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EDITORIAL

Welcome to the January issue of International **TAX INSIGHT**, a quarterly publication highlighting important 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 Belgium, Brazil, the European Union (EU), Finland, Ireland, Mexico, the Netherlands, the Netherlands Antilles, Poland, Switzerland, the United Kingdom and Zimbabwe.

In each case the 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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BELGIUM

Changes to the Participation Exemption

Companies in Belgium are generally permitted when calculating their taxable profits to deduct 95% of their dividends received, whether from domestic or foreign shareholdings.

There have been two changes announced recently to this relief, one of them restrictive and the other favourable.

Firstly the rules governing entitlement to the relief will be tightened with effect from 2010. Previously it was necessary for the Belgian

company's participation in the company paying the dividends to be at least 10% or to have a value of at least €1.2m. The new requirement will be for the company's participation to be at least 10% or to have a value of at least €2.5m.

The second change is to bring Belgium into compliance with EU law. Previously where the amount of 95% of dividends received exceeded taxable profits there was no facility to carry forward the excess for relief against future profits. A carry forward will now be allowed, and with retrospective effect, to the extent that the shareholdings are in companies in the EU or the EEA or in some circumstances in countries with which Belgium has a double tax treaty.

The extent to which retrospective relief can be claimed will vary according to the countries in which the companies paying the dividends are located. For companies in the EU, for example, claims can go back to 1992 or if later the year in which the country in which they are located joined the EU.

Companies in Belgium which have received dividends in the past should review their tax returns to determine whether they are entitled to tax refunds.

BRAZIL

Potential Restrictions on Tax Relief for Interest

Brazil is introducing thin capitalisation rules for the first time, and the rules are being targeted not only at interest payments that Brazilian companies make to related entities abroad but also at interest payments that they make to unrelated entities located in low tax jurisdictions.

For payments to related entities the new general precondition for full tax relief is that the paying company has a debt to equity ratio of not more than two to one, that is to say that the indebtedness on

which the interest is being paid does not exceed twice the amount of the company's net equity. If this requirement is infringed then a corresponding proportion of the interest paid will not qualify for tax relief.

For interest payments to entities in low tax jurisdictions, whether they are related to the paying company or not, there are much tighter restrictions. In these circumstances the payments will qualify for full tax relief only if the indebtedness does not exceed 30% of the net equity of the paying company. If there is such an excess then tax relief will be pared down accordingly.

Whether paying and recipient companies are related, and whether recipient companies are located in lower tax jurisdictions, are matters defined in Brazilian law.

The government has yet to decide whether the new measures will come into effect from 1 January 2010 or 1 January 2011.

Groups with subsidiary companies in Brazil should review urgently their financing arrangements and make such changes as are necessary to ensure that there is no loss of tax relief for interest payments.

EU

Possible VAT Refunds Due on Advisers' Fees

Following the European Court of Justice decision in the case of *Skatteverket v AB SKF*, EU based companies which have sold subsidiary companies in the past and which, in accordance with the previous understanding of VAT law in many EU countries, have not claimed input tax relief for the VAT incurred on the related professional advisers fees, can now consider filing supplementary claims for retrospective relief.

The position generally accepted in the past was that as the proceeds of sales of shares are exempt from VAT then correspondingly no relief could be claimed for the VAT charged on advisers fees related to such sales, on the grounds that there is a direct link between the proceeds receivable and the fees payable.

The Swedish company SKF challenged this interpretation in the Swedish courts and the matter was then referred to the ECJ.

The ruling of the ECJ is that a direct link exists only where the cost of the fees is specifically taken into account in fixing the price for the sale of the shares. Where instead the cost is treated as a general overhead, and this will be the case in the majority of share sales, then there is no direct link between proceeds and fees and accordingly no bar on claiming input tax relief for the VAT incurred on the fees, subject to any partial exemption method which may be in place.

Retrospective claims can be considered, though the national laws of countries within the EU vary as to how far back they can go.

Potential Problem for Group Registrations

EU law permits member states to allow groups of companies to register for VAT as a single entity if they so wish, rather than have each company in the group register individually. All of the transactions of group companies are then deemed to have been carried out by a single taxable person. This can be administratively convenient for groups with a centralised accounting function, and it dispenses with the need for invoices for intra-group transactions.

Typically a group registration will cover a holding company and its trading subsidiaries. In some cases holding companies charge fees to their subsidiaries for management services, in others there are no such charges. It is in this latter situation that a potential problem has arisen.

The European Commission has ruled that it is only companies which carry on a business activity which are eligible to participate in group registrations. Holding companies which charge management fees to their subsidiaries will qualify, but those which do not, and which do not carry out any other business activity, will be barred from joining future group registrations and are likely to be forced out of those where they are currently a member.

