Argentina

Changes introduced to the list of cooperating countries for tax transparency purposes and to the list of low and zero tax jurisdictions

On 31 May 2013 Argentina decided to introduce changes to the list of low and zero tax countries. From now on, it will issue a list of “countries that cooperate for tax transparency purposes”.

As a result, the special treatment afforded by the income tax law to transactions with certain countries shall apply when such a country does not form part of this new and changing list.

Definition of “cooperating country for tax transparency purposes”
The phrase “cooperating countries for tax transparency purposes” is defined to include those countries, jurisdictions, territories, associated States or special tax regimes that have entered into Tax Information Exchange Agreements or Double Tax Conventions which include a broad information exchange clause with Argentina, provided that such information exchange becomes effective.

To be considered a cooperating country for tax transparency purposes, the government of any such country should at least have started negotiations with Argentina in order to enter into a tax exchange information agreement or a convention for the avoidance of double taxation including a broad information exchange clause.

Agreements and Conventions: aspects to be complied with
The agreements and conventions referred to above should meet all international transparency standards adopted by the Global Forum on Transparency and Exchange of Information for Tax Purposes. By application of the domestic legislation of the respective countries, jurisdictions, territories, associated States or special tax regimes, no bank, stock exchange or other type of secrecy legislation can be claimed in response to any specific request for information submitted by Argentina.
Any of the following events shall trigger the loss of cooperating country status for tax transparency purposes:

- withdrawal of the agreement or convention
- cessation of application of the agreement or convention because of nullity or termination provided for under other international agreements, or
- lack of actual exchange of information.

New powers attributed to the Argentine Revenue Administration (AFIP)
The AFIP is empowered to prepare the list of countries, jurisdictions, territories, associated States and special tax regimes considered as cooperating status for tax transparency purposes and will publish it on [www.afip.gov.ar](http://www.afip.gov.ar).

The AFIP will also analyse and assess compliance with tax information exchange agreements, agreements to interchange tax information and agreements to avoid double taxation with broad tax information exchange clauses.

Tax effects of transactions with persons resident in zero and low tax jurisdictions
Below we describe some of the tax implications of certain transactions carried out with persons residing in zero and low tax jurisdictions.

- **Transfer pricing**
  Transactions between local companies and persons domiciled, organised or located in low and zero tax jurisdictions are not deemed to meet the arm's length principle even if there is no economic, legal or functional relation between the parties.

  Therefore, transfer pricing rules will apply to such transactions and hence their pricing should be justified by applying the methods provided under transfer pricing regulations and subject to compliance with relevant duties and formal requirements.

- **Income tax withholding applied to interest on foreign loans**
  Interest paid on receivables, loans or fund investments obtained from a bank or financial entity established in a country considered to be a low or zero tax jurisdiction shall be presumed to be net income subject to a withholding tax of 35% where the borrower is resident in Argentina (but excluding financial entities).

- **Deduction of expenses invoiced by foreign persons**
  Payments made by Argentine companies which are considered to be Argentina-source income of persons residing in zero or low tax jurisdictions, shall be deducted for tax purposes only when the payment is made, not when it is accrued.

- **Presumption of unjustified increase in assets**
  Increases in funding resources from zero and low tax jurisdictions shall be deemed to be unreported income for a borrower residing in Argentina. Hence, such unreported income plus 10% - considered to represent non-deductible expenses – shall be treated as net income for the fiscal year in it is received.

  The Argentine Revenue Administration shall accept that the increase in resources is justified where the taxpayer can effectively demonstrate it was sourced from activities carried out by the taxpayer or third parties in such countries or that it derives from investments abroad that were duly reported.

- **Residents in Argentina who are holders of shares in companies located in low and zero tax jurisdictions with interests in Argentine companies**
  Dividends received by Argentine residents in respect of shareholdings they hold in companies organised abroad who, in turn, have investments in companies organised in Argentina are excluded from taxable income in Argentina unless the foreign company is located in a low or zero tax jurisdiction.

- **The so-called “passive income” of companies located in low or zero tax jurisdictions and its implications for Argentine-resident shareholders**
  Argentine residents with shareholdings in companies located in low or zero tax jurisdictions which derive passive income in sizable amounts, shall be liable to income tax on these amounts in the fiscal year coinciding with the fiscal year end of the company that has accrued such income, irrespective of whether the amounts have been received by the shareholder.

