2012 – exemption) and natural gas used for heating purposes (as a rule, until 31 October 2013 – exemption);
- allowing the prepayment of excise duty which enables the production of goods subject to excise duty outside the tax warehouse;
- uniform application of the Combined Nomenclature (CN).

Also, the Act on Freedom of Economic Activity was amended. Generally, the changes aim at simplifying the formalities required to establish the business activity and strengthening the position of the entrepreneur during inspections, including tax audits. The amendment takes effect, in respective parts, on 7 and 31 March 2009.

20. PORTUGAL

Final text for 2009 Budget Law approved

The Budget Law for 2009 (Law 64-A/2008 of 31 December 2008) was approved. We describe hereunder the main changes as regards the initial proposal described in the previous newsletter.

Financial derivatives

The Budget Law for 2009 repels the controversial amendment which had since 1 January 2008 assimilated to interest income for domestic purposes "gains derived from exchange rate swaps, interest rate swaps, combined interest and exchange rate swaps and forward exchange agreements."

We recall that Taxpayers' positions, up until the 2008 amendment, was that payments under swap and forward agreements when paid to nonresident counterparties would be classed as "business profits" or "other income" under Portugal's tax treaties and therefore not fall under the "interest income" definition under the Portuguese treaties.

Through the 2008 amendment, Portugal changed the level playing field by determining that some financial derivatives would be subject to withholding tax under some tax treaties (with the consequent cash flow impact). This amendment which was not included in the initial proposal is therefore good news for taxpayers with financial derivatives and finally lays a stone on a contentious position which was bound to be litigated by taxpayers.

Banking Secrecy

The Bill extends the situations where tax authorities may have access to information and bank documents without the consent of the taxpayer. The automatic exchange of information mechanism in place with financial institutions was extended to cover the opening and maintenance of bank accounts by taxpayers with unpaid tax debts or who develop activity in high risk sectors.

Supplementary budget program entitled "Initiative for Employment and Investment"

The Portuguese Parliament has approved a Bill providing a supplementary budget program entitled "Initiative for Employment and Investment", which besides amending the 2009 Budget Law also provides for specific tax measures.

Among those measures, we highlight the new investment tax credit exclusively applicable during 2009, the widening of the R&D tax credit and the extension of the Portuguese holding regime to EU-incorporated entities that move their seat or place of effective management to Portugal. The measures are effective as from 1 January 2009.

New investment tax credit for qualified investments

The new *Regime Fiscal de Apoio ao Investimento* or *RFAI 2009* provides for several tax benefits for qualified investments made in certain business sectors, including the following:

- Investment tax credit which operates as a deduction against corporate income tax otherwise payable (up to a limit of 25% of the tax due) equal to 20% (for qualified investments lower than EUR 5,000,000) or 10% (for qualified investments higher than EUR 5,000,000) of the qualified investment. Any unused credit may be carried forward for 4 years.
- Exemption on real estate transfer tax (IMT), property tax (IMI) and stamp tax on the acquisition of real estate for investment purposes. The real estate tax exemptions are, nonetheless, subject to recognition by the Municipality of the interest of the investment to the region.

The following investments are eligible for the tax incentive:

- New tangible assets. Nonetheless, the following new assets are excluded: (i) land (except when used for resource extraction); (ii) buildings (except when used for factories or administrative offices); (iii) non commercial vehicles; (iv) furniture (except when used for tourism purposes); (v) social equipments (except if acquired under legal obligation); and (vi) other assets that are not directly connected with the activity developed.
- Intangible assets which qualify as expenses with transfer of technology through the acquisition of patent rights, licenses, know-how or unpatented technical knowledge. For large companies (i.e. not qualifying as a SME under the EU definition) the investments in intangible fixed assets may not exceed 50% of the qualified investment.

Under the *RFAI 2009* qualifying investments must be maintained for a five-year period subject to a recapture rule and the qualifying investments must be designed to promote the creation of employment during 2009.

The *RFAI 2009* is limited to taxpayers engaged in certain business sectors: agriculture, and is not applicable to companies that fall within the meaning of company in difficulty.

R&D tax incentive

The amount of tax credit available for qualifying R&D investments under the *SIFIDE* was increased.

Following the amendment, tax credits against corporate tax liability will be available for qualifying R&D expenses up to the following amounts:

- A basic credit, equal to 32,5% of the qualifying expenses for the relevant year; and

- An additional credit, equal to 50% of the amount by which the qualifying expenses for the relevant year exceed the average R&D expenses incurred over the 2 preceding years, with a ceiling of EUR 1,500,000.00. This deduction will only be applicable on costs that have not been subsidized by the State. Any unused credit will remain to be carried forward for 6 years.

Extension of the Portuguese holding regime to EU-incorporated entities

The tax regime applicable to Portuguese incorporated holding companies (the so-called SGPS regime) is extended to foreign EU incorporated entities that move their statutory seat or place of effective management to Portugal. The Bill recognizes that the aim of this amendment is twofold. In first place, the measure is designed to eliminate a potential incompatibility with EU Law as regards the non-application of this beneficial regime to foreign holding companies effectively managed in Portugal. Secondly, the measure also aims to stimulate investment and to create an incentive to the transfer of capital to the Portuguese territory.

21. PUERTO RICO

Puerto Rico New Fiscal Emergency Act: The Price of Recovery

The Honorable Governor of Puerto Rico, Luis Fortuño, signed into law on March 9, 2009 the "Special Act declaring a state of fiscal emergency and establishing an integrated fiscal stabilization plan to save Puerto Rico's credit" (the "Act"). The Act is just one of several laws intended to reduce the government's expenses, principally its payroll costs and increase tax collections.

The Act amends, either on a permanent or temporary basis, several tax provisions with the main purpose of increasing tax collections. The taxes affected are income, real property, excise and sales and use. In addition the Act provides a moratorium on the issuance and use of certain tax credits allowed under special legislation and subjects to a special tax certain entities previously exempt from taxes such as savings and loans cooperatives.

The amendments affecting individuals are mainly targeted to high income individuals whose income is composed of several types of exempt income and income subject to preferential tax rates. In the corporate tax side there are amendments affecting both the tax rate structure and the allowable deductions.

As of the date of this article there is no clear estimate of the revenue to be generated from these amendments nor it is possible to determine the short and long term effect they will have on the Island's economic development. It all will depend on the use given by the government to the increased tax revenues. For those taxpayers affected their only hope is that these measures will ignite the Island's recovery process.

Puerto Rico Moves Away from the Sales Tax System

A major change brought by the Act is related to the Sales and Use Tax (the "SUT"). The SUT provisions of the 1994 Puerto Rico Internal Revenue Code, as amended ("The Code"), have been in place at the state level since November 2006 and at the municipal level since July 2006. The system provides for the typical reseller exemption, which subject to certain documentation requirements, allows goods to flow through the distribution chain without the imposition of any tax.

The Act amended the SUT provisions of the Code to eliminate the reseller's exemption effective April 1, 2009. Accordingly, goods will be subject to tax at every step of the distribution chain; however each reseller will be allowed to claim a credit for the taxes paid on its purchases. In essence, each party in the chain will end up remitting to Treasury the tax corresponding to the value they added to the goods being sold (including obviously their mark up). It remains to be determined how will merchants who sell most or all of their goods to exempt persons, such as the government will be able to recover the tax paid on their purchases since they will not collect any tax on their sales.

The Act, on the other hand, didn't amend the inventory exception of the use tax provisions, which allows importers to store their inventory free of tax. Accordingly this creates an uneven treatment for importers—retailers who purchase their goods locally and will have to pay the tax, versus those that import goods who will be able to purchase and store their inventory free of tax.

An interesting side effect of this amendment is the redistribution of the tax collections among municipalities.

Finally the due date for the filing of the SUT return and the corresponding remittance is being changed from the 20th to the 10th of every month. This will place increased pressure on merchants to have the necessary information available to file the return in half of the time previously allowed.

22. ROMANIA

Amendments to social security contributions

The 2009 Budget Law on public social security was published. Starting 1 February 2009 the social security contribution rates are as follows:

- 31,3% for normal work conditions (20,8% paid by the employer and 10,5% paid by the employee);
- 36,3% for hard work conditions (25,8% paid by the employer and 10,5% paid by the employee);
- 41,3% for special work conditions (30,8% paid by the employer and 10,5% paid by the employee).

As such, the social security contribution paid by the employee was increased by 1% and the contribution paid by the employer by 2,3%.

Amendments to the Romanian Fiscal Code are expected

In the up-coming period, the Romanian Fiscal Code is expected to undergo several amendments in light of the current economic context. Until the date of this newsletter no draft of the proposed changes has been made public by the authorities. We will comment on these amendments in the coming newsletters.

23. RUSSIA

Russia issues Tax Treaty List for Information Exchange

On 15 January the Ministry of Finance issued Letter VE-22-2/20 with a list of Russian tax treaties in effect as of 1 January 2009.

The letter instructs tax authorities to use the list when preparing information requests to submit to the competent authorities of other tax treaty countries.

Tax treaty with Singapore enters into force

On 16 January 2009 the double tax treaty between Russia and Singapore entered into force. The treaty will apply as of 2010.

From the Russian perspective, Singapore may be a beneficial location for a holding company for Russian outbound investments in the region. Participation exemption regime in Singapore is beneficial. Singapore applies zero WHT on outbound dividends, while such distribution may qualify for the Russian participation exemption.

Alternatively, inbound investments in Russia may be structured via Singapore as the tax treaty rate for qualifying dividend distribution may be as low as 5%. 5% is the lowest WHT on dividends under Russian tax treaties.

The Russian Ministry of Finance added the Seychelles to the Russian black list

On 2 February the Russian Ministry of Finance issued Order 10n, amending Order 108n of 13 November 2007. The amendment adds the Seychelles to the list of jurisdictions that provide preferential tax treatment or do not require the disclosure and provision of tax information to Russia. Dividend distributions from companies registered in blacklisted countries do not qualify for the Russian participation exemption.

24. SWEDEN

New legislation on restrictions on deductibility of interest expenses enacted

In the 12th edition of Taxand Quarterly, we reported about the memorandum issued by the Ministry of Finance, where severe restrictions on deductibility of interest expenses arising on debt owed to a related legal entity were proposed. Despite the criticism raised by the judicial preview the Swedish government has since then sent a formal proposal to the Swedish parliament where only a few amendments were made, compared to the memorandum issued by the Ministry of Finance.

The Swedish parliament enacted the proposed legislation on 10 December 2008. The new law is effective as from 1 January 2009 and is applicable on interest costs accrued after 31 December 2008. In other words, the restrictions on deductibility would hit any debt that is "forbidden" under the new law, with no safe harbor at the point in time at which the transactions leading to the debt may have been carried out. The new law is presented hereunder.

As previously described, the restrictions will mainly apply to related companies. In this regard, legal entities and Swedish partnerships are considered companies. Companies will be considered as related if:

- one of the companies directly or indirectly by holding shares or in any other way has the controlling influence of one or several other companies, or
- the companies are mainly under unified control.

The restrictions are the following:

1. A company may not deduct interest expenses relating to debts to a related company to the extent the debt is connected to an acquisition of shares (or similar assets), from a related company.
2. The restrictions are also applicable on a debt to a related company, if this debt has replaced a "temporary debt" to a non-related company, if the restrictions on interest deduction according to the description above would have applied had the debt originally been due to a related company.
3. Additionally, the restrictions will also apply on a debt to a non-related company to the extent a related company has a receivable on the first mentioned company, or on a company related to the first mentioned company if the debt can be assumed to be related to this receivable and is connected to an acquisition of shares from a related party. This rule is designed to prevent circumvention through back to back loan financing with unrelated parties.

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

- a. If the beneficial owner of the income corresponding to the interest cost would be subject to taxation of at least 10%, had this been its only income ("10% exception").
- b. Both the underlying acquisition and the debt that causes the interest under test, are "primarily" (approx. 75% or more) motivated by business reasons.

If the beneficial owner is allowed to deduct dividend distributions, the 10% exception will not be applicable if the Tax Agency can demonstrate that the acquisition as well as the debt which underlie the interest cost are not predominantly (more than 50%) motivated by business reasons. This rule is a deviation from the main rule where the tax payer has to demonstrate that he is entitled to a deduction.

In reference to item 3 above – debts to non related parties - the following exceptions which allow for deduction are available:

- a. If the company holding a “back to back receivable” on the non related party would qualify for the 10% exception (see above), or
- b. Both the underlying acquisition and the debt that causes the interest under test, are “primarily” (approx. 75% or more) motivated by business reasons.

As is the case with related debts, the 10% exception will not apply if the company holding the “back to back receivable” is allowed to deduct dividend distributions, and the Tax Agency can demonstrate that the acquisition/debt is not predominantly motivated by business reasons.

The government has assigned the Tax Agency during 2009 to follow up the new rules so as to confirm that they are working the way they are intended to and to see if there are other tax schemes involving interest deductions which need to be prevented.

Analysis

The new legislation does pose several questions. For instance the use of “beneficial owner” taxation would historically only be applied under the so called substance over form doctrine, a pure case law doctrine, which has scarcely been applied in the High Administrative Court.

Additionally, there are some unanswered questions in regard to how to calculate the tax rate when applying the 10% exception.

Further, the above mentioned exception where the acquisition and the debt are primarily motivated by business reasons are according to the formal proposal intended to be applied restrictively; while keeping tax cost low may be considered rational for the business (as pointed out by the judicial preview), the meaning of the wording must be seen in the context in which it is used. As the new legislation is aiming at preventing tax driven transactions, tax reasons cannot be considered as business reasons. Additionally the exception which demands 75% business reasons is a big contrast compared to the Tax Evasion Act (TEA). Under TEA, the tax effect of a transaction may under certain circumstances be disregarded if it is motivated by more than 50 % by tax reasons.

While the above-mentioned items may be seen as negative for tax payers, there are positive aspects of the new legislation as well. Basically, it could now be concluded that if structured carefully, it is “officially” accepted to shift Swedish income by means of reallocating debt and equity within a group, as long as the tax rate is kept at 10%. Combined with inter alia the extensive treaty network, the absence of withholding tax on interest payments and the generous participation regime, Sweden is still a very flexible tax jurisdiction for debt restructuring.

Proposal from Ministry of Finance – foreign loans

On February 12, 2009 the Ministry of Finance sent a memorandum, proposing anti abuse legislation, to the parliament. The proposal contains an extension on the rules of taxation on so called forbidden loans².

According to applicable tax law, if a forbidden loan is granted from a Swedish limited liability company to a natural person (e.g. shareholder in the loaning company), the loan amount is taxable as employment income while if a forbidden loan is granted to a legal entity the loan amount is taxable as business income.

