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EDITORIAL

Welcome to the October issue of International **TAX INSIGHT**.

In this quarter's issue we feature news of tax developments in Belgium, Canada, Gibraltar, Greece, Latvia, Poland, South Africa, Thailand and the United Kingdom (UK).

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 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

Tax Authorities Clarify the Rules for the Patent Income Deduction

The appeal of Belgium as a location for innovative companies which undertake significant research and development has been enhanced by some clarifications which the tax authorities have issued concerning the workings of the patent income deduction in the calculation of taxable profits.

The basic rule is that 80% of qualifying patent income can be left out of account for tax purposes. Belgium's corporate income tax rate is 33%, but currently there is an austerity surcharge of 3% of the tax payable, giving an effective tax rate of 33.99%. Income generated by patents and eligible for the deduction is therefore taxed at 6.8%.

This low rate is not confined to Belgian companies' income from the licensing of patents. It applies also to their profits from their products and services which are generated from the ownership of patents which they have developed.

A basic requirement in law is that the patent in question must have been developed by the Belgian company at a research and development centre in Belgium or abroad. In the past this has deterred some potential claimants in the belief that a fully autonomous research unit has been necessary. Clarification has now been issued that this is not the case. Provided there is some continuity of research work there is no minimum size stipulation. A single employee engaged in research and development can be enough for the company to qualify.

Another area of uncertainty in the law has been whether the reduced tax rate applies only to income generated through a Belgian patent or whether it applies also in the situation where a Belgian company registers foreign patents in countries in which it

markets its products. It is now clear that the latter applies, and this will increase the number of claims for the deduction.

Finally there has been some easing of the rules for determining the extent to which a Belgian company's profits from its products and services are eligible for the deduction when they are attributable to a patent which it has developed. The rule is that the deduction applies to that part of the profits which are equivalent to the income which the company would have received if it had licensed the patent to another company. Previously companies have had to supply a full transfer pricing analysis in support of their claim. It is now confirmed however that this will no longer be necessary in most cases.

CANADA

New Reporting Requirements for some Tax Planning Schemes

Canada has now followed the lead of some other jurisdictions with a proposal to require corporations to disclose to the federal tax authorities details of their more aggressive tax planning arrangements.

According to the plans which have been published for consultation the focus will be on those arrangements which amount to an "avoidance transaction", a concept which is familiar from Canada's general anti-avoidance rule and which refers to a transaction which potentially results in a tax benefit and which cannot reasonably be considered to have been undertaken other than for the purposes of obtaining that benefit.

The intention is that corporations will be legally required to file information returns on avoidance transactions if at least two out of three "hallmarks" are present, these being:

1. The promoter of the scheme, or the tax advisor, is paid a fee which is contingent on the success of the scheme in obtaining a tax benefit.
2. The promoter or adviser demands that the structure and the details of the scheme be kept confidential.
3. The corporation is provided with any form of insurance or indemnity against any failure of the scheme to achieve the tax benefit which is being sought.

Information returns must be filed by the due filing date for the tax return for the year in which the tax benefit is timed to accrue.

The new reporting regime is expected to apply to transactions entered into from 2011 onwards, as well as those entered into earlier and which form part of a series of transactions which is completed in 2011 or later.

The Department of Finance has announced that the filing of an information return will not be taken as an admission that the transaction or series of transactions is caught by the general

anti-avoidance rule, which would automatically negate the planned tax saving. However the common use of the phrase "avoidance transaction" by both the general anti-avoidance rule and by the proposed information return requirement would appear to indicate a close correlation between the two.

GIBRALTAR

Income Tax Act Completes Tax Reform Process

The Gibraltar government will this month promote through parliament a historic bill which is expected to result in a new Income Tax Act taking effect from 1 January 2011. The Act will represent the culmination of a period of transition which will take Gibraltar from its traditional status as a tax haven through to its new position as one of Europe's mainstream financial centres.

Central to the reform is the ending of the distinction between offshore business and onshore business. Previously Gibraltar companies not owned by residents of Gibraltar and not trading in Gibraltar have qualified for exempt company status, enabling them to pay only a small flat rate tax each year. This has contrasted with corporate tax rates for locally owned companies of up to 22%. The phasing out of the exempt company regime has been going on for some time, with no new ones allowed after 30 June 2006, and it will end permanently on 31 December 2010.

The new rules will provide for all companies, however owned, to be taxed on profits earned in or derived from Gibraltar. The rate of tax will be reduced from 22% to 10%, except for utility companies, and companies seen to be abusing a dominant market position, for which the rate will be 20%.