Contributed by
Roberto Murmis, Abelovich, Polano & Associates S.R.L,
Argentina
rmurmis@estabe.com.ar
Tough new rules on tax avoidance and profit shifting

Changes to the Australian transfer pricing rules and the Part IVA anti-avoidance regime contained in the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 were passed into Law on the 25 June 2013.

The changes to the transfer pricing rules are effective as from 1 July 2013, while the Part IVA changes will apply to schemes entered into as from the 16 November 2012, being the date of the release of the exposure draft legislation.

The Government expects the changes to Part IVA and the transfer pricing regime to prevent losses to the tax revenue base of over AUD1 billion per year. Needless to say, it remains to be seen just how effective these measures will be.

Amendments to Part IVA
In general terms, the anti-avoidance provisions of Part IVA apply when the following requirements are met:
1. There must be a scheme
2. A taxpayer must obtain a benefit in connection with that scheme
3. One or more of the taxpayers who participated in the scheme, or part thereof, did so for the sole or dominant purpose of obtaining a tax benefit in connection with the scheme.

The Courts have found that where the three requirements are met, the Commissioner of Taxation can cancel the tax benefit. The amendments to the provisions arise from concern on the Government’s part (driven by the Commissioner) that recent Court decisions, in favour of the taxpayer, particularly concerning the tax benefit test had resulted in an unacceptable narrowing of Part IVA’s application.

The amendments now provide rules to be applied in any analysis of whether a tax benefit has been obtained in connection with a scheme. The amendments are intended to give weight to the purpose test as the fulcrum around which Part IVA operates.

Unfortunately, it is not clear when it will be appropriate to apply the “would have” test rather than the “might reasonably be expected to have” test. The Explanatory Memorandum to the Bill indicates that the “would have” test might generally apply where the particular scheme has no other commercial or economic consequences other than tax. It also indicates that the “might reasonably be expected to have” test will apply where there were real commercial or economic consequences arising from the scheme, such that the relevant events need to be reconstructed to reveal that tax was avoided.

The amendments now confirm that the application of Part IVA starts with a consideration of whether a taxpayer participated in the scheme for the sole or dominant purpose of securing a tax benefit. The amendments are intended to give weight to the purpose test as the fulcrum around which Part IVA operates.

The amendments mean that establishing the purpose of the taxpayer will be of greater importance and will require the determination of purpose and whether or not there has been a tax benefit realised, to be considered together. Considering the importance of evidence and the increasing focus of the Commissioner on a more detailed analysis of possible reconstructed alternatives, it will be incumbent on taxpayers to ensure their position is fully documented.

Transfer pricing
The transfer pricing changes introduced by the Bill, re-engineer Australian transfer pricing law for international business transactions and will impact greatly on companies’ transfer pricing governance.

The changes are accompanied by the Australian Taxation Office’s (ATO) establishment of an anti-profit shifting taskforce and an announced significant increase in investigations of multinational corporations operating in Australia. The changes are the first significant overhaul of Australia’s transfer pricing rules in over 30 years.

The new laws focus on an arm’s length profit and profit allocation and not on transactional pricing, with new broad powers for the Commissioner to replace actual arrangements with deemed arrangements, which have the potential to unwind and reconstruct transactions. The conditions between international related parties must be consistent with those that would have been in place between unrelated parties in

Australia
comparable circumstances, otherwise the reconstruction provisions can apply.

The new laws provide for a self-assessment regime for businesses but have much stronger documentation requirements. Without documentation, a taxpayer will not have a “reasonably arguable position” and will therefore be exposed to tax penalty risks. Unfortunately, at this stage, there is limited guidance as to what the documentation must contain for a taxpayer to have a “reasonably arguable position”.

This has created problems now that the onus falls upon an entity’s Public Officer who must determine whether or not the entity has complied with the new laws before signing and lodging the entity’s Australian income tax return.

The new laws also provide for arm’s length interest rates to be applied to inbound related party debt, based upon rates that would have applied to notional arm’s length amounts of debt. Furthermore, the new laws also provide for a seven year time limit on the Commissioner’s ability to amend assessments to give effect to any transfer pricing adjustments.

The new laws must also be applied to best achieve consistency with the OECD’s transfer pricing guidelines.