The above-mentioned anti-abuse proposal extends the scope of forbidden loans to also include loans from certain types of foreign legal entities.

The memorandum also proposes that interest expenses relating to forbidden loans will not be deductible. The abolishment of the deductibility includes interest on Swedish as well as foreign loans.

The new proposed rules are applicable on loans raised as from 13 February 2009. The abolishment of the deductibility of interest expenses is however applicable also on loans raised before 13 February 2009 but only on interest expenses accrued after 12 February 2009.

Comment

The proposal is basically aimed at counteracting the situations where a natural person places a Swedish closely held company under a foreign Holding Company, and subsequently borrows funds from that holding company. By taking up loans rather than receiving dividends, the natural person is able to use the company wealth for consumption, postponing the rather high taxation which is due on dividend distributions from closely held companies.

While the above aim seems rather clear, the “technical design” of the proposal – where only the “forbidden lenders” rather than the “forbidden borrowers” are specifically defined - implies that the anti-abuse legislation will hit loans also within the corporate sector.

While the above may be reason for groups containing Swedish companies in a borrowing situation to analyse the loan structure, we believe that the final outcome of this legislation will be amended, to better reflect the aim to hit only natural persons. This seems reasonable, given that this is actually an anti abuse legislation, and that the scope of interest deductibility in the corporate sector just recently has been set by the newly enacted rules on deductibility for intra-group interests.

Since we expect the proposal to be criticised and at least partly revised we will return with a thorough analysis in a coming edition of Taxand Quarterly.

² Simplified, according to the Companies Act, a Swedish limited liability company may not grant a loan to its shareholder, unless the shareholder is a company residing within the same Swedish company group, or if there are sound commercial reasons for the loan. Further, it is in certain situations totally forbidden for a Swedish limited liability company to grant loans to facilitate certain share acquisitions.

25. SWITZERLAND

New Double Tax Treaties

On 12 January 2008 Switzerland and France signed the supplementary treaty to the Swiss French double tax treaty. On 6 March 2009, Swiss Federal Council submitted its dispatch on the supplementary treaty to the Swiss Parliament. The supplementary treaty arranges for the changes which are required by the obligations entered by Switzerland with the EU and the OECD since 1966 (e.g. extension of the information exchanges clause for cases of tax fraud and the like, etc.). Furthermore, the supplementary treaty clears the relation of Article 11 of the double tax treaty an Article 15 Para 1 of the Savings Tax Agreements and provides for a positive change of the treaty abuse rule.

On 6 March 2009, Swiss Federal Council submitted its dispatch on the double tax treaty between Switzerland and Turkey signed on 22 May 2008. This double tax treaty follows the line of the OECD Model Tax Convention and the actual double tax treaty policy of Switzerland. The non recoverable treaty dividend withholding tax is 5%. The portfolio rate is 15%. Furthermore, the treaty foresees a branch profits tax of 5% on behalf of the state of source. With regard to interest withholding tax, the right to tax the source state is generally limited to 0%. With regard to royalty payments, the right to taxation is 10%.

On 27 January 2009 the double tax treaty between Switzerland and South Africa entered into force with effect as from 1 January 2010.

Swiss Corporate Tax Reform II

Partial taxation of dividends

The key issue of the reform is that dividends for shareholdings of at least 10% shall no longer be fully taxable in the hands of the individual private shareholder. Instead, only a quota of 60% of such dividends will now be taxed at the level of the individual private shareholder. The new rules entered into force as from 1 January 2009.

Many cantons have already introduced similar relief at *cantonal/municipal level*.

Capital duty

The law provides for the exemption from the 1% capital duty on equity contributions by the shareholders in recapitalization cases on up to CHF 10 million (one-time CHF 10 million floor amount exemption). The new rule entered into force on 1 January 2009.

Furthermore, the regular CHF 1 million floor amount exemption on equity contributions by shareholders now also applies to co-operations (so far only to stock companies and limited liability companies). The new rule entered into force on 1 January 2009.

Crediting of taxes due on income against taxes due on equity at cantonal/municipal level

The law provides an option for the cantons for the crediting of taxes due on income against taxes due on equity (annual equity taxes). This only applies at cantonal/municipal level, since no taxes on equity are levied at federal level. Cantonal/municipal taxes on equity may be waived if income taxes are higher. The cantons have the option to adjust their tax laws as from 1 January 2009.

Swiss Corporate Tax Reform III

Federal Department of Finance informed the country on 10 December 2008 of a third corporate tax reform relative to the taxation of corporations. It is the goal of this tax reform to increase the attraction of Switzerland as a place of business. In this context the abolishment of Swiss one-time capital duty is going to be discussed.

26. THAILAND

Thailand Tax Measures for Economic Stimulus Package

On 20 January 2009, Thai Cabinet has approved various tax measures to boost Thai economy as follows (**Please note that there shall be any implemented regulations on these policies in the short period**).

Tax measures to subsidize part of cost of living and promote Small and Medium-sized Enterprises (SMEs) and Community Enterprises

Individual – Subsidizing part of cost of living

To partly subsidize the cost of living of taxpayers, the threshold for calculation of minimum tax imposed on other incomes than salary and wages, at the rate of 0.5% will be expanded to THB 1,000,000 from THB 60,000. From the new threshold, taxpayers will be able to save money up to THB 5,000.

Community enterprise

To promote community enterprises that have increased continuously in the past few years in order to strengthen local economies, the threshold for tax exemption will be expanded to THB 1,800,000 from THB 1,200,000 during the years 2009 and 2010.

The capital source for SMEs

To encourage qualified venture capital which is a capital source for SMEs and to promote SMEs' shares in the Stock Exchange of Thailand, dividend and capital gain from transfer of SMEs' shares of a qualified venture capital will be exempt from income tax.

Tax measure to promote real estate industry

To encourage real estate industry and to stimulate Thai economy, the amount paid for buying a new house within the year 2009 capped at THB 300,000 will be exempt from personal income tax. This is an additional measure from the deduction of interest on loan for buying a house priced at THB 100,000 maximum in the calculation of personal income tax.

From the new tax measure, taxpayers will be able to pay less income tax, up to THB 111,000 (at the maximum rate of 37%).

Tax measure to promote tourism industry

To promote domestic tourism industry, business enterprises organizing their seminars in Thailand will be able to deduct accommodation expenses and seminar expenses at the rate of 200% in the calculation of corporate income tax for the year 2009.

Tax measures to promote debt restructuring and business restructuring

Debt restructuring

To promote debt restructuring in order to reduce the increase in the economic crisis, tax measures for debt restructuring for non-performing loans (NPL) will be granted, for the year 2009, as follows:

Income derived from the release of debt of the debtor of qualified financial institution creditor or other creditor, will be exempt from income tax.

Qualified financial institution creditor or other creditor will be able to write-off bad debt without the normal rule.

Transfer of property, sale or service, and documenting from debt restructuring between debtor and qualified financial institution creditor, or debtor and other creditor, will be exempt from income tax, value added tax, business tax and stamp duty. In addition, fee for registration of land and building will be reduced under the Land Code.

Transfer of immovable property as collateral as well as its documenting of debtor of qualified financial institution creditor to other person than such qualified financial institution creditor, will be exempt from income tax, value added tax, business tax and stamp duty. However, such income from the transfer shall be paid to such qualified financial institution creditor not more than its unpaid debt or its guarantee contract.

Reorganization (partial business transfer)

To encourage reorganization in order to promote business competition and to reduce some burden expenses, income derived or documenting from partial business transfer of public company or private company will be exempt from value added tax, business tax and stamp duty. In addition, fee for registration of land and building will be reduced under the Land Code. However, such partial business transfer shall be done within 31 December 2009.

27. THE NETHERLANDS

Taxation of lucrative interests

As from 1 January 2009, a new tax regime is effective in respect of so-called "lucrative interests". The tax regime aims to discourage so-called carried interest schemes and resembling remunerations ("sweet equity") by taxing them at the progressive rate which runs up to 52%.

To be a lucrative interest, the interest must be issued as a reward for labour activities of the holder of such interest. The presence of good leaver/bad leaver arrangements is an indication that the interest is issued as remuneration for services rendered. Next to this main condition, specific conditions apply to different assets that can qualify as lucrative interest.

Shares constitute a lucrative interest if there are various classes of shares and either (a) the shares held by the taxpayer rank junior to other classes of shares and the class of shares held by the taxpayer constitute less than 10% of the total paid-in share capital, or (b) the taxpayer owns preference shares with a preferred dividend of at least 15% per annum.

Receivables constitute a lucrative interest if the yield depends on 15% or more of managerial or shareholder targets such as profit, turnover, EBITDA, cost reduction and realisation of an exit. In addition, the new regime for lucrative interests also applies to loans payable which may be (in whole or in part) waived by the creditor and it can reasonably be assumed that such waiver is meant to form a remuneration for services rendered by the taxpayer or certain related persons.

The final category contains assets that, from an economic perspective, resemble the shares or receivables set out above, as well as other assets or obligations that may increase in value dependent on satisfaction of managerial or shareholder's targets. As a safety-net clause, the final category of assets is very broad and not-limitative.

In principle, the new regime will also apply to non-resident taxpayers if the lucrative interest is meant to form remuneration for services rendered in the Netherlands. However, in most tax treaties, the right to tax income from stock and other assets than real property is allocated to the country of which the recipient is a resident (limited taxation may be possible in case of dividends and interest).

28. TURKEY

Law No. 5838 Concerning the Introduction of amendments on some of the Laws has been promulgated in the Official Gazette on 28 February 2008. Pursuant to the Law, the following amendments have been introduced in the Corporation Tax Code:

Deducted Corporation Tax Application

Article 32/A has been added to the Corporation Tax Code, and the conditions for the deducted corporation tax application have been determined.

According to the regulation that is introduced, corporation taxes can be applied at deducted rates for purposes of acceleration of economic development, increase of the employment potential, elimination of the differences in levels of development between the regions and the encouragement of incentives.

Pursuant to this regulation, the gains that are derived from the investments that are supported by an investment incentive certificate drawn up by the Under secretariat of Treasury, shall become subject to corporation taxes at discounted rates starting from the beginning of the period on which the investments have partially or completely begun to operate, until the total contribution regarding investment has been reached.

For the purposes of this law, the total contribution regarding investment refers to the portion of the investments to be met by the State through the relinquishment of the taxes by the application of the discounted corporation tax rates, and the rate to be calculated through the division of this total to the total investments, refers to the rate of contribution to investments.

The corporations operating in finance and insurance industry, joint ventures, contractual works, and the investments realized within the scope of Law No. 4283 and Law No. 3996, and the investments that are realized within the framework of a license fee, are not allowed to benefit from the discounted corporation tax application.

The Council of Ministers has been authorized to,

- Divide the provinces into groups by taking into consideration the national welfare and the levels of socio-economic development and to determine the sectors to be developed as per each group, and to determine the potential of investment and employment for each group;
- To determine the contribution rate toward investment for each group of provinces, provided that such rates do not exceed 25% in regular investments, and 45% for major investments the total investment of which **(not exceeding?)** exceeds TRY 50 million, and to apply the discounted corporation tax rates at a discount of up to 90%.
- To impose limitations separately, or as a whole, on the expenditures concerning lands, buildings, used machinery, spare parts, software, patents and know-how that are included within the investment expenditures.

Accordingly, in investments to be realized by the same investors within provinces that are subject to contribution to investment and taxes at different rates - depending on the rate corresponding to each province, the rate of contribution to investment - tax rates shall be applied at discounted rates.

Moreover, the Ministry of Finance has been authorized to determine the procedures and principles relating to the regulation envisaged to be applied on the income tax liabilities.

The Consideration of the Investment Portfolios and the Portfolio Management Companies as Permanent Representatives

Pursuant to Temporary Article 3 added to the Corporation Tax Code. The participants or the founders of nonresident funds that are qualified to corporation tax liabilities, and provided that they are not tax resident persons or legal entities, the portfolio management companies that operate for the purpose of the management of the portfolios of such funds, and the portfolio management funds established according to the Capital Market Law, will not be considered as the business centers of such funds, and instead, will be considered as their permanent representatives.

Through this regulation, the nonresident funds that do not have tax resident persons or legal entities among their founders, are granted the opportunity to have their funds invested in Turkey, and accordingly, the taxation of their gains earned through such funds that are invested only in Turkey by the portfolio management firms established in Turkey, are attempted to become subject to tax in Turkey.

The Application of Corporation Tax at Discounted Rates on the Textile and Ready-to-Wear Sector Operating in the Designated Provinces

Through temporary Article 4, added to the Law, also effective on the liability of income tax, the Ministry of Finance has been authorized to allow the application of corporation tax at discounted rates on the persons and entities that are exclusively engaged in textile, ready-to-wear, and garments, leather and tannery sectors, who transfer their production facilities to the provinces that are announced until 31 December 2010, and who provide employment opportunities to at least 50 people in those regions, at discounts not exceeding 75% for a five-year period on the gains that they generate from their production facilities at such provinces, starting as of the account period which follows the date of transfer of the production facility

The Ministry of Finance is authorized to determine the procedures and principles of this regulation.

29. UKRAINE

13% Temporary Surcharge on Imports

On 4 February 2009, the Verkhovna Rada of Ukraine passed the Law (effective as of March 7, 2009) according to which temporary surcharge at 13 % rate was imposed on imports of wide range of goods. In particular, such surcharge was applicable to automobiles, certain items of foods, household appliances, clothes and footwear.

The temporary surcharge on imports was introduced in order to restrict imports and balance Ukraine's international trade foreign exchange position in light of decreasing exports. Such temporary measures are viewed by the Government as in line with General Agreement on Tariffs and Trade. Ukraine has notified WTO Committee on Balance of Payment Restriction about the temporary surcharge on import. As of today no response has been obtained from the WTO.

However, on 18 March 2009 the Cabinet of Ministers of Ukraine, responsible for implementation of the mentioned surcharge, adopted, but yet not published, Resolution which canceled 13% surcharge, except for automobiles and refrigerating equipment. The document conflicts with the mentioned Law, leading to practical problems during customs clearance of goods.

30. UNITED KINGDOM

Taxation of Foreign Profits: What You Need to Know

Legislation is under consultation in the UK that will introduce one of the most significant changes to the taxation of multinational corporations for decades. The proposed legislation sets out an exemption from UK taxation on foreign dividends paid to UK companies.

Prima facie, this is a positive change. However, the revenue cost to the tax authorities of the exemption is to be paid for by the introduction of a new restriction on interest deductions for connected party borrowing ("the debt cap"). For groups which have UK interest deductions in excess of their non-UK external borrowing costs, there could be a significant potential tax cost and given the complexity of the proposed rules, there is also likely to be an increase in the compliance burden.