As they are not deemed to be carrying on a business they will have no right to register for VAT as a single entity, and consequently they will have no means of recovering the VAT they incur on their purchases of goods and services. Groups where for example the holding company bears all of the professional costs could be seriously disadvantaged.

Groups in this situation should look at their structures and their current intra-group charging strategies and make such changes as are necessary to ensure that they do not suffer any loss of VAT input tax relief.

FINLAND

Accelerated Depreciation for New Building Projects

The European Commission has confirmed that it will raise no objection to Finland's new accelerated rates of annual tax depreciation. There had been speculation that the move might be opposed on the grounds that it constituted anti-competitive state aid under the EC Treaty but this possibility has now been dismissed.

The enhanced rates, an increase from 7% to 14% for expenditure on the construction of factories and workshops commenced after 1 January 2009, and from 25% to 50% for expenditure on new machinery and equipment in such buildings, apply only for 2009 and 2010, and they constitute a clear incentive to bring forward the completion of new building projects where this can be achieved.

IRELAND

Incentives for Business in Budget for 2010

The Minister of Finance has announced his Budget proposals for 2010 and they reaffirm the government's commitment to ensuring that the country remains a noticeably business friendly environment.

The measures proposed include the following:

- The generally applicable corporate tax rate of 12.5%, one of the lowest to be found anywhere, will continue for 2010.
- The plan to grant a partial tax holiday to companies which started up a new trade in 2009 will be extended to cover companies which do so in 2010. The intention is that companies will be exempted from corporate tax, on both trading profits and capital gains from the sale of trading assets, in the first three years in which the new trade is carried on, to the extent that the tax liability in each year does not exceed €40,000. Some trades will not qualify for the relief, for example professional services trades. The government is currently constrained from implementing the scheme by an ongoing European Commission review as to whether it amounts to anti-competitive state aid under the EC treaty.
- The accelerated tax depreciation now granted for expenditure on energy-efficient equipment will be extended to cover refrigeration, cooling and electro-mechanical systems.
- Companies which create new jobs and which fill them with individuals who have been unemployed for six months or more will be exempt from pay related social insurance contributions in relation to each such employment for the first 12 months.

MEXICO

Congress Enacts New Provisions for 2010

The principal changes affecting foreign based investors are as follows:

- The rate of corporate income tax, 28% in the 2009 tax year, will increase to 30% for 2010, 2011 and 2012, then reduce to 29% for 2013, and finally revert to 28% for 2014.
- There are radical changes to the tax consolidation regime. Holding companies and their subsidiaries can file a consolidated tax return if they obtain permission from the authorities. If the consolidated result is a loss this can be carried forward for relief against future consolidated results. Intra-group dividends can flow tax-free under the regime. Tax savings generated for a group by tax consolidation are treated as a deferral, and in practice in the past the deferral has often been indefinite. Now however the deferral will be limited to five years. The new rule is that 60% of the tax deferred in year 1 will be recaptured in year 7, with a further 10% recaptured in each of the following four

years. The new system is retroactive, so 60% of the tax which a group deferred through consolidation in 2004 will be payable in 2010. Multinational groups with companies in Mexico will need to note this important change and budget accordingly.

- The rules for calculating the profits assessable to the business flat rate tax (IETU) have previously provided that any excess of deductions over receipts can be offset against the company's corporate income tax liability for the same year. From 2010 this will no longer be permitted. Any such excess may only be carried forward for future IETU relief.
- The rate of VAT is increased from 15% to 16% with effect from 1 January 2010.

THE NETHERLANDS

Tax Reductions for Income from Research and Development

Significant improvements have been made with effect from 2010 to the already favourable optional tax regime for income arising as a result of research and development expenditure.

Previously a special rate of tax of 10% applied to a capped amount of income arising from patents, the cap being equivalent to four times the amount of research and development expenditure which led to the grant of the patent, with a maximum cap of €400,000.

For the current year onwards the special rate of tax is reduced to 5%, the requirement that the income must arise from a patent is removed, and the cap on the amount of income to which the special rate applies is abolished.

The removal of the condition that the income must arise from a patent widens the scope of the regime considerably. It will now benefit also those companies which undertake research and development expenditure without intending to apply for a patent, and those which carry out such expenditure on projects where generally a patent cannot be obtained, for example the development of computer software.

A particular feature of the optional tax regime, and one which continues unchanged, is that the special rate of tax applies to income even if up to one-half of the related research and development costs consists of outsourcing to an entity in another EC state.