The ATO have indicated that their initial focus on compliance with the new laws will be directed towards companies that have deliberately restructured their operations to route profits through low tax jurisdictions or tax havens, particularly where this involves offshore hubs with little substance.

Also, the new laws seem to have been drafted to allow the ATO to treat the regular incurrence of losses by an Australian entity as an indication that non arm’s length conditions exist, whether or not these losses arise from third party or even domestic transactions. This adds to the difficulties faced by a taxpayer, as the ATO is seemingly taking the position that the losses are due to non-arm’s length transactions, leaving the taxpayer to argue otherwise.

There is no doubt the changes give multinationals new challenges when dealing with transfer pricing issues in Australia meaning that it is now more important than ever to ensure their pricing and financial outcomes reflect arm’s length commercial conditions.

Contributed by
Stephen Rogers, Nexia Australia, Australia
srogers@nexiacourt.com.au

Belgium

Belgian notional interest deduction: EU conviction pending

The so-called “notional interest deduction” has proven to be an innovative tool in international tax law enabling all companies subject to Belgian corporate income tax to deduct from their taxable income fictitious interest based on their shareholder’s equity (net assets).

The main purpose of the deduction is to reduce the tax discrimination between debt financing and equity financing. The rule also intended to reduce the effective corporate tax rate and promote capital intensive investments in Belgium and attract activities such as intra-group financing, central procurement and factoring. Please note that this deduction applies to companies subject to corporate income tax (Belgian companies) or non-resident corporate income tax (Belgian permanent establishments of foreign companies).

The calculation of the tax deduction starts from the so-called “qualifying equity”, ie the equity as stated in the statutory accounts minus certain amounts. One of these amounts is the net equity assigned to foreign permanent establishments situated in a country with whom Belgium has concluded a double tax treaty.

In an earlier edition of this newsletter, we commented on the concerns that the EU Commission and certain tax payers expressed regarding the exclusion of the “equity” of the foreign permanent

Belgium
establishments. This tax payer revolt is commonly known as “the Argenta Case”, claiming that the companies opening Belgian establishments are treated differently than companies opening foreign establishments.

On 4 July 2013 the European Court has ruled that the aforementioned exclusion mechanism is a violation of Community Law, especially the right of free establishment. By doing so, the European Court followed the vision of the Advocat General as expressed on 19 September 2012. To avoid any misunderstandings we note that, regardless of the Court ruling, the net asset base of foreign permanent establishments outside of the European Union remain under the exclusion rule (unless the upcoming legislative initiative of the Belgian government is more benevolent). The right of free establishment does not apply with non-EU countries.

As EU Court Decisions are regarded as “a new fact”, it allows tax payers to file formal complaints on prior year’s assessments. Procedural details would lead us too far, but this is surely a blast of dynamite not only for Belgian tax practices but especially for cross-border tax planning practices. Furthermore, the Belgian Ministry of Finance is currently examining how the legislation could be amended to make it EU compliant.

Please note that apart from the foregoing Court Case, there is a second procedure running against the Belgian State (by the European Commission and not by a specific tax payer) fighting another exclusion mechanism. Under the current legislation, the book value of real estate lying outside of Belgium also needs to be deducted from the equity. Taking into consideration “the Argenta case”, it cannot be excluded that in the coming months, a second conviction follows. It would be to his credit if the Belgian Minister of Finance would tackle both issues in one and the same legislative initiative. Let us hope that governments are now able to act decisively and not just one step at a time.

Contributed by:
Filip Viaene, VGD, Belgium
filip.viaene@vgd.eu

China

Clarifications of permanent establishment creation by non-resident foreign entities: SAT announcement 19, 2013

In September 2010, China’s State Administration of Taxation (SAT) recently released Announcement 19 [2013] (“Announcement 19”), Issues Relating to Collection of Corporate Income Tax on Labour Services Provided by Personnel Dispatched by Non-resident Enterprises Within the Territory of China. Announcement 19 not only discusses the conditions under which a PE is created, but also provides guidance to local tax bureaus as to the documentation they should review in making PE determinations. In the following discussion, it should be noted that the terms of China’s tax treaties remain intact, as do the terms of tax agreements with Hong Kong and Macau.