The exemption from tax for foreign source dividends

At first glance, many groups could benefit from the introduction of an exemption from UK taxation for almost all dividends received by UK companies from overseas sources.

Currently, the UK operates on a credit system with respect to the taxation of foreign source dividend income; once the exemption is in force, it should be possible to repatriate profits to a UK parent company or through the UK to an overseas holding company without any incremental taxation.

Will all dividends qualify?

The de facto position is that all dividends received by UK companies (including those from other UK companies) will be taxable unless they fall into one of the exempt categories. Most dividends will fall into one of the exempt categories unless they are paid in pursuance of certain tax avoidance schemes that are the subject of targeted anti-avoidance provisions.

How does this compare with other regimes?

In some ways, the new exemption is more generous than those afforded by regimes in other European jurisdictions because in order to qualify for a UK exemption, there is neither a minimum participation requirement nor a minimum holding period with respect to the shareholding from which a dividend is derived. However, the associated debt cap changes described below reduce the attractiveness of the overall package.

Changes to the controlled foreign company legislation

Consequential amendments are to be made to the UK controlled foreign company ("CFC") rules. The exemption previously afforded to CFCs that pursued an acceptable distribution policy will no longer be available to exempt CFC profits earned after commencement of the new regime from being apportioned back to the UK taxpayer. The CFC exemption for exempt activity holding companies is also to be removed following a two-year transitional period designed to give taxpayers the opportunity to unwind existing structures. The removal of this exemption is likely to render ineffective certain bona fide commercial structures that have relied on the holding company exemption to prevent a CFC apportionment arising on interest income earned from exempt activity subsidiaries resident in the same jurisdiction as the holding company.

The Worldwide Debt Cap

According to the HM Treasury's own estimates, the introduction of the dividend exemption discussed above is expected to represent a significant cost to the public purse. Therefore, as part of the overall reform package, revenue generating measures are proposed to redress the balance. The payback comes in the form of a "Worldwide Debt Cap" whereby the UK tax deduction available for connected party borrowing costs will be restricted by reference to the external borrowing costs of the worldwide group of which the UK taxpayer is either the parent or a 75 per cent subsidiary.

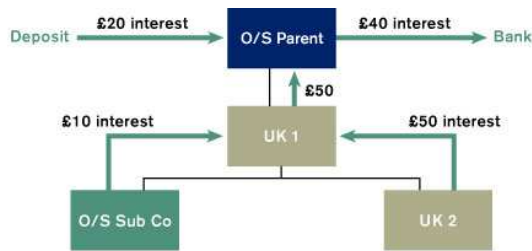
Operation of the debt cap

The current proposals represent a complex regime which, if enacted as drafted, will operate broadly as follows:

- The gross intra-group finance costs of UK group companies ("The Tested Amount") are compared to the worldwide non-UK group consolidated external financing costs net of worldwide (including UK) consolidated finance income ("The Available Amount").
- To the extent that the Tested Amount is greater than the Available Amount, the excess will be disallowed.
- When there is more than one UK company with intra-group finance costs, the taxpayer may determine which company suffers the disallowance.
- When there has been a disallowance, any UK intra-group financing income received from either UK companies that have suffered a disallowance or from overseas sources is exempt from tax ("Unrestricted Reduction") up to a maximum amount equal to the amount disallowed by the application of the debt cap ("Income Exemption Limitation").

Inbound debt

The impact of the proposed debt cap in an inbound scenario is illustrated in Figure 1 below:



Available amount	= £20 (£40 – £20)
Tested amount	= £100 (£50 + £50)
Total disallowance (to be allocated by group to UK 1 and UK 2)	= £80 (£100 – £20)
Unrestricted reduction (income of UK 1 not charged to tax)	= £60 (£50 + £10)
Net impact	= £20 increase in taxable profits

Figure 1: Application of debt cap in Inbound scenario

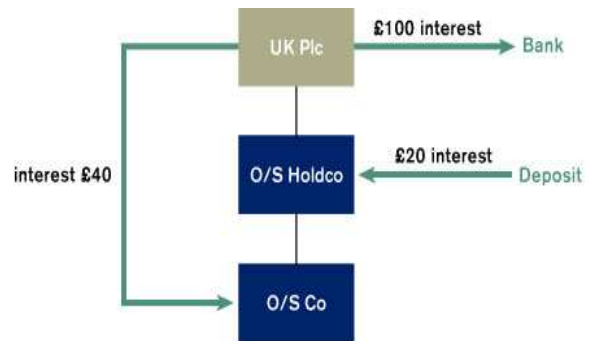
Groups with no external borrowing

When an overseas headquartered group has no external borrowing, no interest deductions are available for any intra-group financing costs incurred in the UK group. This situation could arise in the current economic climate in which a UK subsidiary of a cash-rich group has struggled to obtain external lending on competitive terms. This may be caused by the shortage of credit; in this market, the subsidiary may alternatively obtain funding on normal arm's length terms from its cash-rich overseas parent. In this case, no UK deduction would be available potentially leading to a one-sided income pick-up in the lending jurisdiction and economic double taxation.

Outbound debt

One objective of the new regime is to capture upstream lending situations as depicted in Figure 2. For many UK headquartered groups, this will be a common scenario where cash that represents low taxed overseas profits has been repatriated through upstream lending to avoid the incremental tax costs that would arise on receipt of a dividend. Whilst the new dividend exemption may give groups the opportunity to unwind upstream lending positions through payment of a dividend, this will not be possible in all cases where there are either insufficient distributable reserves or other local corporate law restrictions.

The application of the proposed debt cap in an outbound scenario is illustrated in Figure 2 below:



Available amount	= NIL (£0* – £20)
Tested amount	= £40
Disallowance in UK Plc	= £40

*As no non-UK external financing costs. Note the available amount cannot be less than 0.

Figure 2: Application of debt cap in Outbound scenario

Administrative burden

As well as the potential tax costs for both Inbound and Outbound groups, the new proposals are extremely complex and will therefore introduce a significant additional compliance burden on the taxpayer. This is contrary to previous initiatives by HM Treasury to reduce compliance burdens and encourage UK business. By way of example, whilst it is anticipated that only a small number of Inbounds will suffer a net disallowance, it will take a significant amount of work to monitor relative debt levels on an annual basis and to file the necessary returns. In addition to this, groups that thought they had achieved certainty on cross-border intra-group lending by entering into Advance Thin Capitalisation Agreements ("ATCAs") will now see this certainty removed as the new rules would apply in priority to any prior agreement with the tax authorities.

Alvarez & Marsal Taxand UK Says

Despite the UK Government's stated objectives of making the tax system more competitive and creating greater certainty for large corporate taxpayers, it is difficult to see that these measures, when looked at in their entirety, achieve those aims. The issues raised in this update are currently being debated among UK tax authorities in an effort to minimise the negative impact on groups with UK operations. However, in its current form, the legislation is likely to increase the burden on these groups at a time when many are cash strapped. Our recommendation for all of our clients is to:

- Monitor the development of the draft legislation closely— there is an ongoing consultation process and the rules may change prior to enactment;
- Conduct a review of current intra-group financing arrangements to identify those existing transactions likely to be impacted by the new rules once the final proposals are known;
- Evaluate the cash and accounting impact on implementation of the new regime;

- Minimise any adverse consequences by restructuring the existing capital structure e.g., consider refinancing existing intercompany balances;
- Consider distributing receivable balances created through previous upstream lending to the UK;
- Ensure that the resources and systems are in place in good time to ensure that the UK group companies can effectively meet their compliance requirements.

31. VENEZUELA

In the Official Gazette of 9 January 2009 was published the Law approving the Treaty between Venezuela and Belarus to avoid double taxation and prevent tax evasion in income tax, as issued by the National Assembly.

RULINGS

1. CHINA

China clarified taxation of stock appreciation rights and restricted stock units

On 7 January 2009, China issued a notice (Caishui [2009] No.5) to clarify that the preferential tax treatment is applicable for income derived from stock appreciation rights and restricted stock units, which were previously only applicable to income derived from stock options. This will reduce the individual taxpayers' individual income tax burden whilst also serving as an incentive policy for listed companies to reward their employees.

China released final rules for Transfer Pricing issues

The State Administration of Taxation ("SAT") issued the Implementation Measure of Special Tax Adjustments (Trial Version) ("the Measures") on 8 January 2009, which takes retrospective effect from 1 January 2008. The Measures are elaboration of "Chapter 6 - Special Tax Adjustments" of the new Enterprise Income Tax Law and its Detailed Implementation Regulations. The Measures also consolidate and update the provisions of the previous Chinese transfer pricing regulations. The Measures cover various aspects of special tax adjustments regarding Transfer Pricing, Thin Capitalization, Controlled Foreign Corporations and General Anti-avoidance Rules, etc.

China specified administrative measures for withholding Enterprise Income Tax ("WHT")

The SAT has prescribed specific procedures for WHT (Guoshuifa [2009] No.3). Enterprise with withholding obligation is required to submit copy of the contract given rise to the passive income (a nonresident enterprise's China-sourced dividend, interest, rental and royalty income, and gains from the alienation of properties), along with a registration form and other relevant documents within 30 days of the signature of the contract. This procedure also applies to each subsequent revision, supplementation or extension of the contract.

Withholding enterprise should also submit the WHT Return and the amount withheld should be remitted to the central treasury within 7 days. Qualified foreign institutional investors (QFII) also subject to WHT of 10% on PRC-sourced dividend and interest income (Guoshuifa [2009] No.47).

Foreign invested enterprises, foreign enterprises and individuals are subject to Real Estate Tax in China

According to Order No. 546 of the State Council, foreign investment enterprises, foreign enterprises and individuals are subject to Real Estate Tax in China, effective 1 January 2009. Previously, Real Estate Tax were only levied on domestic enterprises and individuals, which are calculated based on the original value of the real estate owned and self-used by the taxpayer or the rental income of the one owned by the taxpayer while rented to others.

China uplifts Value-Added Tax ("VAT") refund rate for export textile and clothing products

According to Caishui [2009] No.14, export VAT refund rates for certain textile and clothing products were uplifted to 15%. The circular is effective from 1 February 2009, using the export date listed on the "Customs Declaration Form (Export Rebate Only)", as the date of reference.

2. CYPRUS

Deduction of losses and distribution of expenses for taxable income

In order to clarify the tax treatment cases whereby losses are claimed or an allocation or apportionment of expenses and discounts is required the Commissioner of Income Tax has proceeded with the issue of a circular according to which an analysis of Article 13 of the Income Tax Law as well as the case law of the Supreme Court of the Republic of Cyprus is provided for.

In line with the above, losses may be offset against income from other sources for the same tax year or they may be carried forward during subsequent years. Offsetting of the losses is only allowable where had the said loss been a profit, it would have been taxed in accordance with the provisions of the Income Tax Law.

Based on the above principle, if the taxpayer has income which is either exempted or excluded from income tax either under the provisions of the Income Tax Law or under any other law; or subject to a special tax rate under the provisions of the Income Tax Law; a deduction of allocated expenses or discounts relating directly or indirectly to the income is made from the said income, as well as a deduction of a proportion of overheads and the taxable income is determined accordingly.

It has to be underlined also that any losses deriving from a business activity, the income or profits of which are exempted or excluded from income tax may not be offset against income or carried forward in subsequent years.

The above-mentioned developments are not enforceable to cases already examined and settled unless an objection has been raised within the provided timelines. This development may be seen as an adverse development for companies whose income mainly consists of tax-exempt income while companies not having any income being subject to tax at the Cyprus level are not anticipated to be affected by the abovementioned provisions. Exempted income from a Cyprus perspective includes gains from the sale of securities and dividend income.

3. INDIA

India issues important guidelines on Foreign Direct Investment

The Department of Industrial Policy and Promotion (DIPP) of the Government of India has issued a series of Press Notes that make some significant changes in the Foreign Direct Investment policy as they relate to downstream investments by Indian companies.

The new Press Notes now make a distinction between companies that are owned and controlled by Indian residents (or by companies that are owned and controlled by Indian residents) and companies that are owned or controlled by nonresidents.

Ownership is defined as beneficial ownership in more than 50% of the equity interest, and Control as the power to appoint a majority of the directors.

Downstream investments by companies that are owned and controlled by Indian residents will not be treated as foreign investment in the downstream company. On the other hand, downstream investments by companies that are owned or controlled by nonresidents will be treated as indirect foreign investment in the downstream company and will be subject to the applicable foreign direct investment norms.

Shareholder agreements dealing with appointment of directors, exercise of voting rights, creating disproportionate voting rights or other incidental matters would have to be filed with the approving authority in order to determine the control and/or ownership of the company.

Corresponding changes have also been made to the process to be followed and filings to be made in the case of downstream investments.

The new guidelines provide clarity of policy and flexibility of operations to Operating-cum-investing companies (owned or controlled by nonresidents) which have or propose to have downstream investments.

Moreover, since the Press Notes do not articulate any restrictions on Indian companies with foreign investment, albeit not owned or controlled by nonresidents, the logical outcome is that such entities will not be saddled with the foreign investment norms and procedures for their downstream investments, other than in circumstances specifically defined. In respect of downstream investment by such entities (which are neither owned or controlled by foreign investors) in areas prohibited or restricted for foreign investment whilst the guidelines carry no explicit restrictions, it will be advisable to await express clarifications and guidance from the policy makers to exclude the possibility that this aspect has been inadvertently overlooked and may be subsequently clarified.

4. IRELAND

Tax Residence Rules

The Finance (No.2) Act 2008 provides that, for the tax year 2009 (i.e. calendar year 2009) and subsequent tax years, an individual shall be deemed to be present in Ireland for a day if the individual is present in Ireland at any time during that day. Previously, it was only necessary for an individual to be present in Ireland at the end of the day (i.e. at midnight) in order for that day to count for tax residence purposes.

In the practical operation of the new rule, the Irish Revenue Commissioners will apply the following treatment:

Individuals in transit

An individual will not be regarded as being present in Ireland for any period during which he arrives in, and departs from, Ireland and throughout which he remains "airside" (i.e. remains throughout the period in Ireland in a part of an airport or port not accessible to members of the public).

'Force majeure' circumstances

Where an individual is prevented from leaving Ireland on his intended day of departure because of extraordinary natural occurrences (for example, sudden and severe adverse weather conditions) or an exceptional third party failure or action (for example, the breakdown of an aircraft or a labour strike), none of which could reasonably have been foreseen and avoided, the individual will not be regarded as being present in Ireland for tax residence purposes for the day after the intended day of departure provided the individual is unavoidably present in Ireland on that day due only to 'force majeure' circumstances.

