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EDITORIAL

Welcome to the October issue of International **TAX INSIGHT**, our quarterly publication highlighting cross border tax developments which may affect those doing business in global locations.

In this quarter's issue we feature news of tax developments in the European Union (EU), France, Indonesia, the Netherlands, Russia, Singapore, Spain and Taiwan.

The tax information given is intended as a brief overview and may not cover all circumstances. Readers should seek professional advice before taking any action. Baker Tilly International member firms worldwide will be pleased to advise further. To locate your nearest firm, please see the Worldwide Directory at www.bakertillyinternational.com.

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EU

Proposal Presented for a Financial Transaction Tax

As widely anticipated the European Commission has now formally announced a proposal for the introduction of a financial transaction tax (FTT) throughout the 27 member countries of the EU.

If it is adopted the FTT will be a tax on transactions in financial instruments between financial institutions where at least one of the parties to the transaction is resident in an EU country.

Financial institutions will be widely defined to include for example banks, insurance companies, pension funds, stockbrokers, hedge funds and collective investment vehicles.

Minimum rates of tax are proposed of 0.1% for transactions in stocks and shares and bonds and 0.01% for trades in derivative products, with the tax being payable by each party to the transaction to the EU country in which it is resident. Member countries would be free to impose higher rates if they wished. The ten member countries which already have some form of financial transaction tax of their own would be required to align their rules to those of the common FTT and would have to ensure that they charge at least the minimum rates.

With most trading of this nature taking place electronically it is anticipated that the tax will generally be payable daily.

Revenues from an FTT are predicted to be substantial and the plan is that they should be shared between the EU itself and the EU countries which initially collect the tax. The EU's portion would go partly towards reducing members' contributions to its budget and partly towards funding projects for growth.

The proposal will now be discussed by the 27 countries in the EU's Council of Ministers, its senior decision making body, with a

view to introducing FTT in 2014. Opposition is expected from some of the countries, notably the UK, which house major financial centres, on the grounds that it will drive business elsewhere. The EU is aware of this objection, and is lobbying for an FTT type tax to be introduced globally. It will present its case to its partners in the G20 at their summit in Cannes early in November.

FRANCE

First Moves on Convergence of Tax Rules with Germany

Although the 27 countries of the EU operate a common system of indirect tax, VAT, they currently have little in common so far as their direct tax systems are concerned. There are Directives on some cross-border matters, for example forbidding in prescribed circumstances the deduction of withholding taxes from dividends, interest or royalties paid to entities in another member state, and members are not allowed to have rules which discriminate in favour of their own businesses at the expense of those elsewhere in the EU, but otherwise they are free to frame their tax laws as they wish.

However two of the EU's founder members, and largest economies, France and Germany, have now signalled their intention to work towards a convergence of their tax systems, with President Sarkozy and Chancellor Merkel giving this historic development their official approval at their summit meeting in August.

There is little indication as yet as to the pace at which this remarkable coming together of two national fiscal codes will be accomplished, but an early start has been made, and one proposed change in particular is likely to have an immediate impact on those businesses operating in France which currently have net operating losses (NOLs).

Currently in France a company can carry back a NOL for relief against the profits of the three preceding years, and to the extent that the NOL remains unrelieved it can then be carried forward for relief against the profits of future periods without any restriction.

Now, however, the government is proposing to move to a simulation of the much more restrictive rules which apply in Germany. This would result in the carry back being limited to one year, and to a maximum amount in that year of €1m. The remainder of the NOL would then be available for relief against later profits, but with the potential restriction in each year that to the extent that profits exceed €1m only 60% can be relieved by the NOL brought forward. This would introduce the concept of a minimum taxable profit in each year of 40% of profits in excess of €1m, and companies with NOLs would be paying taxes earlier than they had anticipated.

As we go to press this proposal is due to be debated in the French parliament. If enacted it could take effect as early as the current calendar year.

INDONESIA

Relief from Branch Profits Tax

Indonesian branches of foreign companies are generally subject to a branch profits tax of 20% on the remittance of post-tax profits back to head office either directly or indirectly.

This extra tax can be avoided if the net profits are reinvested back into Indonesia. Previously this exemption applied only if the net profits were reinvested in an equity participation in a newly established company in Indonesia, but this strict requirement has now been eased. Reinvestment can now take the form also of the purchase of fixed assets or intangible assets for use by the branch in Indonesia, or an investment in an equity participation in an existing company in Indonesia.

Whatever the form of the reinvestment it must be maintained for a minimum of three years for the exemption from branch profits tax to be sustained, and for this purpose branches will have reporting obligations for the year of the reinvestment and the following three years.