PE creation related to employees dispatched by NRFEs

In general keeping with the provisions of the 2008 EIT law and Circular 75, Article 1 of Announcement 19 clarifies the two basic criteria that dictate whether a PE is created when an NRFE dispatches employees to provide labour services in China. The NRFE shall be deemed to have PE in China if: 1) the NRFE assumes some or all of the liabilities and risks for the dispatched employees’ work; and 2) the NRFE assesses the dispatched employees’ work performance under normal circumstances. Also, and consistent with statements in China’s tax treaties, Article 1 states that if the NRFE is from a country that is party to a tax treaty, if the office or premises for the provision of dispatched employees’ labour services is relatively fixed and permanent, a PE is created.

Article 1 of Announcement 19 goes on to list the specific factors that local tax officers shall consider when judging whether or not a PE has been created by the presence of NRFE employees under the two basic criteria given above, as including:

A. The China entity receiving the labour services making payments such as management fees or service fees to the dispatching NRFE
B. The payment made by the China entity to the dispatching NRFE exceeds the wages, salaries, social security contributions and other costs borne by the dispatching NRFE
C. The NRFE reserves a portion of the payments made by the China entity, rather than passing all of the received funds to the dispatched personnel
D. Individual Income Tax (IIT) on the wages and salaries paid by the NRFE to its dispatched personnel is not levied in full in China
E. The dispatching NRFE determines the number of dispatched personnel, as well as the dispatched employee qualifications, remuneration criteria and work location in China.

If one or more of these specific factors is present, it may be deemed that the basic criteria have been met, and the NRFE would thus be considered to have created a PE in China. Note that if a tax treaty is in place, the dispatched employees usually must be present in China for a period of six months (90 days if no treaty exists), but other
conditions do apply, as per the tax treaties and previously issued SAT circulars.

If an NFRE is judged as having a PE, the NFRE shall be liable for EIT filing and payment as related to income received as a result of the service provision by its employees. The NFRE must go through all formalities involved in the EIT declaration process. Generally according to the rules, the NFRE shall pay EIT on an actual basis and maintain accurate records to substantiate its claims. However, in practice, tax bureaus do not allow an NFRE to register for tax declaration purposes on its own behalf, so it is usually the responsibility of the China entity to make the tax declaration on behalf of the NFRE. If accurate accounting records are not maintained by the NFRE (or not made available to the China entity that makes the tax declaration), the tax authority in charge shall deem the NFRE profits according to the service fees charged by the NFRE and the applicable existing regulations. In this case, the China entity acts as withholding agent and is required to withhold any applicable taxes when paying for the services rendered by the NFRE.

Article 2 of Announcement 19 provides that where an NFRE dispatches its personnel to China for the sole purpose of exercising the shareholder’s rights and protecting its legitimate rights and interests in the China entity, the NFRE shall not be deemed as establishing its office, premise or a permanent body in China, even if the employees’ activities take place in the business premises of the China entity. The exercise of shareholder’s rights includes activities such as providing suggestions related to the investment in the China entity, or attending the general meetings of shareholders or the board of directors on behalf of the dispatching NFRE.

Documents examination in determination of a PE
In the determination of whether or not a PE exists as a result of NRFEs dispatching employees to China, Article 5 of Announcement 19 instructs local tax authorities to review the following documents:
A. The contracts or agreements executed between the NFRE, the China entity and dispatched personnel
B. The rules for management of the dispatched personnel by the NFRE and/or the China entity, including specific responsibilities, job descriptions, performance appraisals, risk-taking and other aspects
C. All relevant accounting records, including payments made by the China entity to the NFRE, as well as the IIT declaration and payment records for the personnel dispatched by the NFRE
D. Other documentation as needed to determine whether or not the China entity has made “hidden payments” such as offsetting transactions, abandoning claims or forgiving debts, and other related-party transactions.

In line with the review of such information that may be related to the dispatch of employees by a NFRE, communications between various China agencies are being strengthened and shall be used to determine the tax status of dispatched employees, whether or not business tax or Value Added Tax has been paid in transactions between the NFRE and the China entity and other such records as needed to make determinations.

The release of Announcement 19 provides further evidence that China’s SAT is continuing to step up its efforts to collect its fair share of taxes when foreign entities earn income from doing business in China. Additionally, the clarifications in the document may help to bring more uniformity across China’s local tax bureaus in the application of regulations in determining when a PE exists, which should be of benefit to NRFEs. Of further benefit to NRFEs, it is not only clear what criteria shall be used in determining the creation of a PE when they dispatch employees to China, but also the types of documentation that should be created and maintained.