"Double Residence" situations – tax treaty countries

Where a person is resident in Ireland for a tax year and is also a resident in a country with which Ireland has a tax treaty for the same tax year, the operation of the standard "tie-break" provision in the tax treaty will ensure that the individual is deemed for the purposes of the tax treaty to be a resident of only one of the countries.

Double Tax Treaties recently signed by Ireland:

Macedonia on 14 April 2008;

Malta on 14 November 2008;

Turkey on 24 October 2008;

Vietnam on 10 March 2008, and

Georgia on 20 November 2008.

5. PERU

Peruvian source income generated by a nonresident air or sea transport company is not levied with the Peruvian Income Tax as long as a reciprocity rule applies to the corresponding country

According to the Peruvian Income Tax Law, nonresident taxpayers are taxed only on their Peruvian source income, which includes income derived from air and sea transport activities between Peru and other countries. Hence, such income is subject to a WHT in Peru. However, the aforementioned law also provides that a foreign air or sea transport company is Income Tax exempted in Peru whenever it provides evidence that its country of origin grants the same tax benefit to Peruvian transport companies.

Concerning the application of this benefit, the Peruvian Tax Authority (SUNAT) recently ruled that a foreign company need only prove that the tax benefit for the Peruvian companies is in force in its country, should there be a Peruvian transport company operating there or not.

Finally, SUNAT established that the referred tax exemption in Peru will be applicable to those periods in which the same tax benefit for Peruvian corporations was in force in the other country.

6. SPAIN

Permanent establishment: commissionaire and toll manufacturing agreements

As is known, commissionaire and toll manufacturing agreements have given rise to a number of disputes with the tax authorities.

In this context, two rulings by the Directorate-General of Taxes ("DGT") have recently come to light. Both rulings addressed the same scenario, that is, an entity resident in Switzerland entered into a commissionaire or toll manufacturing agreement with another company resident in Spain. The rulings analyzed whether the Swiss entity had a permanent establishment ("PE") in Spain.

With respect to the commissionaire agreement, the DGT took the view that the Swiss entity would not have a PE in Spain and that the Spanish commissionaire would therefore be an independent agent if the following requirements were met:

- The commissionaire must act in the name of another and for its own account.
- The acts performed and the contracts made by the commissionaire must not be binding on the principal.
- The principal must not have the power to control or manage the commissionaire's activity, even though it may set certain guidelines.
- The commissionaire must bear the risk of mismanagement of its activity.
- The commissionaire agreement must be made at arm's-length prices.

With respect to the toll manufacturing agreement analyzed by the DGT, the Swiss entity agreed to purchase the raw materials, indicate the volume of production and bear the risk of losing the products (which never left its ownership), while the Spanish company agreed to process the raw materials and provide storage, logistics and transportation services, all for a price equal to the actual cost of the service plus a mark-up. The DGT took the view that there was no PE for the following reasons:

- The Spanish company's main activity was production, and it provided the service to other entities in the group.
- The agreement was entered into with a legally separate company at an arm's-length price.
- The Swiss entity did not have the power to control or manage the Spanish company's activity, even though it could give clear manufacturing instructions.
- The Swiss entity retained title to the materials throughout the entire processing phase.
- Only manufacturing-related risks were borne by the Spanish company.

However, the DGT also pointed out that a PE could exist if the Spanish companies started performing any other type of additional activity for the Swiss entity, binding the Swiss entity to third parties.

7. THAILAND

Thailand issued a ruling regarding determination of market price of shares in case of several tiers shareholding.

Under Section 65 bis (4) of the Revenue Code, market price or arm's length price is the price of consideration, service fee or interest which independent contracting parties acting in good faith would charge in a commercial manner for the same characteristics, categories or types of property, service or loan that are transferred or provided on the date of the transfer of property, provision of service, or lending of fund. Therefore, in general practice, if a Thai holding company holds shares in a listed company, the determination of share transfer price will be based on the market price in the stock exchange. On the contrary, if a Thai holding company holds shares in a non-listed company the determination of share transfer price will be based on either selling price or book value of the transferred shares, whichever is the greater.

Recently, Thai Revenue Department issued a tax ruling No. Kor. Khor. 0702/5326 dated 27 August 2008 regarding determination of share transfer price under the aforesaid Section 65 bis (4). According to the ruling, a Thai holding company held 99.99% of a second holding company in country B. Then, this second holding company held 95% of a third holding company in country C. Moreover, the third holding company held 77.60% of a company listed in a stock exchange of the same country. In this case, the Thai company would like to transfer all the shares in the second holding company in country B to its 100% shareholding foreign company.

In this case, Thai Revenue Department rules that the value of the underlying shares in all tiers will be considered. Therefore, the market price in the listed company in country C shall be used in determining the share price of the third, the second and Thai holding companies, respectively, even though there was no adjustment reflecting real market price of the shares in the financial statements of the third and the second holding companies. The determined price will be deemed as the market price of the transferred shares of the Thai holding company under Section 65 bis (4).

Our comments

It is important to note that from now on Thai tax authorities will consider the value of the underlying shares in all tiers. Even though the transferred shares are not in the listed company, the market price of the underlying shares in the stock exchange anywhere in the world of any tier shareholding shall be considered. At present, the consideration of selling price or book value of the transferred shares is not enough. Moreover, in the determination of the market price of the transferred shares, it is interesting to note that there shall be any adjustments or variance – for example, any costs, income tax payment, business operation, market fluctuation, any influenced factors, etc.

8. UKRAINE

Tax Treatment of Interest Expenses

On 10 November 2008, the State Tax Administration of Ukraine ("STAU") issued its ruling on tax treatment of interest expenses incurred in connection with acquisition or creation of depreciable fixed assets. The same logic may apply though to interest expenses incurred on acquisition of any capital assets, such as land or shares. Essentially, the STAU states its position that all interest expenses incurred in connection with acquisition or creation of a fixed asset up to the moment when the fixed asset put into operation should be treated as a capital expense and should be added to tax value of fixed assets.

Ukrainian CIT Law was not explicit on whether interest expenses related to acquisition or creation of a fixed asset could be immediately deductible for tax purposes, or whether such expenses should be treated as capital expenses and, therefore, should be added to the tax basis of a relevant fixed asset. The practice has not been consistent on this matter, as some companies deducted such interest expenses, while others capitalized such expenses for tax purposes. The practice was also affected by one year tax losses carry-forward restrictions, which used to apply in Ukraine prior to year 2006. To avoid undesirable tax losses, companies, especially in the construction industry, often capitalized interest expenses incurred in relation to construction related financing.

The STAU in its tax ruling clarified that interest expenses payable under loans attracted for the purpose of acquisition or construction of a fixed asset, should be capitalized. In accordance with the tax ruling, only interest that was incurred prior to putting of the fixed asset into operation should be capitalized. Interest expense incurred after a fixed asset is put into operation may be treated as currently deductible expense, in accordance with STAU's position. Although, the STAU takes a liberal position with respect to interest incurred after a fixed asset becomes operational, this position is questionable, as it is based on treatment of interest expenses in financial accounting, and the CIT Law makes no reference to financial accounting standards.

It will be exciting to see how this recent position of the STAU may potentially develop and whether the tax authorities would finally take a broader position that interest expenses incurred on acquisition of any capital assets, including land and shares, should be treated as a capital expense and may not be currently deductible. This may potentially effect widely used in Ukraine debt push-down structures for inbound cross-border corporate acquisitions.

Inbound Contribution of Assets to Capital Are Exempt from Import Duties, But Maybe Not

The State Customs Service of Ukraine ("SCSU") has recently published a highly disputable clarification on exemption from customs duties for goods imported into Ukraine as a contribution of a nonresident investor into share capital of a domestic company. This clarification may effect many MNCs with operations in Ukraine, as

inbound investments are often made in Ukraine by MNCs by way of contribution of property, plant & equipment, produced outside of Ukraine, to the capital of their Ukrainian subsidiaries; in which case, import of such items (with certain exceptions) is exempt from import duties in Ukraine.

As a tax avoidance measure the foreign investment law provides that import duties should be paid with penalty interest if the invested property is sold or otherwise alienated by a domestic subsidiary (referred to as a company with foreign investments) within three years after the property was contributed.

In its ruling of 20 January 2009 No 31, the SCSU clarified that in the opinion of the customs services sale or any other transfer of shares in a Ukrainian subsidiary by a foreign parent within the three-year period, including transfers of the shares as a part of any corporate reorganization, qualifies as an alienation of the invested property and triggers payment by the domestic subsidiary of import customs duties and interest penalties. Although position of the SCSU is highly questionable, the customs authorities are planning to conduct audits of domestic subsidiaries of MNCs and enforce their opinion in relevant cases. Payment of customs duties may also result in VAT deficiencies for the periods when the contributed property was imported as VAT is payable on customs value of the imported goods, increased by import customs duties.

Shall PE pay tax on financing from parent company?

Foreign companies operating in Ukraine through their branches (permanent establishment or "PE") may be affected by the letter of 12 January 2009 issued by the State Tax Administration of Ukraine (STAU).

STAU clarified taxation of financing received by Ukrainian PE from its foreign head office. Clarification relates to a situation where a French company (through its Ukrainian PE) provides services to Ukrainian road authority. The project is financed by loan from EBRD. The French company needs to transfer funds to PE for compensation of PE expenses and payment of salaries.

STAU reiterated its earlier position that financing received by Ukrainian PE from its nonresident parent company constitutes PE's taxable income. It may be understood that specific purpose of the financing is irrelevant. Although CIT Law provides that no income shall be recognized on the transfer of funds between Ukrainian entity and its domestic branches, this provision shall not apply to a PE of foreign companies

If the STAU approach is followed, this may result in several negative consequences for a PE:

- Unfair taxation. PE may be held liable for tax not on profits but on the amount up to the total cash received from the parent company. Notably, this appears to be discrimination against PEs, as branches of resident entities do not recognize income on funding from head office.

- Cash flow disadvantages. Corporate profits tax is paid on quarterly basis. Due to mismatch of the financing received and expenses incurred in the same quarter PE may overpay the tax. If the expenses are incurred in next quarters, a taxpayer may be entitled for refund which is difficult to obtain.

STAU position remains consistent as letters with similar opinion were issued in 2003 and 2005.

Our comments

Taxpayers may choose to disagree with STAU interpretation.

First, if there is a double tax treaty, a taxpayer may apply treaty provisions providing for taxation of profits (not income) attributable to permanent establishment. This approach has merits but implementation may require litigation with tax authority.

Second approach requires careful planning of funding and expenses to ensure that the amount of funding precisely matches the amount of expenses of PE for the same quarter.

9. VENEZUELA

In the Official Gazette of 28 January 2009, there appears published Administrative Ruling N SNAT/2009/0014 of the SENIAT, informing that the average interest rate for loans, set by the Venezuelan Central Bank for December 2008, was 23.32%, in order to calculate late payment charges caused by tax debts, which are determined at 1.2 times said rate.

In the Official Gazette of 28 February 2009, there appears published Administrative Ruling N SNAT/2009/0002344, of the SENIAT, resets the value of the Tax Unit from forty-six Bolivares no cents (VEF 46.00) to fifty-five Bolivares no cents (VEF 55.00).

In accordance with the provisions of Paragraph Three of Article 3 of the Tax Organic Code, the tax unit applicable to the cases of taxes to be settled on an annual basis, shall be valid for at least one hundred and eighty-three (183) days of the respective period other than annual, shall be in force at the beginning of the period.

COURT CASES

1. EUROPEAN COURT OF JUSTICE

22 December 2008, Case C-414/07 (Magoora) – Poland – Input VAT deduction on fuel

On the date of entering the EU (1 May 2004) Poland changed rules restricting the deductibility of input VAT on fuel for vehicles used for a taxable activity. On 22 August 2005 the rules in question were changed yet again.

Based on the standstill clause, the ECJ ruled that the VI Council Directive 77/388/EEC of 17 May 1977 precluded Poland from replacing national provisions, on the date on which that directive entered into force on its territory, by provisions laying down new criteria in that regard, if the latter provisions have the effect of extending the scope of the restrictions on deductibility. It precludes it also from subsequently amending its legislation so as to extend the scope of those restrictions as compared with the situation existing prior to that date.

Practical implications

The taxpayers are entitled to full deduction of input VAT if only they were entitled to do so under the rules in force before 1 May 2004. No restrictions of deductibility introduced on this date or afterwards are applicable. This not only concerns input VAT on fuel, but also on the purchase or lease of vehicles.

The taxpayers may claim the refund of the VAT overpaid since 1 May 2004. Most importantly, for procedural reasons, if their tax settlements for this period have already been audited, any final decisions issued by the tax authorities need to be challenged no later than on 23 March 2009 (i.e., within one month after formal publication of the ECJ ruling).

The Ministry of Finance issued guidelines concerning implications of the discussed ruling. We believe MF's interpretation to be too restrictive in certain aspects.

12 February 2009, Case C-138/07 (Cobelfret NV) – Belgian participation exemption violates EU-law.

The European Court of Justice ("ECJ") has ruled on 12 February 2009 in the Cobelfret-case that the Belgian participation exemption regime is incompatible with the EC Parent Subsidiary Directive (Directive 90/435/EEC of the council of 23 July 1990 – the "Directive").

Legislation

The Directive aims at ensuring that a common system of taxation is applicable on shares income in the case of parent companies and subsidiary companies established in different member states of the European Union. More specifically, article 4(1) of the Directive requires the State of residence of the dividend receiving company, to grant a tax relief on received dividends by either (a) granting a tax exemption or (b) by allowing a tax credit for the corporate tax paid by the subsidiary on the underlying profits.

Belgium has implemented the Directive by providing a 95% deduction from the taxable basis of the parent company for qualifying dividends. In this respect, the dividends need to relate to a participation having an acquisition value of at least EUR 1.2 million or need to relate to a participation representing at least 10 % of the subsidiary's nominal share capital.

However, due to certain technicalities related to Belgian corporate taxation, the dividend deduction only takes place in a later stage of the calculation of the taxable basis, and provided that taxable income is overall still present. If for instance, recoverable losses have compensated in an earlier stage of the taxable basis calculation taxable profits, the dividend deduction can no longer be effectively applied, but on the other hand, tax recoverable losses are "lost" since they were imputed in an earlier stage. On the other hand, the "excess of unused" dividend deduction amount is also lost because it cannot be transferred to future taxable periods; neither can it be carried back to any previous tax periods.

As a consequence, several parent companies, (such as Cobelfret, a Belgian company which received qualifying dividends from a UK subsidiary, during a period in which Cobelfret incurred tax losses and could not exercise its dividend deduction) considered that Belgium did not correctly implement art. 4 (1) of the Directive since the taxpayer was unable in certain cases to claim the full benefit of the dividend deduction.