These moves will result in some Gibraltar based operations, including banks, insurance companies and investment houses, paying tax there for the first time.

For international groups however, Gibraltar will remain an attractive location for companies. As well as economic stability, strong regulation and high calibre financial personnel, there will continue to be a competitive tax environment. In addition to the new low rate, the territorial basis of tax is retained, so that companies will not be taxed on profits earned outside of Gibraltar. Interest, other than that of a trading nature, and royalties are exempt from tax, and there is no tax on capital gains. Finally, there is no withholding tax on the payment of dividends to non-resident shareholders of a Gibraltar company.

GREECE

Major Changes in Taxing Corporate Profits

The introduction of differential rates of corporate income tax for retained profits and for distributed profits is the most significant feature in a package of tax reforms which has now been approved by parliament.

There is good news for corporations (AEs) and limited liability companies (EPEs) in that the rate of tax on retained profits is set to steadily reduce over the next few years. For the current year the rate is 24%, and it will then become 23% for 2011, 22% for 2012, 21% for 2013, and 20% from 2014 onwards.

For distributed profits however there will now be a new tax charge of 40%, with immediate effect. In addition to applying to the distribution of current and future profits the charge will extend to the distribution of profits earned in earlier years, with a credit given for the tax previously paid on those profits. The payment of the 40% tax will be reflected in equivalent tax credits for the shareholders. For corporate shareholders this will ensure that there is no further tax to pay if the profits are distributed further up the chain of ownership. For individual shareholders the credit will not necessarily satisfy their income tax liability in full as the top rate of tax, on taxable income in excess of €100,000, will be 45% for 2010.

This is an important reconstruction of the corporate tax system in Greece, and international groups with trading interests there might wish to undertake an urgent review of their profit distribution policies.

Other elements of the reform package which have international implications include an increase from 20% to 25% in the rate of withholding tax on royalties paid abroad, though for payments made to intellectual property owners in countries with which Greece has a double tax treaty a lower rate may be prescribed by the treaty; and an increase from 3% to 15% in the annual tax payable by offshore companies on the value of real estate that they own in Greece.

LATVIA

Proposed Tax Credits for Substantial Investment

Proposals now under consideration by the cabinet of ministers would re-introduce tax credits to Latvia's corporate tax system following a gap of five years.

The plan, subject to the approval of parliament, is to provide manufacturing companies with an incentive to invest in new projects in the three year period 2011 to 2013. Conditions are likely to include that the investment must amount to at least LVL10m, consist of the acquisition of new industrial buildings or new production equipment, and result in the modernisation of existing production processes or the introduction of a new business activity.

For projects which qualify the intention is to grant a tax credit of 25% of the cost of the project up to LVL35m and of 15% of any cost in excess of this amount. If tax credits cannot be used because of an insufficiency of taxable profits they will be available to carry forward to future periods.

A clearance mechanism is proposed under which the authorities will consider in advance whether a planned project will be eligible for the tax credits. For qualifying projects the credits will be granted in the period in which the project is completed, and this must be not later than the end of 2013.

Latvia has a very competitive corporate income tax rate of 15%.

POLAND

Changes Announced to VAT Rates

Poland's coalition government is proposing changes in the rates of VAT with effect from 1 January 2011, with increases in the standard rate from 22% to 23% and in the preferential rate from 7% to 8%. There will be a new lower rate of 5% for basic food products, which were previously amongst the commodities charged at the 7% rate.

The proposals have still to be debated in parliament, at the time of writing, but they are expected to be approved.

Businesses have a window of opportunity to review their sales contracts before the increases take effect. If these specify prices which are net of VAT then the higher costs will fall upon the purchaser. If prices are stated as being inclusive of VAT however, then the increased rates will potentially result in reduced profits for the seller. In these circumstances it could be worth considering whether there is scope for amending existing agreements which will continue to apply into 2011, and the higher rates of VAT should also be taken into account when negotiating new contracts.

SOUTH AFRICA

New Headquarter Regime Aims to Attract Multinationals

From 1 January 2011 South Africa is set to become a favoured location for regional holding companies. Legislation now passing through parliament for a new headquarter regime will interest international groups looking for a suitable jurisdiction in which to locate an intermediate holding company for the ownership of operating subsidiaries, particularly if the subsidiaries are based elsewhere in Africa.

The benefits of having a South African resident headquarter company, if all of the conditions are satisfied, are that the dividends it receives from the subsidiaries, and any capital gains it makes from the sale of subsidiaries, will be exempt from tax, and that its profits can be distributed to its foreign shareholders free of any withholding taxes.