As is most often the case when new announcements, regulations and implementation rules are released, not all questions are answered. Thus, even as China authorities attempt to provide for uniform application of policies by all local branches of the various ministries, much remains open to interpretation at the local level. In all cases, we advise our NFRE clients to err on the side of caution and to minimise risk by creating and maintaining all necessary documentation related to their activities in China. This includes use of detailed service agreements, employment contracts, accounting records and other documents that may help to substantiate claims. Remember, when an NFRE makes any claim with a government agency in China, the burden of proof always falls on the NFRE.

Contributed by
Scott Heidecke and Lam Fong Kiew, Nexia TS Tax Services Pte. Ltd., Shanghai, China
scott@nexiats.com.cn and lamfongkiew@nexiats.com.sg
Greece

2013 tax reform

Towards the end of July 2013 two major legislative acts concerning the Greek tax system were introduced: L. 4172/2013 introduces a new Income Tax Law which will be applicable as from 1 January 2014 and L. 4174/2013 introduces a new Code of Tax Administration Procedures. A third legislative act covering real estate taxation and tax incentives for investments is expected within the autumn of 2013 to conclude the last pillar of the tax reform expected for Greece.

The new Tax Law does not bring any changes to the basic tax rates for individuals or corporations, but it is governed by an entirely novel (to Greece) philosophy of general principles and rules as opposed to detailed case by case regulation. This new approach does create some legislative and administrative gaps and explanatory circulars are expected before the end of the year.

For the first time, concepts of the International Tax Law are introduced in the Greek tax legislation such as the definition of tax residency for legal entities, the place of effective management and the concept of Controlled Foreign Companies. Strict requirements for Transfer Pricing Documentation are set as are an annual disclosure to the tax authorities of a Summary Information document providing details on transactions (amounts, transaction type and documentation method) per related party. The Tax Consolidation Group for income tax or VAT purposes has not yet been introduced in Greece.

The main provisions of the Tax Law concerning corporate taxation, are summarised below:

**Legal persons or legal entities**
The definition of entities subject to corporate tax broadens to include any form of organisation, corporate or not, irrespective of legal personality and profit or non-profit making character, such as associations, organisations, offshore companies, trusts or foundations or any form of similar nature, joint ventures, any form of civil law company, participating or “shadow” companies, civil law associations.

Entities are considered to have their tax residence in Greece if any of the following conditions are met, at any period during the fiscal year:

a) They are incorporated or established under Greek Law, or
b) They have their registered address in Greece or
c) They have the effective place of management in Greece (excluding shipping companies). There are indicative, but not exhaustive, criteria to be taken into account by the tax authorities, such as the place where the day-to-day management is located, the place of taking strategic decisions, the place of the annual general meeting of the shareholders, the place where the Board of Directors or any other Executive governing body hold their meetings, the place where the books and records are kept. It is stated that the place of tax residency of the majority of shareholders or partners, can be also be taken into consideration for determining the place of effective management.

As regards the definition of a permanent establishment (PE), this is amended to be in line with Article 5 of the OECD Model Convention on the Double Tax Treaties, with the exception of time allowed for a construction site to constitute a PE in Greece, which is limited to three months instead of 12 months, as suggested by the OECD Model Convention.

**Corporate tax rate**
The corporate tax rate is 26%, regardless the legal type of the entity. Small business entities (mainly personal companies or associations with turnover below EUR1.5 million) opting for not keeping double entry books are taxed at 26% for profits up to EUR50,000 and at 33% for exceeding amounts.

The withholding tax on dividends or profits distributed is 10%, limited to 0% when the parent company is a tax resident of another EU member state and holds a participation of at least 10% for more than 24 months.

**Interest deductibility – thin capitalisation rules**
The conditions and tests on the deductibility of interest expenses and thin capitalisation are radically amended. Interest expense on loans undertaken between third parties (regardless if they are related or not), except for bank loans is deductible to the extent that the interest does not exceed the interest if calculated at the interest rate for credit lines to
non-financial corporations at the date closest to the loan contract date, as shown at the Statistical Bulletin of the Central Bank of Greece.