The Court

The ECJ ruled that art. 4 (1) of the Directive has a direct effect into national law and does not allow Belgium to limit the application of the dividend deduction regime to companies having sufficient taxable profits to fully enjoy the dividend deduction.

Furthermore, the ECJ denied the request of the Belgian government to limit the temporal effect of its judgment. As a result, and considering that art. 4 (1) of the Directive has a direct effect, the taxpayers can apply the consequences of the Court's decision as well to dividends received in the past, i.e. before the Court's decision.

Action points

Any Belgian company should analyze its current and past position regarding the total amount on dividend deduction amount it was and is entitled to, based on the Court's decision, and its effectively "used" deduction amounts. Any discrepancy between the above amounts may need to be included in the first tax return to be filed by the taxpayer as an additional tax deduction.

Belgian Government has already expressed its concern over the financial consequences of the Court's decision, which are expected to be "very substantial", and may cost the Belgian Treasury billions of Euros...

12 February 2009, Case C-67/08 (Block) - Germany - Inheritance Spanish tax

The ECJ has recently held that given the current stage of development of Community law, domestic legislation (in this case German) that does not allow a credit for the inheritance tax paid in one Member State (where the assets are located) to be taken against inheritance tax payable in another Member State (where the heir resides) is not contrary to Article 56 of the EC Treaty (free movement of capital).

In the Block case, a German resident who inherited the estate of a decedent who was also resident in Germany was not able to credit the inheritance tax paid in Spain on certain deposits held in Spanish bank accounts against the German inheritance tax payable (however, the heir was allowed to deduct the Spanish inheritance tax expense from the basis of assessment of inheritance tax payable in Germany).

Following the line it took in earlier judgments (in the Kerckhaert and Morres and Columbus Container cases), the ECJ held that the double taxation arising in this case was merely the result of the exercise in parallel by two Member States of their non-harmonized fiscal sovereignty: thus, in the case of Germany, the connecting factor to tax the inheritance of these kinds of assets was the residence of the creditor holding the capital claims against (i.e., the holder of the deposits at) the depository institution (which meant, moreover, that the deposits were not considered to be "foreign assets," the taxes on which could be credited against the German tax), whereas in the case of Spain the relevant connecting factor was the place where the assets were located or where the inherited rights were exercised.

12 February 2009, case C-475/07 (Commission vs. Poland) – Taxation of energy products and electricity

The ECJ ruled that Poland failed to implement, as of 1 January 2006, the provisions of the Council Directive 2003/96/CE of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity. Contrary to the Community law, up till 1 March 2009 under the Polish domestic regulations excise duty was charged on the producers of electricity and not at the time of its supply by the distributors or redistributors.

ECJ did not limit the temporal effects of its ruling.

Practical implications

Energy producers are entitled to claim the refund of tax overpayment in excise duty for the period 1 January 2006–28 February 2009. Accreo Taxand represents Clients in disputes concerning this issue.

However, the Polish Ministry of Finance argues that the ruling gives no ground to claim the refund insofar as the tax burden economically was suffered by an entity other than a taxpayer. In such case the refund would give rise to the unjust enrichment of a taxpayer.

This interpretation thwarts the impact of the ruling. Yet, we believe it to be unfounded, as it is not justified to employ the unjust enrichment concept without clear legal grounds.

The Supreme Administrative Court in Warsaw is expected to issue a resolution on this question.

2. COUNTRIES

2.1 AUSTRALIA

Virgin Holdings SA v FCT

The Federal Court of Australia recently handed down a judgment on the impacts of Australia's double tax treaties on the ability of Australia to impose capital gains tax on profits made by nonresidents from dealings with assets in Australia.

The taxpayer, a Swiss resident company, sold all the shares of its Australian subsidiary in two tranches in November and December 2003, making a profit of about AUD 192 million. It was agreed that this was a capital profit and so liable to tax (if at all) under the capital gains tax provisions which form part of the Australian income tax. There was no dispute about the fact that the capital gain provisions as they were then drafted purported to apply.

The Court agreed with the taxpayer's argument that the profit arising on the sale of the shares was immune from Australian tax on the basis of article 7 (business profits) of the double tax treaty between Australia and Switzerland. That is, the nonresident could not be taxed in Australia because the profit arising on the sale of the shares was a business profit within the scope of the article and thus immune from Australian tax unless the profit was attributable to a permanent establishment of the taxpayer in Australia. As both sides agreed that the taxpayer did not have a permanent establishment in Australia, the profit would be taxable only in Switzerland.

The tax authorities had argued that the provisions of the double tax treaty between Australia and Switzerland were irrelevant to the dispute because the treaty entered force in 1981 and its effect did not extend to the capital gains tax provisions which began operation only in 1985. The Court held that the treaty did extend to the capital gains tax provisions – when these provisions were added to Australian law they formed part of the "Australian income tax" which the treaty covered. The judge did not think that this issue was one which raised the question whether the operation of a treaty was ambulatory or static – that is, whether the term "the Australian income tax" should be read to mean different things as the domestic circumstances changed. The judge observed that, in his opinion, "the better and preferred approach should be ambulatory and not static," but he concluded that it was not necessary to resolve the issue because even in 1981 the term "the Australian income tax" extended to tax on profits of a capital nature in some circumstances.

2.2 CANADA

PREVOST UPHELD - DUTCH INTERMEDIARY IS BENEFICIAL OWNER UNDER TREATY

On 26 February 2009, the Federal Court of Appeal issued its decision in *The Queen v. Prévost Car Inc.*, 2009 FCA 57 confirming the earlier decision of the Tax Court of Canada that a Dutch holding company was the “beneficial owner” of dividends for the purposes of the reduced withholding tax rate under the Canada-Netherlands Income Tax Convention.

More specifically, this case raises two issues of treaty interpretation which may be of interest to international tax practitioners. The first, as indicated above, concerns the interpretation to be given to the term “beneficial owner”, found at article 10(2) of the OECD Model Tax Convention (“Model Convention”). The second raises the question of whether national courts should rely on evolving OECD commentary for guidance when interpreting bilateral treaties which are based on the Model Convention, and if so to what extent.

In essence, Prévost Car is about tax authorities attacking treaty shopping. In 1995, Volvo (a resident of Sweden) and Henlys (a resident of England) jointly purchased all of the outstanding shares of Prévost Car (“Prévost”), a Canadian resident corporation incorporated in the civil law province of Quebec. The two companies incorporated a Dutch corporation, Prévost Holding B.V. (“PHB.V.”) through which they held the shares of Prévost. Whereas under their respective treaties the companies would have had to pay either 10% or 15% tax in Canada on dividends from Prévost, their Dutch-based holding company was only subject to a 5% tax on dividends under that nation’s treaty (were no treaty to apply the general Canadian withholding tax rate of 25% would have applied). Furthermore, any dividends paid by PHB.V. to Volvo and Henlys would not be taxed in the Netherlands.

Not liking this outcome, the Canadian tax authorities taxed both Volvo and Henlys directly on the dividends distributed to PHB.V. on the basis that they were the “beneficial owners” of those dividends. The outcome of the case thus centered on the interpretation to be given to the term “beneficial owner”.

The Tax Court of Canada (“Tax Court”) – the Canadian Court of first instance – found that the “beneficial owner” of dividends is the one to receive them for its own use and enjoyment, thus assuming the risk and control of the dividend received. The Court held that there was no need to pierce the corporate veil provided that the corporation was not just a conduit for another with no rights to personally use or apply the funds received. In adopting this approach, the Tax Court rejected a definition that would have looked solely at who can ultimately benefit from the dividends paid.

Despite some irregularities in Prévost’s books identifying Volvo and Henlys as its shareholders (instead of PHB.V.), and PHB.V. having no physical offices or employees, and mandating another company to pay its interim dividends, PHB.V. was nevertheless held to have enough discretion over the use of its funds (the Board had to vote to issue dividends) to not be considered a conduit for its shareholders. This conclusion was sustained even though a Shareholder Agreement between Volvo and Henlys set out that Prévost dividends would be paid each quarter. The Court found that although the agreement may bind the shareholders, PHB.V. itself was not bound by these terms. As a result Volvo and Henlys were spared from paying Canadian tax on dividends paid by Prévost to PHB.V.

The Tax Court’s definition of “beneficial owner” was endorsed on appeal. The Federal Court of Appeal – the Canadian appellate court in tax matters – approved of the definition primarily because it accorded with subsequent OECD Commentaries and the OECD Conduit Companies Report. The Federal Court of Appeal found that the worldwide use of the Model Convention and the general acceptance of using its Commentaries to interpret existing bilateral conventions allowed for this approach.

Indeed, the Court found that later commentaries, in other words, those released after a treaty has been signed, could be used to interpret the treaty as long as “they represent a fair interpretation of the words of the Model Convention”, did not conflict with Commentaries in force at the time the treaty was signed, did not relate to a provision that had been subsequently and substantially amended, and was not one to which the treaty partners had registered an objection. The Federal Court of Appeal thus chose to apply the 2003 Commentaries to an agreement contracted to by the parties in 1987; a full 16 years earlier.

In conclusion, the Prévost Car decision seems to implicitly recognize a separate existence for holding companies as beneficial owners of dividends, even if the latter are ultimately flowed through to their shareholders, provided that, through its directors, the company exercises some discretion over the funds in the interim. Should the courts be uncertain as to what this means, they should look at current OECD Commentary for guidance.

As for the potential of applying the Tax Court’s definition to the term “beneficial ownership” in other articles of the Model Convention, such as those dealing with withholding tax on interest and royalties, it is at best very limited. Regardless of how similar a structure could be to the one analysed in Prévost Car, in the end, the default position does not change. Corporations which are simply conduits for funds are not the “beneficial owners” of these funds. Thus, had there been a contractually “predetermined or automatic flow of funds” in Prévost Car, a fundamental characteristic of back-to-back financing arrangements for example, the Canadian courts may well have found that PHB.V. was a conduit for its shareholders.

The Supreme Court of Canada clarifies interest deductibility but muddies the GAAR

Singleton-Type Interest Deductibility Planning More Certain

On 8 January 2009 the Supreme Court of Canada released its decision in *Lipson v. Canada*, 2009 SCC 1 ("Lipson"). While the appellant in this case was not ultimately successful in obtaining the benefit of his spouse's interest deduction, this decision does provide a measure of comfort for other taxpayers in that Singleton-type interest deductibility tax planning appears to be alive and well (*Singleton v. R.*, 2001 SCC 61, [2001] 2 S.C.R. 1046 (S.C.C.)).

By way of background, the appellant and his spouse undertook certain transactions that gave rise to tax benefits for both of them. In simple terms, the appellant's spouse borrowed money that she then used to acquire certain investment company shares from the appellant. The appellant then used the money that he received on the sale of the shares to acquire a home. The effect of these steps was to have interest on the spouse's borrowing qualify for tax deductibility as the borrowed money was used to earn income from the acquired shares. Had the appellant instead borrowed to buy the home, that interest would not have so qualified as it would not have been for the purpose of earning income. This type of planning had been previously blessed by the Supreme Court of Canada in the Singleton case (hence the references in Canadian tax circles to "Singleton-type planning").

But the tax advantages to the taxpayers did not stop there. They also took advantage of certain "spousal attribution rules" that are generally intended to prevent "income splitting" where a high income spouse transfers investment property to a low income spouse. In such a case, the income or loss from the investment is attributed back to the high income spouse. Here, because the shares were not paying any current dividends, the spouse was in fact earning losses because of her interest expenses, and the appellant took the position that those losses were attributed back to him.

Accordingly, the tax issues raised by transactions undertaken by the appellant and his spouse in this case may be characterized into two categories: (1) the interest deductibility transactions; and (2) the spousal attribution transactions.

The majority and dissenting judgments in this case agreed on the essential object, spirit and purpose of the interest deductibility provisions in paragraph 20(1)(c) and subsection 20(3) of the Income Tax Act (the "Tax Act"). LeBel J., writing for the majority, stated:

Section 20(1)(c) allows taxpayers to deduct interest on borrowed money used for a commercial purpose. The purpose of this provision is to "create an incentive to accumulate capital with the potential to produce income" (Ludco Enterprises Ltd. v. Canada, 201 SCC 62, [2001] S.C.R. 1082, at para. 63), or to "encourage the accumulation of capital which would produce taxable income" (Shell Canada Ltd. v. Canada, [1999] 3 S.C.R. 622, at para. 57). Section 20(3) was enacted

"[f]or greater certainty" in order to make it clear that interest that is deductible under s. 20(1)(c) does not cease to be deductible because the original loan was refinanced. It serves "a practical function in the commercial world of facilitating refinancing" (Tax Court judgment, at para. 20).

The appellant's interest deductibility transactions were found to be consistent with the purpose of paragraph 20(1)(c) and subsection 20(3) of the Tax Act. As such, the court determined that the general anti-avoidance rule (the "GAAR") did not apply to deny the interest deduction to the appellant's spouse, even if it ultimately applied to deny the attribution of this interest deduction to the appellant.

The court effectively blessed Singleton-type tax planning, acknowledging that the result of the interest deductibility transactions was acceptable since the appellant's spouse financed the purchase of income-producing property with debt. Indeed, it described the interest deductibility transactions as "unimpeachable" and found there was no misuse or abuse of the interest deductibility provisions of the Tax Act. In his dissent, Binnie J. similarly held that "Singleton illustrates the proposition that there is nothing abusive in principle for a taxpayer to rearrange his or her capital (borrowed or non-borrowed) in a tax efficient manner." In other words, the GAAR did not apply to the impugned interest deductibility transactions and to deny the interest deduction to the appellant's spouse.

Going forward, taxpayers may feel comfortable arranging their affairs such that the direct use of their loan is for the purpose of earning income, even if the loan proceeds merely "filled the hole" left as a result of rearranging their business or investment financing, whether alone (as in Singleton) or a with another family member (as in Lipson). Undoubtedly taxpayers and their advisors will continue to look for ways to structure their debts within the parameters of paragraph 20(1)(c) and subsection 20(3) of the Tax Act.

The General Anti-Avoidance Rule Less Certain

As the appellant discovered, the GAAR places limits on structures and transactions which will be respected. Each tax benefit claimed from the interest deductibility and spousal attribution transactions must be evaluated in light of the whole series of transactions. Transactions which do not result in an abuse or misuse in one context might well be considered abusive in another context even, as in this case, where the direct use of a loan is for the purpose of earning income. Although the interest deduction to the appellant's spouse was not abusive, that same interest deduction attributed to the appellant was held to be abusive.