NETHERLANDS ANTILLES

New Conditions for Tax Exempt Status and Changes to the Participation Exemption

Parliament has approved some legislative amendments which will have retrospective effect from 1 January 2009, though a grandfathering relief is available on request to companies which complied with the rules laid down in the old legislation.

Existing structures should be reviewed to ascertain whether they will be affected by the amendments, which are as follows:

- Close companies registered in the Antilles can in some circumstances qualify for tax exempt status if their stated purpose is suitably restricted and provided their actual activities are consistent with the stated purpose. Previously companies were limited to making “investments in debt instruments, securities and deposits”. This is now extended to include “the licensing of intellectual and industrial properties and similar assets in accordance with the laws of the Netherlands Antilles or the laws of other jurisdictions”.

For a company to qualify for tax exempt status its subsidiaries outside of the Kingdom of the Netherlands must be subject to a tax regime which provides for a tax rate of at least one-half of the rate in the Antilles, currently 30%, or which appears on a list of comparable regimes to be published by Ministerial Decree.

A company can have its tax exempt status cancelled if more than 5% of its income is made up of dividends from non-qualifying subsidiaries, and for this purpose there is now a new definition of a dividend in the legislation.

- The participation exemption, previously limited to 95% of dividend income from qualifying subsidiaries in some cases, will now extend to 100% of the income if conditions are satisfied but will be limited to 70% of the income if they are not. The conditions are that the subsidiary is located in a jurisdiction with a tax rate of at least 10% and that less than one-half of the income of the subsidiary consists of royalties, interest or dividends. Income from subsidiaries which invest mainly in real estate will qualify for the exemption in full.

Capital gains from the disposal of subsidiaries will continue to be exempt.

POLAND

Interest Payable on Late VAT Refunds

Foreign companies which are due refunds of Polish VAT are entitled by law to receive them within six months, but in practice they often have to wait much longer for the money which is due to them. Some companies in this position claimed that they should be paid interest to compensate them for the delays. These claims were resisted initially by the authorities but they have now been upheld by the Supreme Administrative Court. Accordingly refunds of VAT which are made later than the six months deadline will now qualify for an interest supplement.

The ruling has retrospective effect, so foreign companies which have suffered delays in the past in receiving refunds can now consider filing interest claims.

SWITZERLAND

Major Changes to VAT Law

Although Switzerland is not a member of the EU the country nevertheless operates a VAT system, and a significant reform of the law comes into effect from January 2010, with more than 50 individual changes announced.

Included in these are a simplification of the rules for claiming input tax relief, which could lead to higher claims in some circumstances, changes to the place of supply rules, which will affect the zero-rating of services to foreign entities, and an expansion of the facility of opting to tax transactions which would otherwise be exempt, which can be beneficial for example in increasing the recovery of input tax.

Businesses registered for VAT will have new opportunities for making elections for particular treatments to apply.

Groups with interests in Switzerland would be well advised to have their VAT position there reviewed in the light of the changes which have been made.

UNITED KINGDOM

Tax Authority Gets Tough on Corporate Residence

Corporation tax, currently with a top rate of 28%, is charged on the worldwide profits of companies incorporated in the UK and of companies incorporated outside the UK but which are deemed to be resident in the UK. A foreign incorporated company is deemed to be resident in the UK if the central management and control of the company takes place in the UK.

Challenges from the tax authority HM Revenue & Customs (HMRC) that a foreign incorporated company is resident in the UK have been relatively infrequent in the past and have generally been confined to cases in which a company was set up in a zero rate tax haven but has the appearance of being operated from the UK.

Companies incorporated and paying taxes in industrialised jurisdictions abroad have usually been safe from allegations that they are resident in the UK. The top executive in HMRC has now indicated in a newspaper interview however that they are reviewing the residence position of the top companies in several large groups. This change of approach can be seen as a direct response to the moves which some groups have made to switch the official base of their operations away from the UK in the light of new rules which have been introduced for the taxation of foreign profits.

HMRC will be encouraged by their success in the recent court case of *Laerstate BV v HMRC*, in which it was held that a Dutch company was *de facto* managed and controlled from the UK and therefore liable to corporation tax on its worldwide profits.

Groups with companies that though not incorporated in the UK are to some extent administered from within the UK may wish to take advice on whether they should make some management changes with a view to avoiding a UK tax charge.

ZIMBABWE

Tax Reductions in Budget for 2010

The Budget for 2010 was presented to Parliament in December, and the provisions of particular interest to foreign investors are as follows:

- The basic rate of corporation tax is reduced from 30% to 25%.
- The rate of withholding tax on dividends, interest, royalties and technical fees paid abroad is reduced from 20% to 15%.
- The rate of withholding tax on dividends paid abroad by a company listed on the Zimbabwe Stock Exchange is reduced from 15% to 10%.

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