Thin capitalisation rules no longer look at the debt to equity ratio of 3:1, but to EBITDA. Moreover, from the wording of the law, it is not specified that the new thin cap rules are applicable only for loans from related parties. It seems that it is applicable to all loans, including loans from banks. Explanations are required also as to whether the new rule is applicable for loans undertaken as from 1 January 2014 or for existing loans as well.

In particular:
• thin capitalisation is determined in relation to the taxable profits before interest, tax and depreciations (EBITDA). It is provided that interest expense is not deductible to the extent that the surplus of interest expenses over interest income exceeds 25% of EBITDA
• an exception from the restriction on deducting interest expense is provided where the enterprise is not part of a group and the amount of net interest expense does not exceed EUR1 million per year
• the excess interest expense can be carried forward for five consecutive years.

Tax losses
The general rule is that tax losses are carried forward for five years. The new law introduces anti-avoidance limitations such as the non-recognition of losses carried forward for set-off where there is a change in ownership above 30% unless the company proves that the change of ownership was made merely for business or commercial purposes and not for tax avoidance or tax evasion.

Losses arising from foreign sources are not taken into account for the computation of taxable profits or against future profits with the exemption of income arising in other EU or EEA Member States, provided that they are not exempt from tax under double tax treaties.

Local or cross-border group restructuring
The Merger Directive and the Cross-border change of registered address within EU had been adopted into Greek legislation, but these provisions are now integrated in the tax law and also cover Greek companies restructuring and in particular the contribution of assets in return of shares, the exchange of shares, mergers and demergers or business sector(s) spin-offs, as well as the transfer of the registered address of a Societas Europaea out of Greece to another member state.

• it is explicitly provided that the transformation of a branch into a subsidiary company is considered as a contribution of assets
• it is clarified that in the case of a contribution of assets or merger or spin-off, the recipient company will calculate the depreciation of the assets according to the rules that would have been applicable for the contributing company, had the contribution of assets or merger or spin-off not taken place
• the receiving company is granted the option of receiving the tax loss of the contributing company
• the receiving company is granted the option to receive provisions and tax free reserves of the contributing company

• it is explicitly specified that in the case of a contribution of assets, the contributing company values the titles transferred to the recipient company at their market value at the time of the transfer, even though the respective capital gains are not taxed at the time of the contribution. The law, however, does not specify the time of taxing the capital gain, eg in case of capitalisation or distribution
• it is clarified that the favourable provisions concerning the contribution of assets, mergers, spin-offs etc. of companies incorporated in the EU, are only applicable if the contributing company and the recipient company are tax resident in Greece and/or another EU Member State
• it is clarified that liquidation proceeds are considered to be a distribution of profits during the tax year in which the liquidation of the legal person/entity was completed, to the extent that the proceeds exceed the paid in capital
• it is explicitly mentioned that the arm’s length principle should apply to Greek and cross-border business restructuring (transfer of business) making a direct reference to the general principles and OECD guidelines on intra-group transactions and transfer pricing.

Anti-avoidance provisions - CFCs
There are numerous provisions referring to tax avoidance and concepts introduced for the first time.

The provisions for the disallowance of costs and expenses incurred by legal entities or individuals who are residents of non-cooperative countries or countries with a “privileged tax regime”, are maintained, unless the tax payer can prove that the transactions reflect actual and usual business transactions and do not result in the transfer of profits, or income, or capital, with the aim to avoid or evade taxes in Greece. “Privileged tax regimes” include countries who are members of the EU or EEA with effective tax rates below 50% of the corresponding Greek tax rates and they will be included in a list to be issued by the Greek Minister of Finance in January each year.

The benefits connected to local or cross-border business restructuring are cancelled where those actions are not driven by valid business purposes, but have tax evasion or tax avoidance as their main objective.

A Controlled Foreign Company definition applies for the first time in Greek tax legislation and rules are set. These rules provide for the inclusion in the taxable income of the Greek taxpayer (individual or legal entity) of “passive” income “resting” undistributed in other jurisdictions, provided the following conditions are all met:
• the taxpayer, his/her own or jointly with related persons, holds, directly or indirectly, more than 50% of the shares, participation or voting rights in the capital of the said entity or is entitled to receive more than 50% of the profits of the said entity
• the above legal entity is subject to taxation in a non-cooperative state or in a state with a “privileged” tax regime
• it is not a public/listed company
• more than 30% of the net income before taxes realised by the
legal entity falls in one or more of the following categories:
1. interest or any other income generated from financial assets,
2. royalties or any other income generated from intellectual property
3. income derived from dividends and the transfer of shares
4. income derived from movable assets
5. income derived from real estate property, unless the Member State of the taxpayer entity would not be entitled to tax such income according to an agreement concluded with a third country
6. income derived from insurance, bank and other financial activities.