The appellant chose not to dispute the Minister's assertions that he had enjoyed a "tax benefit" and had engaged in an "avoidance transaction", both preconditions to the GAAR. Consequently, the only issue to be decided by the court was whether the transactions constituted abusive tax avoidance, that is, whether there had been a misuse or abuse of the interest deductibility or spousal attribution provisions of the Tax Act. As noted above, the court rejected the Minister's claim that the interest deductibility provisions of the Tax Act had been misused or abused.

The court found that the purpose of subsection 73(1) of the Tax Act is to facilitate inter-spousal transfers of property on a rollover basis for the reason that "it is undesirable and perhaps unfair, to impose a tax on transactions that do not involve a fundamental economic change in ownership, even though there may be a change in form or legal structure." Consequently, when the appellant sold shares to his spouse no gain was realized. Additionally, pursuant to subsection 74.1(1) of the Tax Act the net income or loss derived from the shares was attributed to the appellant. This allowed him to reduce the dividend income attributed to him by the interest paid on the loan that financed his spouse's purchase of the shares.

LeBel J. stated: "the purpose of s. 74.1(1) is to prevent spouses from reducing tax by taking advantage of their non-arm's length relationship when transferring property between themselves. [. . .] It seems strange that the operation of s. 74.1(1) can result in the reduction of the total amount of tax payable by Mr. Lipson on the income from the transferred property. The only way the Lipsons could have produced the result in this case was by taking advantage of their non-arm's length relationship. Therefore, the attribution by operation of s. 74.1(1) [. . .] qualifies as abusive tax avoidance." However, Binnie J., in his dissent, found that "what LeBel J. believes s. 74.1(1) is designed to prevent is actually a reasonable statement of what s. 74.1(1) seeks to permit." He continued: "far from constituting indicia of abuse, the spousal relationship is precisely the reason Parliament permits the attribution of income or loss back to the transferor." Binnie J. also noted that "[i]n my view, Parliament must have contemplated that by giving taxpayers a choice under s. 73(1), they would exercise it in a tax-minimizing manner." Binnie J. concluded that the Minister had not shown that the abusive nature of the impugned transactions under subsection 74.1(1) was clear, and, therefore, the GAAR should not apply.

Notwithstanding the majority's finding that the spousal attribution rules had been misused, more disturbing was their apparent reduction of the burden placed on the Minister in establishing abusive tax avoidance. In *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, the Supreme Court determined that "[i]f the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer." Yet, in this case, the majority stated, with no apparent analysis, the test for abusive tax avoidance could be met "on a balance of probabilities". If correct, this distinction could represent a dramatic shift for GAAR cases in the future.

Another important issue that the Supreme Court has yet to shed much light on is the role of the GAAR when specific anti-avoidance rules may be applicable. In the present case, Rothstein J., writing in dissent and on his own, rejected the application of the GAAR because the specific anti-avoidance rule in subsection 74.5(11) of the Tax Act should have applied. In this respect he stated, "[t]he GAAR was enacted as a provision of last resort" and "all other relevant provisions of the Act [must] be read before the Minister may have recourse to the GAAR." Since the Minister had recourse to assess the appellant under subsection 74.5(11), Rothstein J. found that the GAAR did not apply.

Both LeBel J. and Binnie J. disagreed with Rothstein J.'s analysis and preferred to leave the question of subsection 74.5(11) to another day. Among their reasons was that this provision was not relied on by the Minister as a basis for reassessment and was not raised by the appellant as a reason the Minister's GAAR claim should fail. LeBel J. stated "where the language of and principles flowing from the GAAR apply to a transaction, the court should not refuse to apply it on the ground that a more specific provision – one that both the Minister and the taxpayers considered to be inapplicable throughout the proceedings – might also apply to the transaction". To this, Rothstein J. replied that "[t]he fact that the parties did not rely on s. 74.5(11) – either as a basis for reassessment or as the reason why the Minister's claim should fail – does not change the fact that the section applies in law. [. . .] It is not open to this court to assist the Minister by allowing him to ignore the applicable specific anti-avoidance rule and instead rely on the GAAR."

Once the GAAR was held to apply, the final challenge was for the court to decide exactly what tax adjustments should be made. The Minister's position was to deny the interest deduction to the appellant while at the same time attributing the dividend income to him. The appellant argued that subsection 74.1(1) only attributes the net income or loss and that neither it nor the GAAR contemplates parsing the dividend income separately from the related interest deduction. With no analysis, the court disallowed the interest deduction to the appellant and attributed the same interest deduction to his spouse without the corresponding dividend income. Unfortunately, this interest deduction cannot ultimately be used, because the appellant's spouse's relevant tax reassessments were not appealed. It is not completely clear how subsection 245(5) can be interpreted in a manner that permits these adjustments. The court acknowledged such adjustments are only permitted under the GAAR if the court determines that they are reasonable in the circumstances. Without discussing what standards for reasonableness might apply or why the adjustments might be reasonable in these circumstances, the court simply stated that its decision was a "reasonable outcome".

Conclusion

This decision of the Supreme Court truly is a mixed-bag for taxpayers. On the one hand, interest deductibility tax planning is more certain. On the other hand, the GAAR has not been clarified in a meaningful way, and its reach and scope may in fact be expanded. This expansion may occur from the court lowering the bar for abusive tax avoidance from the clearest of cases (where any doubt is to be decided in the favour of taxpayers) to a balance of probabilities standard. This decision also suggests that the GAAR may no longer be seen as a provision of last resort, but might be used in cases where other specific anti-avoidance provisions could have applied. And the court, without explanation, used the GAAR to make adjustments that were arguably outside the scope of the adjustments permitted by subsection 245(5). The appellant's decision not to dispute the avoidance transaction pre-condition to the GAAR denied the court the opportunity to clarify the uncertainty that has emanated from lower court, post-Canada Trustco analyses of this issue.

Hopefully, the Supreme Court will, in a near future, will provide further clarification with respect to the standard of proof for abusive tax avoidance, answer whether the GAAR truly is a provision of last resort, make clear what constitutes an avoidance transaction and explain the "reasonable" adjustments that may be made pursuant to subsection 245(5).

2.3 FRANCE

Pension funds – WHT on dividends: restriction on the freedom of capital movement

The French Supreme Administrative Court ("Conseil d'Etat") issued a decision concluding that the withholding tax (WHT) levied on dividends paid by French companies to Dutch pension funds constitutes a restriction on the freedom of capital movement prohibited by Article 56 in the EC Treaty.

Indeed pension funds established in France are non-profit making institutions which, as such, are tax exempted on the dividends derived from companies established in France.

Consequently, the WHT on French-source dividends paid to EU-pension funds which are non-profit making institutions, such as Dutch pension funds, constitutes a restriction on the freedom of capital movement

Supreme Court – 13 February 2009 - n^o298108 (Fondations Stichting Unilever Pensionfonds Progress et autres)

2.4 INDIA

Vodafone International Holdings BV vs UOI, ADIT (Supreme Court)

The Indian Supreme Court declined to intervene in Vodafone's plea challenging the Bombay High Court judgement (rendered in December 2008), in relation to the show cause notice issued by the Revenue Department, alleging taxability of offshore sale transaction.

Vodafone International BV ("Vodafone"), a Dutch resident company had acquired interest of Hutchison Telecommunications International Limited ("Hutch") (a company registered in the Cayman Islands) in CGP Investments (Holdings) Ltd ("CGP Investments") also registered in Cayman Islands. CGP investments, through a host of intermediate companies, held a 67% equity interest in Hutchison Essar Limited ("HEL"), an Indian telecom company.

The Indian Revenue had issued a show cause notice to Vodafone arguing that they had failed to discharge withholding tax obligation with respect to tax on gains made by Hutch on sale of shares to Vodafone. Vodafone had filed a writ petition against the show cause notice issued by the Revenue in the Bombay High Court. The High Court dismissed the writ petition filed and against this, Vodafone approached the Supreme Court.

While dismissing Vodafone's petition, the Supreme Court made the following observations and issued directives:

- Vodafone should have filed agreements in relation to the transactions before the Bombay High Court.
- Vodafone's petition merely entails reply to Revenue Department's show cause notice and that, it did not warrant intervention by the Supreme Court.
- The Court directed the Revenue to look into jurisdictional issue on the basis of its ruling in Express Newspaper's case.
- Vodafone is at liberty to move the Bombay High Court in the event the Revenue answers the jurisdictional questions in the negative and that, the High Court should admit such a petition as it entails a question of law.

The attention will now shift to the Revenue, who would examine the issue of jurisdiction, prior to passing an assessment order. This is clearly a moral victory for the Revenue. It was anticipated that the Supreme Court while examining Vodafone's plea would set out the law on taxability of such transactions. However, as the Supreme Court declined to intervene, the Bombay High Court observations and assertions would stand.

Clifford Chance (Bombay High Court)

The taxpayer, a UK based firm of solicitors, was appointed as legal advisors for certain projects in India. For the relevant tax year, the partners of the taxpayer firm were present in India for a period exceeding 90 days, which was the threshold limit specified in Article 15 of the DTAA between India and UK dealing with Independent Personal Services. The tax officer held that the fees received by the taxpayer for the entire project is taxable in India and not only the amount which is attributable to the services rendered by it in India. The Bombay High Court observed that Article 15 (1) of the DTAA clearly lays down that income may be taxed in the source state, if such services are performed in that State, and if the professional is present in that State for a period(s) aggregating to 90 days in the relevant fiscal year, only so much of the income as is attributed to the services rendered in India is taxable. The Court observed that the income arising out of operations in more than one jurisdiction would have territorial nexus with each of the

jurisdictions on actual basis. If that be so, it would not be correct to contend that the entire income "accrues or arises" in each of the jurisdictions. The Court held that the income would be taxable only when the twin conditions of service being rendered and utilized in India are satisfied simultaneously. Thus, it reiterated that sufficient territorial nexus with India is essential for imposition of tax. With the above observations, the Court has held that the income of the taxpayer should be taxed only to the extent of services rendered in India.

Delta Airlines Inc (Mumbai Tribunal)

The US airline company owned security / baggage screening equipment at certain Indian airports and the equipment were shared with other airline operators for a fee. It also provided charter handling services to certain foreign charter companies and claimed that the income from these services were not taxable in India by virtue of article 8 of the Indo-US DTAA, which provides that the 'profit derived for operation of aircraft in international traffic' was taxable only in the taxpayer's country. The term 'profit from operation of aircraft in international traffic' was defined in the article, as profit from transportation by air of passengers, mail, livestock or goods, including any activity 'directly connected with such transportation'. The tax officer rejected the claim and contended that the term 'derived' used in article 8, had to be given a narrow meaning and the equipment sharing income cannot be treated as an activity directly connected with the transportation of 'such passengers'. He also contended that the term 'such passengers' as used in the article meant the 'taxpayer's own passengers'. The Tribunal held that a narrow meaning to the word 'derived' need not be given, especially when the para 2 of the article itself extended its applicability also to 'activities directly connected with such transportation'. However, the Tribunal held that equipment sharing is not an activity directly connected with such transportation and held that income therefrom would not be covered by the article and denied the benefit of the article to the taxpayer.

Golf in Dubai, LLC (Authority for Advance Ruling - AAR)

A nonresident entered into agreements with golf clubs and an event organizing company for organizing tournaments in India. It received sponsorship fee, management fee and income from sale of merchandise from organizing golf tournaments. The question raised before the AAR was whether the taxpayer had a Permanent Establishment (PE) in India as per Article 5 of the Indo-UAE Double Taxation Avoidance Agreement (DTAA) and accordingly, whether income would be taxable in India. The AAR held that the applicant did not have a service PE as it did not render any service by organizing golf tournaments and that even if service was rendered, none of the employees spent the requisite amount of time to constitute a PE. It held that it did not have an agency PE, as the golf clubs and other event organizers were independent third parties, and it did not have a fixed place PE, since though the golf course could be considered as a fixed place at the disposal of the applicant through which its business activities are conducted, the activities were not undertaken with regularity / repetitiveness, to consider it as a place of

business. Accordingly, the AAR held that no portion of the income was liable to tax in India

2.5 RUSSIA

Russian Court issued ruling on relevance of residence certificate for application of tax treaty

On 9 December Federal Arbitration Court of Cassation of the Ural Region issued Decision F09-9207/08-C3. According to this decision a tax residence certificate does not necessarily confirm beyond any doubt residence of a taxpayer for tax treaty purposes.

Facts of the case

A U.K. registered company claimed that it is a tax resident in Cyprus due to its place of effective management in Cyprus. Therefore the U.K. registered company regarded itself entitled to tax treaty benefits under the tax treaty between Russia and Cyprus.

The U.K. company managed to obtain a residence certificate from the Cypriot tax authorities as Cyprus uses the place of effective management as a tax residence test.

The company claimed that dividend withholding tax on dividend distribution from Russia should be withheld at the rate of 5%, which is the withholding tax rate for qualifying dividends under the Cyprus-Russia tax treaty. The reduced dividend withholding tax rate under the tax treaty between Russia and U.K. is 10% and the Russian domestic dividend withholding tax is 15%.

The Russian tax authorities held that the taxpayer did not prove that the payment was made to a tax resident of Cyprus and that the reduced tax treaty withholding tax rate should apply. It appears that the tax authorities' argument was that the tax residence certificate did not confirm beyond a doubt tax residence of the company in Cyprus.

Issue before the Court

The court had to decide whether the tax residence certificate confirms the tax residence of the taxpayer in Cyprus or whether more investigation may be required.

Court Decision

The lower courts concluded that because the U.K. company had a management and control branch in Cyprus, the U.K. company qualified as a tax resident in Cyprus. That fact was confirmed by the Cypriot tax authorities by issuing a tax residence certificate.

The court of cassation quashed the lower court decisions on formal grounds, concluding that because Cypriot tax authorities did not mention a branch in submitted documents, the lower courts' conclusions were not based on the facts of the case. The case was transferred to the court of first instance for more careful investigation.

Implications

Russian tax authorities generally accept tax residence certificates without challenging the tax residence of a company providing the certificate. However, in this case where from the facts of the case it appears that treaty shopping might be involved; they did not accept the certificate without question.

The court of cassation effectively confirmed that a tax residence certificate is not an unquestionable confirmation of tax residence in a particular country. The matter might need to be investigated without accepting the tax residence certificate or any other document as decisive. It is unclear at present whether this sets a precedent, because the decision of a court of cassation in principle may be reviewed by the Supreme Arbitration Court.

Confirming the tax authorities' right to investigate tax residence and therefore the applicability of tax treaty benefits to payments to nonresident companies beyond reviewing formal proofs like tax residence certificates indicates that the tax authorities and the courts might take a more substance-focused approach. This could make the use of nonresident holding and financing companies that lack substance less efficient because of possible difficulties with confirming those companies' entitlement to tax treaty exemptions.