The conditions however are strict. A qualifying headquarter company must be owned as to more than 50% by non-residents of South Africa, it must, since incorporation, have had only shareholders who own a minimum 20% of its shares, it must, at the end of each financial year since incorporation, have had a

minimum 80% of its assets in shares in or loans to foreign companies in which it owns 20% or more of the equity, and it must, in each of those financial years, have had 80% or more of its income consisting of dividends or other income from its subsidiaries.

An additional factor which gives the proposed headquarter company regime special appeal is that South Africa has a good network of double tax treaties with other countries, providing in many cases for reduced withholding taxes on dividends paid to South African companies from their operating subsidiaries. In particular South Africa has some favourable treaties with other countries in Africa, and the potential new headquarter company tax exemptions will strengthen its claims to being a good location for regional holding companies.

One matter which has still to be resolved is how headquarter companies will be treated in the context of South Africa's exchange control laws, but the expectation is that foreign companies will be free to invest funds in such companies and to repatriate their profits from them.

THAILAND

New Tax Reductions for Regional Operating Headquarters Companies

Many international trading groups have for some time taken advantage of the favourable tax rules which Thailand provides for locally registered regional operating headquarters companies, and with changes which are expected to become effective by the end of this year these have become even more attractive.

Regional operating headquarters companies are those which provide managerial, technical or administrative support to foreign and domestic affiliated entities. In order to qualify for the special tax regime in Thailand they must have a registered share capital of THB10m or more, and they must supply their support services to affiliates in at least three other countries within five years of their registration.

For those which qualify there will now be complete exemption from corporate income tax for ten years on service fee income from foreign affiliates, and a reduced tax rate of 10% for ten years on service fee income from domestic affiliates. Previously the 10% rate applied to all such income. The general rate of corporate income tax in Thailand is 30%.

Qualifying companies which satisfy the further condition that more than one-half of their income comes from service fees and royalties from foreign affiliates will also be eligible, for ten years, for exemption from corporate income tax on the dividends they receive from foreign affiliates, and a 10% tax rate, reduced from 30%, on the interest and royalties that they receive.

As an added incentive, companies which incur operating expenses of at least THB150m in the ten years for which they qualify for these special reliefs will have them extended for a further five years.

Finally there are personal tax reliefs for expatriates working in Thailand for companies which satisfy all of these conditions. For a prescribed period they are taxed on their income at just 15%. Personal tax rates in Thailand normally range up to 37%. The prescribed period was previously the first four years of employment. This has now been changed to the first eight years of employment.

UK

Coalition Government Brings in Phased Tax Changes

In its inaugural "emergency budget" the new Conservative and Liberal Democrat coalition government has announced extensive changes to tax rates and regulations which will affect both businesses and individuals over the coming months and years. Combined with planned spending cuts they are designed to tackle the UK's excessive fiscal deficit.

For businesses the new measures include a steady reduction in the rates of corporation tax, though with reductions also in the rates of tax depreciation on plant and machinery, an increase in the rate of employers' social security contributions, though with the introduction of a geographic differential, and a significant rise in the rate of VAT.

The main rate of corporation tax, chargeable if annual profits exceed £1.5m, reduces from 28% in the tax year to 31 March 2011 to 27% in the year to 31 March 2012, 26% in the year to 31 March 2013, 25% in the year to 31 March 2014, and 24% from the year to 31 March 2015 onwards. The lower rate of corporation tax, chargeable if annual profits do not exceed £300,000, reduces from 21% to 20% from the year to 31 March 2012 onwards. If annual profits fall between £1.5m and £300,000 the tax rate is calculated on a sliding scale between the main rate and the lower rate.

The reductions in tax depreciation allowances – called capital allowances in the UK – will take effect from the tax year to 31 March 2013. Allowances are calculated on the reducing balance basis, with a percentage applied to the residual expenditure brought forward, and the percentage will reduce from 20% to 18% for plant and machinery in general and from 10% to 8% for plant which is integral to a building and for long-life assets. Businesses with large capital spending plans might wish to consider bringing them forward.

Employers' social security contributions will rise by 1% to 13.8% from next April, but the effect will be mitigated by an increase in the starting threshold. There is also a new feature, designed to

encourage employment, under which new businesses setting up outside of London and the south-east will be exempt from paying the first £5,000 of contributions for each of the first ten employees they hire in their first year of trading.

Finally the main rate of VAT is to increase from 17.5% to 20%. This will raise considerable revenue, and it is unhappy news for those organisations which are unable to recover their input VAT, for example those making exempt supplies, and charities. The start date has been deferred to 4 January 2011, so businesses have at least been given time to make the necessary changes to their systems.

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