This relaxation in the rules should enable many more foreign companies with Indonesian branches to escape the branch profits tax charge.

It remains the case that some of Indonesia's bilateral double tax treaties with other countries provide for a reduction or elimination of the branch profits tax.

Tax Holiday Incentive for Large Investors

In another move, the government is offering generous tax holidays in a bid to boost inward investment, though the capital expenditure requirement is substantial, and the list of qualifying industries is tightly defined.

The minimum project cost is set at Rp1tn, which is equivalent to about US\$115m or €80m.

The primary sectors which qualify are base metals, industrial machinery, oil refining, petrochemicals, renewable energy resources and telecommunications equipment, though other trades may be admissible if they support national industrial competitiveness.

Applications regarding new projects must be made to the Ministry of Industry, and if granted the tax holidays will be for between five and ten years from the commencement of commercial production, with a 50% corporate tax rate reduction for a further two years. Existing businesses established for less than a year and which have yet to make a profit may also apply.

THE NETHERLANDS

Limits Placed on Loan Interest Relief for Leveraged Acquisitions

Following earlier indications that restrictions were to be imposed on the tax relief given for loan interest payments when foreign acquisitions of Dutch companies are considered to be funded by an excessive amount of debt, the details of the proposed new rules have now been announced as part of the 2012 Tax Plan to be debated in Parliament.

Planning for foreign takeovers of Dutch companies typically involves the formation of a Dutch acquisition vehicle which is funded largely by loans, either intra-group or third party. Following the purchase of the target company's share capital the acquiring company then forms a fiscal unity with the target company. This enables tax relief to be claimed for the loan interest payments against the post-acquisition profits of the target.

This strategy remains valid, but for acquisitions taking place from 2012 onwards, if the proposals are adopted, there will need to be some careful planning in order to avoid potential restrictions on the availability of tax relief for the interest payments.

There will be no limitation on tax relief if the interest payments are fully covered by the acquiring company's own profits. If relief for the payments is claimed against the profits of the target company it will be granted in full, provided all other conditions are satisfied, if companies in the fiscal unity have a debt to equity ratio of not more than 2 to 1. In calculating this ratio the book value of the participations held by the fiscal unity must be deducted from the equity. If the debt to equity ratio of the fiscal unity exceeds 2 to 1 then potentially there will be a proportionate restriction on tax relief for the interest payments. Interest of up to €1m per year however will qualify for tax relief in any event.

It is proposed that interest which does not qualify for tax relief because of these restrictions will be available to carry forward for relief in succeeding years if the requirements for full relief are then satisfied.

RUSSIA

New Transfer Pricing Law from 2012

Russia's long anticipated transfer pricing reform has at last become law, and international groups with trading interests in Russia will have to move quickly to prepare themselves for its implementation in January 2012.

The tax authorities are now expected to carry out many more detailed investigations than they do at present into the pricing of goods and services in transactions between Russian corporate taxpayers and related entities abroad, with a corresponding increase in the number of occasions when they make an upward adjustment in the taxable profits reported to them.

There is a requirement under the new law for transactions with related parties to be notified to the authorities annually, and for this purpose there will be an expanded definition of what constitutes a related party. Any situation in which the relationship between a Russian taxpayer and another entity is such that transactions between them might be priced otherwise than on arm's-length terms will result in the two parties being regarded as related, and this will specifically be considered to be the case when one owns directly or indirectly more than 25% of the shares of the other or can nominate more than 50% of the board of directors of the other.

The reporting requirement will extend to transactions with third parties where they involve the trading of goods on some of the global commodity exchanges, or where the other party is located in one of the tax havens included in a prescribed list. In each case there is an exemption where the total annual income from the designated type of transaction does not exceed RUB60m.

All relevant transactions must take place at arm's length prices, failing which the authorities can make an adjustment to the taxable profits of the Russian taxpayer entity. The law recognises five alternative transfer pricing methods – comparable uncontrolled price, discounted resale price, cost plus, comparable profits, and profit split – with a stipulation that the first is to be used wherever possible.

Documentation must be maintained to support the prices charged in transactions covered by the new law, and it must be produced to the authorities within 30 days of a request, though this cannot be made earlier than 1 June following the year in which the transactions took place. As a transitional measure, for 2012 and 2013 the documentation requirements will apply only where transactions with the same party exceed RUB100m and RUB80m respectively. From 2014 there will be no threshold.

SINGAPORE

Tax Relief Boost for Growth by Acquisitions

The Inland Revenue Authority has now issued full details of the mergers and acquisitions (M&A) scheme which was announced previously and which aims to encourage Singapore based companies to expand their businesses through acquisitions of other companies, both domestically and internationally.