2.6 SPAIN

Supreme Court questions deductibility of board member compensation for corporate income tax purposes

The Supreme Court has recently published two judgments (both dated 13 November 2008) that question the right to treat compensation paid to board members as a deductible expense for corporate income tax purposes.

In this regard, Article 13 of Corporate Income Tax Law 61/1978, of 27 December 1978 (in force until 1995) established that expenses necessary to obtain revenues were deductible and listed a number of specific expenses that were deductible by their very nature, two of which stand out: first, amounts accrued by third parties as direct or indirect consideration for personal services, and second, directors' shares in the income of the entity, provided that such shares were mandatory under the bylaws or were approved by the competent body and did not exceed ten percent of the entity's income.

The recent judgments address the case of an entity the bylaws of which established that "The Directors' compensation shall consist of a fixed allowance with the possibility of annual review and a share in income, subject to the statutory limit. In any event, where it consists of a share in the income of the company, it shall be subject to a maximum limit of 10% of such income and may only be deducted in the manner and subject to the limits established in the legislation currently in force". Additionally, among the facts described by these judgments, it was said that in this entity the Director's compensation was agreed by the general shareholders' meeting.

The Supreme Court held that in order for compensation paid to board members to be treated as a deductible expense for corporate income tax purposes, it must be mandatory (a requirement that would ostensibly be met if the compensation were set forth in the company's bylaws) and, therefore, necessary to obtain revenues.

The Court ruled that for directors' compensation to be regarded as mandatory, and therefore a deductible expense, it is not enough for the bylaws to merely refer to the compensation; instead, it must be established with certainty, which will happen if at least the following requirements are met:

- The bylaws must establish the specific compensation system, meaning that it is not enough to provide for various compensation systems for the directors and to then leave it to the shareholders' meeting to decide on which is to apply at any given time. In short, even though corporations can choose between different compensation systems (i.e., fixed, variable, or a mix of the two), the system must be clearly reflected in their bylaws.
- Mere designation in the bylaws of the "form of compensation" does not meet the legal requirement, that is, if a variable compensation system is chosen and it takes the form of a share in the company's income, the setting of a ceiling on that share is not sufficient; instead, the percentage must be perfectly determined in the bylaws.
- Where the bylaws provide for a fixed allowance, it is not enough to simply provide for its existence and mandatory nature; rather, the bylaws must in all cases set the "quantum" of the compensation or, at least, the rules that make it possible to determine its exact amount, without any room for discretion.

Lastly, please note that the Directorate-General of Taxes ("DGT") issued a report on 12 March 2008 stating that these judgments are not directly applicable to the Corporate Income Tax Law in force, and that Board Members' compensation is tax deductible as long as it is established in the bylaws (if the remunerated nature of the post is stipulated in the by-laws), and as long as the said expenses are recognized in the entity's accounts in accordance with Spanish accounting rules.

OTHER NEWS

1. COUNTRIES

1.1 AUSTRALIA

Inquiry into Australia's Future Tax System

In 2008, the Australian Government announced a proposal for a 'root and branch' review of Australia's tax system. During 2008 that project gathered some momentum, releasing three substantial papers – the *Architecture of Australia's Tax and Transfer System* (August 2008), *Australia's Future Tax System – Retirement Income Consultation Paper* (December 2008) and *Australia's Future Tax System – Consultation Paper* (December 2008). The project began with a focus on issues affecting households and individuals from the operation of the tax and social welfare system. However, the scope of the project has now clearly expanded to include a number of issues relevant for businesses.

The papers are largely descriptive of current laws and practices, which disclose little about the Review's preferred responses to them. Future papers will, hopefully, contain some greater inkling about what these observations imply. So far, these papers have elicited almost 500 submissions from interested citizens, businesses and organizations.

The Review plans to hold consultations in major urban areas in the near future and is due to deliver its final report to the Government by the end of next year, just in time for Australia's 2010 election.

1.2 BELGIUM

European Commission initiates action against certain exclusion clauses of Notional Interest Deduction (NID).

The European Commission has initiated on 19 February 2009, an infringement procedure against Belgium. The Commission argues that certain provisions of the Belgian NID would be in breach with (i) the articles 43 and 48, and (ii) the article 56 of the EC Treaty, respectively forbidding any restriction to the freedom of establishment and on the free movement of capital within the EC. The Commission did not take the position that the NID would be in violation with the State Aid rules.

The notional interest regime has been applicable since early 2006, and it allows Belgian companies and Belgian branches of foreign companies to deduct a notional interest that is calculated on the aggregate amount of their adjusted Belgium GAAP equity.

The NID is calculated by applying a percentage (currently: 4,473%) on the accounting equity of the company or branch concerned, as this equity is reflected in the annual accounts of the accounting year preceding the taxable period for which the NID is applied. However, a number of (negative) corrections are imputed on the fore-mentioned calculation basis. Amongst these exclusions are mentioned (a) net asset value attributable to a foreign establishments located in a Tax Treaty

country (art. 205, §2 Income Tax Code – "ITC") and (b) the net value of immovable property (other than immovable property forming part of a permanent establishment) located in a Tax Treaty country (art. 205, § 3 ITC), and in both cases assuming that the revenues of these assets are exempt based on relevant double tax treaty.

According to the letter sent to the Belgian Minister of foreign affairs, the EC states that the above restrictions are violating the freedom of establishment (art. 43 and 48 EC Treaty) and the free movement of capital (art. 56 EC Treaty) since it dissuades those taxpayers benefitting from the NID to invest abroad.

On the basis of the Commissions' letter referred to above, the Commission does not attack the NID system as such, and this contrary to some early press comments. On the contrary, the Commission indicates that certain limitations on the NID which are currently applicable may be in violation with the EC rules and therefore need to be modified or cancelled.

The Belgian Minister of Finance already indicated that he is considering extending the application of the NID-regime.

1.3 CHILE

New Tax and Customs Courts

A new Law establishes a new scheme for specialized and independent tax and customs courts. These new courts will depend directly from the Supreme Court of Chile. Until the enactment of this Law the courts were inside the Chilean Internal Revenue Service and the Customs Service, respectively. The judges will be specialized in tax and customs matters. The new courts will be gradually implemented in 4-year process starting with the extreme north regions the first year.

1.4 CYPRUS

Definition of securities expanded and very welcomed!

In accordance with the provisions of the Cyprus Income Tax Law, the gain from the disposal of securities is exempt from tax. So far, the definition of the term "securities" was limited to shares, bonds, debentures, founder's securities, other securities of legal entities incorporated in Cyprus or abroad and rights thereon. Accordingly, the need to diversify and expand the definition of the term "securities" under the Cyprus legislation proved desirous.

As a result to the above, it was recently announced by the Commissioner of Income Tax by means of a circular, that for the purpose of interpreting the term "securities", the following instruments are deemed to qualify as securities within the meaning of the law:

1. Ordinary shares;
2. Founder's shares;
3. Preference shares;
4. Options on titles;
5. Debentures;

6. Bonds;
7. Short positions on titles;
8. Futures/forwards on titles;
9. Swaps on titles;
10. Depository receipts on titles, such as ADRs and GDRs;
11. Rights of claim on bonds and debentures, excluding the rights on interest of these instruments;
12. Index participations only if they result in titles;
13. Repurchase agreements or Repos on titles;
14. Participations in companies; such as Russian OOO and ZAO, US LLC provided that they are subject to tax on their profits, Romanian SA and SRL and Bulgarian AD and OOD;
15. Units in open-end or closed-end collective investment schemes having been incorporated, registered and operating in accordance with the provisions of the relevant legislation of their country of incorporation.

Examples of such collective investments schemes are:

- Investment Trusts, Investment Funds, Mutual Funds, Unit Trusts, Real Estate Investment Trusts;
- International Collective Investment Schemes – ICIS;
- Undertakings for Collective Investments in Transferable Securities or UCITS;
- Other similar financial/investment institutions.

The tax treatment and respective application of the favorable Cyprus law provisions on the gains from the disposal of any other instrument not expressly mentioned in the above list may be sought by way of a request for a tax ruling, submitted to the Commissioner of Income Tax.

Further to the above, while the provisions of the circular are intended to apply to tax years from 2003 onwards, it is emphasized that in no way shall an examination of already settled cases take place and neither will a revision of the tax treatment of any gains from the disposal of such instruments in tax returns that have already been submitted prior to the date of issue of the circular for which no objection has been raised on this matter.

As aforementioned, the gains from the disposal of shares are exempt from Cyprus corporate income tax. The extended list of instruments falling within the definition of securities increases the competitiveness of the Cypriot jurisdiction from a tax planning perspective even further given that the ability of investors to reduce or even eliminate their tax liability by the use of a Cyprus holding company in their structure is further enhanced.

Equally, the fact that the exchange of information provisions have now been enacted into legislation in Cyprus, promotes the conclusion of additional Double Tax Treaties as the means of minimizing and/or eliminating taxation thus extending the already wide network of treaties currently in force.

1.5 MALTA

Value Added Tax

Malta has agreed with the EU to retain VAT exemption on foodstuffs and medicine even after the expiry of a temporary derogation at the end of 2010. In the EU, VAT is normally paid on all foodstuffs and medicinal products. The only exceptions to the rule were the UK and Ireland which had both obtained a permanent derogation and Malta which had been given a temporary derogation until the end of 2009 later extended by a year. Under the new arrangement, Malta may keep its current zero-rated VAT regime as long as the UK and Ireland keep the same VAT regime.

1.6 PORTUGAL

New Forms for the application of the EU Interest & Royalty Directive

Portugal has published new forms to benefit from the reduced rate or to apply for a tax refund under the Interest and Royalties Directive (Council Directive 2003/49/EC):

- **Form Modelo 01-DJR** is intended to claim for the reduced withholding tax under the transitional regime applicable to Portugal until 30 June 2013. Currently Portugal may levy a 10% gross withholding tax which will be reduced to 5% as from 1 July 2009.
- **Form Modelo 02-DJR** is intended to claim for the partial refund of tax withheld at the applicable domestic rates.

Unfortunately Portugal continues to insist on issuing stringent administrative procedures, by requiring forms to be duly certified by the competent tax authorities of the EU Member State where the beneficiary is located. These forms undermine the simplicity of the Directive and may entail disproportionate costs.

SPECIAL FEATURES

FURTHER DEVELOPMENTS ENHANCING CYPRUS' POSITION IN THE INTERNATIONAL TAX PLANNING ARENA

Cyprus is established as an international business and financial center and became the country with the lowest corporation tax rate (10%) in the EU. A significant number of double tax treaties have been concluded thus avoiding the double taxation of income earned in any of the countries Cyprus has an agreement with. The usage of Treaties has greatly prevented double taxation resulting in a reduction of the tax payable. The existence of such treaties combined with the low Corporate Income Tax in Cyprus offer tremendous possibilities for tax planning via Cyprus.

The aim has always been to establish Cyprus as a tax incentive country and not as a tax haven. A Cyprus Holding Company can be effectively used for international tax planning purposes. Besides the extensive double tax treaties and the 10% corporate tax rate, Cyprus offers the ability to pull profits from the country of the subsidiary (if it holds at least 1% of its share capital) with very low withholding tax, provided a DTT is in existence. A Cyprus Holding Company can benefit from the EU Parent-Subsidiary Directive whereby dividends paid between associated enterprises that are both situated in the EU (if holds 15% of its share capital as of 1 January 2009) are made without any withholding taxes. Beyond this, the fact that under Cyprus legislation neither withholding tax on dividends distribution to the nonresident shareholders of the Cyprus Holding company nor capital gains tax on the disposal of shares are levied, offer Cyprus a further additional incentive.

The Cyprus special contribution to the defense fund received special clarifications and more specifically dividend exemption from abroad constituting an additional tax incentive for the island. The non-applicable exemption relates to the charge of foreign tax on the income of the paying dividend company which is 'substantially lower' than the tax charge of the company which is a Resident in the Republic or not and has permanent establishment on the island. The Inland Revenue Department proceeded into offering a determination, clarifying that substantially lower foreign tax means below 5%.

Tax treatment of exchange differences arising directly or indirectly by trading in shares constitute a new change in the Cyprus tax regime. Any relevant profits deriving from such exchange differences are tax relieved and the relevant exchange losses are not allowed to be deducted from the taxable income, however, this change will be applicable for the 2003 tax-year and onwards.

Never ending tax-privileged legislation extended to include interests attributable to intangible costs of fixed assets in terms of considering goodwill, trade or business name etc. as part of the assets used by the company. The expenses for the acquisition of the intangible costs of

fixed assets should take place from independent third parties otherwise the new treatment available cannot take place. As a result, the related company paying interests are deductible from the taxable income.

Any gains arising from disposal of securities is exempted from tax under the Cyprus jurisdiction. The term 'securities' was retaining a limited definition until recently where the term 'securities' expanded in order to include more instruments within the meaning of the law for example: Founder's shares, preference shares, options on titles, debentures, bonds, units, options etc. The evolution of the list of instruments defined as 'securities' increase significantly the competitiveness of the Cypriot jurisdiction in terms of tax planning.

The continuous changes regarding the tax sector establish the Cypriot jurisdiction among the best tax planning and structuring jurisdictions worldwide.

FINANCING U.S. AFFILIATES OF FOREIGN ENTERPRISES — SUMMARY OF RELEVANT U.S. FEDERAL INCOME TAX RULES AND RECENT DEVELOPMENTS

Foreign enterprises investing in the U.S. seek to align the financing of U.S. affiliates with their overall global tax and cash management strategy. Some strategies used by foreign enterprises rely on leveraging the U.S. operations to reduce U.S. taxable income. This is because interest payments may be deductible and dividend payments are not. The U.S. has sophisticated rules to combat these strategies, but Congress, the U.S. Treasury and the Internal Revenue Service work relentlessly to extend the reach of the rules and update their application to innovative structures implemented by foreign enterprises and their advisors. This article provides a brief overview of the rules now in place, a general discussion of legislative or regulatory proposals, and an update on other developments in this area.

Potential Recharacterization of Transaction

Debt versus Equity

The initial hurdle faced by foreign enterprises relates to the classification of a financial instrument for U.S. income tax purposes as one representing debt or equity. Various factors must be considered by a taxpayer when characterizing a financial instrument, including but not limited to:

- a. A fixed and determinable interest and maturity date;
- b. The relative security status compared with other corporate debt;
- c. Whether the debtor has adequate capitalization (e.g., debt-to-equity ratio); and
- d. Whether the instrument allows for participation in the management of the corporation or conversion into its stock.

Characterizing a financial instrument as debt or equity requires a “facts and circumstances” analysis. This is an important determination, given the use by foreign enterprises of hybrid instruments, which are cross-border arrangements in which a financial instrument is inconsistently characterized by a taxpayer as debt or equity for U.S. and foreign tax purposes. The successful characterization by the IRS of a financial instrument as equity rather than debt will result in treating the payments made by the U.S. taxpayer as non-deductible dividends potentially also subject to dividend withholding.

In 2007, the IRS issued an industry directive classifying international transactions involving hybrid instruments as a Tier 1 issue and making it a mandatory examination issue that requires the approval of the International Hybrid Instrument Transaction Issue Management Team prior to resolution. The directive highlights the potential benefits of hybrid instruments as tax planning tools given that they can provide a taxpayer with U.S. interest expense deductions, lower treaty withholding rates on interest payments, and potential non-recognition of interest or dividend income in the foreign jurisdiction.

Anti-Conduit Financing

Another tool for potential recharacterization by the IRS is found in the conduit financing regulations. The IRS has the authority to recharacterize a multi-party financial arrangement (i.e., back-to-back loans) under the conduit financing regulations by disregarding the participation of one or more intermediate entities involved in a conduit financing arrangement. The financial arrangement would be recharacterized as a transaction directly between the remaining parties. Such a recharacterization can significantly affect the potential application of withholding taxes or the availability of U.S. income tax treaty benefits.

Until recently, tax practitioners maintained that fiscally transparent entities (i.e., check-the-box disregarded entities) involved in conduit financing arrangements were not considered intermediate “entities” because they were not “regarded” for U.S. tax purposes. Under proposed regulations issued on December 19, 2008, the term “person” in the context of the conduit financing regulations was expanded to include disregarded entities, thus creating an important exception to the check-the-box rules and broadening the application of the conduit financing regulations to prevent potentially abusive transactions. In the preamble to the proposed regulations, the IRS requested comments on the potential application of the conduit financing rules to hybrid instruments, although it cautioned that no inference should be drawn from its request for comments.

Transfer Pricing

The U.S. transfer pricing rules also provide the IRS with the authority to examine lending transactions among related parties to ensure that such transactions reflect an arm’s length interest rate as would arise among unrelated parties. The regulations provide a safe harbor for certain forms of related party indebtedness if the interest charged is at least equal to 100 percent, and not more than 130 percent, of the applicable federal rate. The regulations provide an interest-free period for intercompany trade receivables and payables that varies based on the

underlying transaction giving rise to the receivable or payable. Failure by a U.S. affiliate of a foreign enterprise to properly account for interest on related party indebtedness, including trade receivables or payables, can result in an IRS assessment. It is important to note that the capitalization, set-off or restructuring of intercompany accounts or debt instruments may be treated as a payment of the principal and unpaid interest, triggering U.S. income taxes, including withholding and reporting obligations.

Denial of Interest Expense Deduction

Earnings Stripping

Assuming that a financial instrument is properly characterized as debt for U.S. income tax purposes, earnings stripping rules defer the interest expense deduction of the U.S. corporation. The rules deny a current deduction for interest payments on financial obligations due to, or guaranteed by, related persons who are not subject to U.S. income tax on the interest payments (e.g., not subject to 30 percent withholding) to the extent of the corporation’s “excess interest expense.” A corporation’s “excess interest expense” is the excess of its net interest expense (i.e., interest expense in excess of interest income) over 50 percent of adjusted taxable income (i.e., basically cash flow from operations prior to interest expense). Interest payments currently disallowed can be carried forward indefinitely and deducted when the taxpayer meets this criteria.

Past legislative proposals — such as the Jumpstart Our Business Strength Act (2004, S. 1637) and the American Competitiveness Act (2002, H.R. 5095) — and various president budget proposals have focused on tightening the earnings stripping rules. The proposals seek to increase excess interest expense, eliminate the safe harbor currently provided by those rules for corporations whose debt to equity ratio does not exceed 1.5:1, and limit or eliminate the carryforward period for disallowed interest expense deductions. Although it has yet to be established that the earnings stripping rules in their current form provide an inadequate safeguard against foreign enterprises involved in leveraging the operations of U.S. affiliates, the recent wave of corporate inversions has prompted the Treasury to create Form 8926, Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information. The purpose of Form 8926 is to solicit detailed information about a corporation’s earnings stripping computation and thus to establish a basis for gauging the impact of future modifications to these rules and their administration.

OID and Payments to Related Parties

The Internal Revenue Code contains other provisions that can potentially delay and/or disallow a corporation’s interest expense deduction, such as rules governing applicable high-yield discount obligations (AHYDO) and rules that defer the deduction on interest accrued to related parties until the interest is actually, or deemed, paid. Debt instruments containing, among other factors, a significant amount of original issue discount (OID) may be characterized as AHYDO, and all or a portion of the interest may be permanently disallowed (i.e., recharacterized as a dividend), or a portion may be

deferred until paid. A corporation can potentially accelerate interest expense deductions while delaying the corresponding cash payment by issuing debt instruments with OID. However, if OID accrues to a related foreign person, the interest expense deduction may be deferred until the interest is paid.

Anti-Treaty-Shopping Measures

Limitations on Benefits Clause

As a policy matter, the U.S. Treasury safeguards access to its treaty network through the use of a strict limitations on benefits (LOB) clause that prevents residents from non-treaty countries from obtaining treaty benefits (i.e., treaty shopping) by simply establishing a legal entity in a treaty country. The LOB provision contains a number of objective tests that seek to establish a further connection between the resident claiming treaty benefits and the treaty country, such as the:

1. Public company test;
2. Ownership/base-erosion test;
3. Active trade or business test; and
4. Derivative benefits test.

The LOB clause has evolved over time, with certain provisions becoming stricter to prevent potential abuses, while other provisions were relaxed because perceived abuses did not materialize. For example, the Treasury tightened the public company test by requiring that a public company's primary shares be traded on a stock exchange in its country of residency or that the company's primary place of management be in its country of residency. Similarly, Treasury removed the ability for treaty residents to count the ownership by, or payments to, residents of the other contracting state to qualify for the ownership/base-erosion test, respectively. The modifications to the public company test and ownership/base-erosion test reflect the Treasury's intent that foreign persons relying on such provisions have a closer connection to the treaty country. In contrast, the active trade or business test and the derivative benefits test have not been modified significantly. The active trade or business test now includes a new attribution rule that makes it easier for a related group of companies to satisfy the active trade or business test, as well as a lower threshold for taxpayers engaged in investments activities.

Changes to the LOB clause can be found in different degrees in the U.S. treaties signed with Belgium (2006), Bulgaria (2007), Canada (2007), Denmark (2006), Finland (2006), France (2009), Germany (2006), Iceland (2007) and Sweden (2005), as well as the 2006 U.S. Model Treaty.

On November 28, 2007, the Treasury submitted a report to Congress on earnings stripping, transfer pricing and U.S. income tax treaties. In this report, the Treasury identified certain treaties that required special attention because of the treaty shopping potential provided by the absence of any type of LOB provision and a low or zero withholding rate on particular items of income. These treaties included those with Greece (1953), Hungary (1979), Iceland (1975), Pakistan (1959), the Philippines

(1982), Poland (1976), Romania (1976) and the former U.S.S.R. (1976).

From these treaties, the Treasury further identified Hungary, Iceland and Poland as high priority given the recent increase in the flow of interest payments made by U.S. corporations that are at least 25 percent foreign owned to related parties in these countries; the Treasury found the increase to be drastic for Hungary and Iceland. The Treasury compiled this data from the information provided in Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a Trade or Business; U.S. corporations that are at least 25 percent foreign owned are required to report on Form 5472 all of their transactions with related parties in other countries. A new U.S.–Iceland income tax treaty and protocol were signed in 2007 foreclosing this jurisdiction for treaty shopping. Furthermore, the Deputy Assistant Treasury Secretary for International Tax Affairs, Michael Mundaca, has stated that the Treasury hopes to update the treaties with Hungary and Poland to include anti-treaty-shopping provisions and that the Treasury is in ongoing discussions to that effect (on July 10, 2008, while testifying before the Senate Committee on Foreign Relations; and again on December 9, 2008, while speaking at the IRS-George Washington University Institute on Current Issues in International Taxation).

Anti-Hybrid Legislation

In addition to bolstering the LOB provisions of the 1996 Model Treaty, the U.S. is also taking unilateral steps to prevent perceived treaty shopping. For example, the Code denies treaty benefits on certain exempt payments made through hybrid entities — entities that are fiscally transparent for U.S. tax purposes and recognized as a separate entity for foreign tax purposes. Proposals to expand the application of these provisions, such as those found in the Rangel Bill (H.R. 3970) and the Doggett Bill (H.R. 3160), were introduced in Congress during 2007. In general, these bills may increase the withholding tax on certain payments (including interest and royalties) made to foreign persons who may otherwise be entitled to treaty benefits. According to the bills, if the ultimate foreign parent of the payee is not entitled to the benefits of a U.S. income tax treaty, then the payee will not be entitled to treaty benefits. However, the Doggett Bill would also increase the applicable withholding rate to the payee in the case where the ultimate foreign parent's income tax treaty provides for a higher withholding rate than the rate applicable under the payee's income tax treaty.

Alvarez & Marsal Taxand Says

Foreign enterprises seeking to mitigate U.S. income taxes in connection with the operations of their U.S. affiliates — and the repatriation of income arising from them — through related party financing strategies need to be aware of the array of rules that can potentially apply to such transactions. Such rules can recharacterize a financial instrument, deny or defer deductions for interest payments on related party obligations, or prevent the application of treaty benefits. Furthermore, foreign enterprises should continue to monitor any developments

in connection with these inbound financing rules, such as their potential application to hybrid instruments, the modification of the earnings stripping and conduit financing rules, or the negotiation of U.S. income tax treaties to include stricter LOB clauses. Alvarez & Marsal Taxand can assist foreign enterprises as they navigate through the U.S. inbound financing rules when designing a U.S. inbound investment structure. We can also help foreign enterprises evaluate their current structure to identify any potential exposures arising from the current rules or potential modifications to them.

TAXAND NEWS

31 TAXAND MEMBERS VOTED TOP IN ITR TAX TRANSACTION SURVEY

Tax executives from multinational companies, tax officials and advisors voted in the second International Tax Review online poll for their top 3 tax transactional firms in 47 jurisdictions. In 31 countries, that's nearly three quarters of the territories covered, Taxand members were selected as either number 1 or number 2 local advisors.

Taxanders in Argentina, Australia, Brazil, Canada, Chile, Columbia, Cyprus, Denmark, Finland, France, Germany, Greece, India, Ireland, Japan, Korea, Luxembourg, Malaysia, Malta, Norway, Peru, Poland, Portugal, Russia, Singapore, Spain, Sweden, Switzerland, Turkey, Venezuela and the USA were all recommended. In just one year Taxand has achieved votes in 45% more countries demonstrating the rapidly rising market recognition of Taxand excellence worldwide.

Taxanders from around the world were invited by the ITR to comment on the market context surrounding the survey which was published in the March edition. In an economic environment commanding tax executives to generate cash and preserve it, Taxand advisors have achieved increased recognition by listening to our clients and helping them cope.

TAXAND 2009 GLOBAL CONFERENCE > CASH IS KING

In his keynote speech at the Taxand 2009 Global Conference, Tony Alvarez advised delegates that in the current economic climate, "Cash Is King". This perspective was a recurring theme as Taxanders from around the world presented a global view of the key tax issues facing multinational clients today and in the future.

Hosted by Alvarez and Marsal Taxand LLC, Taxand's US member, this year's Taxand Global Conference took place at The Westin Diplomat Hotel in Miami, Florida from the 18th to the 20th February. Over 200 Taxand delegates attended alongside more than 60 global Taxand clients to deliver and contribute to a wealth of sessions focused on making the most of the economic downturn.

Key pointers from the conference included how to:

- help our clients generate more cash by managing tax effective supply chain management
- leverage sophisticated advice to deliver tax efficient operations
- prepare for the impact of the OECD business restructuring paper
- structure acquisitions in a cash efficient manner
- identify refund opportunities
- realise value from depreciating real estate through distressed asset investment or divestment
- organise the model tax department of the future

- restructure the debt of your global operations
- leverage from changes anticipated in the tax audit arena
- achieve global tax efficiencies through benefiting from new contract manufacturing regulations

Anecdotes, case studies and surveys carried out across Taxand's 47 member countries were also shared to help clients picture how to apply Taxand's experience to their businesses. All of the materials are downloadable at www.taxand.com/events.

Representatives from the International Tax Review, an influential Euromoney publication, also attended the event to present three newcomer awards given in 2008, recognising the quality of our international tax advice in the Americas, Asia and Europe.

Client feedback from the event has been outstanding. One particular client comment really hit home:

"I would like to thank you [Taxand] on behalf of all of the tax professionals in industry for providing us with an alternative for high quality tax advice".

The 2010 Taxand Global Conference will be held in Berlin. Watch this space for further details.

TAXAND REAL ESTATE TAX AT MIPIM 2009

Members of the Taxand global real estate tax team from across Europe represented our network at MIPIM, the primary event for the international property trade, held in Cannes, France, between 9th and 13th of March.

Taxand hosted a cocktail reception at the Majestic Barrière Hotel, an exhibition stand in the Palais des Festivals, a Taxand lunch and one to one client meetings at the event. As well as networking with peers, clients were able to talk to our Taxand Real Estate team experts from around Europe and pick up materials from the stand. For those of you travelling light or not able to make MIPIM this year visit www.taxand.com/events/regional_events. Here you can download all of the materials available on our stand from our presentation sharing experiences on how to profit in a crisis, to our Taxand Real Estate Calculator - a tool designed aid your investment planning by bringing together up-to-date key local real estate tax rates from around the world -, to a list of contact details for your key Taxand Real Estate Tax advisors in nearly 50 jurisdictions worldwide.

Taxand supports ITR Asia Tax Executives' Forum 2009

May 13-14, 2009, Shangri-La Hotel, Singapore

This conference, which is now in its fourth year, is expected to bring together a top-class line-up of tax executives, officials and advisors to network and debate today's tax issues in and around Asia. Organised by the International Tax Review in association with the Tax Executives' Institute, the event is being supported by a number of the 12 Asia-Pacific member firms of the Taxand network. As well as speaking at the event and hosting an exhibition stand we are arranging bespoke meetings between one or all of our Taxand colleagues

and clients on-site. Find out more about the conference programme, Taxand advisors speaking and participating in the event and who to contact at www.taxand.com/regional events.

For further information on all Taxand news please visit www.taxand.com.

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