The central feature of the M&A scheme is a tax relief of 5% of the cost of acquiring ordinary shares in other companies, with the relief given in equal instalments over a five year period beginning with the year of assessment in which the acquisition occurs.

The scheme will apply to acquisitions made between April 2010 and March 2015, and in each year of assessment there will be a cap of S\$100m on the cost of acquisitions eligible for the relief, giving maximum relief for each year of S\$5m. Any unutilised potential for relief can be carried forward to succeeding years.

Claimant companies must be incorporated and resident in Singapore, and if they are a member of a group the ultimate holding company must also be incorporated and resident in Singapore. They must carry on a trade or business in Singapore at the time of the relevant acquisition, and employ at least three local people, in addition to any company directors, in the 12 months prior to the acquisition.

In order to qualify for the relief an acquisition must result in more than 50% of the target company's share capital becoming owned, or more than 75% if there was previously a holding of between 50% and 75%. Acquisitions of shares in connected companies, as defined, do not qualify for relief.

It is a condition also that at the time of the acquisition the target company is carrying on a trade, in Singapore or elsewhere, and has employed at least three people throughout the preceding twelve months.

To supplement the tax relief there is also a stamp duty exemption, capped at S\$200,000 per year of assessment. This will be relevant when the acquisition is of unlisted ordinary shares in a Singapore based company or in a foreign company which is registered in a register kept in Singapore.

SPAIN

Temporary Tax Changes Include Loss Relief Restrictions

For larger businesses with operations in Spain and which have accumulated NOLs there to relieve against current and future profits the temporary tax measures brought in by the government to reduce the public deficit may result in an earlier exposure to corporate income tax liabilities than they had previously anticipated.

The law has been that NOLs brought forward can be relieved against subsequent profits without restriction until the NOLs have been fully utilised, subject to a time limit, and for the majority of companies this remains the position. For those with an annual sales turnover of €20m or more however there will be a limitation in 2011, 2012 and 2013 on the extent to which their profits can be reduced by NOLs, and for many of them this will lead to unexpected tax liabilities.

The ruling for each of the years in question is that companies with a turnover of between €20m and €60m may offset a maximum of 75% of their taxable income with NOLs brought forward, while for those with a turnover in excess of €60m the maximum offset will be 50%.

Unrelieved NOLs will continue to be carried forward, and to compensate for the temporary restrictions the time limit for the relief of NOLs is extended from 15 years to 18 years, a change which will apply to all companies and not only those affected by the restrictions.

Meanwhile, for taxpaying companies in these same turnover brackets there are temporary increases in the advance payments they must

make on account of their tax liabilities. Companies are required to make payments in April, October and December, and these are generally based on 21% of their provisional taxable profits for the first 3, 9 and 11 months of the year respectively. For the remaining two payments in 2011 and for the three in each of 2012 and 2013 this percentage is increased to 24% for companies with a turnover of between €20m and €60m and to 27% for those with a turnover of more than €60m.

TAIWAN

Thin Capitalisation Rules Threaten Tax Relief for Interest

Guidelines have now been issued by the Ministry of Finance on how the thin capitalisation rules announced earlier this year and effective from 2011 will be operated.

The new provisions target those Taiwan subsidiaries of foreign parent companies, and Taiwan branches of foreign companies, which the authorities consider to be financed to an excessive extent by related party debt as compared with risk equity, and the potential sanction is a restriction on the tax relief which will be given for interest payments on the debt.

Related parties are defined in the same way as for the transfer pricing regulations, and include situations where one enterprise owns directly or indirectly 20% or more of the shares of the other, and those where one can control or influence significantly the financing and management decisions of the other.

Related party debt refers not only to loans and other forms of financing provided directly or indirectly by a foreign affiliate to the Taiwan entity but also to third party loans which an affiliate arranges or which it guarantees.

The equity of a Taiwan entity is defined as the higher of its net asset value and the total amount of its paid-in capital and capital reserve.

The acceptable ratio of related party debt to equity is set at 3 to 1. This applies across the board, except that the finance industry, in particular banks, insurance companies, securities traders and financial holding companies, is exempted from these provisions.

Where debt to equity exceeds 3 to 1 there will be a restriction on the tax relief which is given for the interest payments. The disallowance will be calculated as related party debt x (1 minus 3 / related party debt divided by the owner's equity).

For example, a Taiwan company with equity of 100 and related party borrowings of 900 on which it pays interest annually of 100 will be denied tax relief on $100 \times (1 - 3/9) = 67$.

Groups with trading operations in Taiwan may need to review their financing structures to ensure that they are not caught out by these new rules.



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