An exemption is provided where the CFC is tax resident in an EU or EEA Member State and an agreement for the exchange of information, as provided by Directive 2011/16/EU exists, unless the establishment or financial activity of the legal entity constitutes an artificial arrangement created for tax avoidance purposes.

Contributed by
Eleni Kaprani, Eurostatus S.A., Greece
ekaprani@eurostatus-nexia.gr

Poland

New regulations on transfer pricing have entered into force

On 18 July 2013 new provisions relating to transfer pricing were introduced into Polish tax law. The aim of the amended Ordinance of Ministry of Finance regarding corporate and personal income taxes in the scope of estimating prices for transactions between related entities is to adjust the existing Polish tax regulations to bring them more into line with recent changes in worldwide standards, especially those developed by the European Union Joint Transfer Pricing Forum and those set out in the OECD Guidelines on Transfer Pricing for Multinational Enterprises and Tax Administrations.

The amendment provides significant clarification to issues which till now were not directly regulated by Polish law, which had caused a great number of doubts and difficulties to taxpayers. That is why taxpayers’ attention should be drawn to the provisions regarding transfer pricing, specifically to those issues mentioned below.

Business restructuring
According to the new provisions, restructurings (both on the domestic and the international level) should be understood as any transfer of economically relevant functions, risks or assets between related entities. The tax authorities should analyse whether a restructuring activity performed by related parties is an “arm’s length” transaction. When undertaking the analysis, the following conditions should be considered: (i) the business justification for the restructuring, (ii) the expected benefits for the parties involved and (iii) the realistic options available for the related entities engaged in the restructuring process. Based on the new regulations, the tax authorities have the right to examine whether a particular taxpayer engaged in a restructuring should receive any remuneration related to such activities and whether a relevant amount was allocated correctly. Implementation of the said provisions concerning business restructuring indicates that, starting from now on, the tax authorities will pay more attention to the evaluation of such transactions in the light of the transfer pricing regulations, whereas, up to now, they were not de facto that interested.

Low value adding services
“Low value adding services” is a new term introduced into the Polish regulations relating to transfer pricing. It includes services having a routine nature and solely supporting the performance of the taxpayer’s main activity and consequently, does not bring any extra value to any party of a given transaction. The following may be considered as such services: simple IT support, HR advisory, quality control, marketing, legal, accounting or administrative services (a sample catalogue enumerating low value added services can be found in the Ordinance). According to the Ordinance, the documentation of such services will be simplified. In addition, the scope of their verification shall be limited.

Shareholders’ costs
Amendments to the scope of low value added services are linked with another change introduced by the Ministry of
Finance – a definition of a shareholder’s expenditure, ie shareholder’s costs which are only of benefit to the shareholder (eg amounts spent on holding the shareholders’ general meeting, management activities etc). Under the Ordinance such expenditures shall be excluded from the cost base when calculating remuneration for services provided. In order to avoid additional queries, the legislator has provided a sample list of shareholder’s costs. Still, the list should not be regarded as a comprehensive one.

Choice of the method of estimating income
According to the revised Ordinance of the Ministry of Finance a hierarchy of methods for estimating prices no longer exists. The comparable uncontrolled price method should no longer be the tax authorities’ first choice when estimating taxpayer’s income. As a result, it is the most suitable method for the given circumstances that should be applied by the tax authorities.

Division of profits and losses
The Polish Ministry of Finance has clarified the manner of applying the method for the division of profits and losses, in what can be regarded as a positive response to the OECD recommendations for tax administrations in terms of popularisation of the above method. The new provisions give no space for misinterpretation – both profits as well as losses incurred in relation to relevant transactions are being divided.

Comparability analysis
Moreover, the amendment specifies rules for the tax authorities on how they should apply the comparability analysis. It seems that knowledge of these guidelines should strongly improve the level of preparation of transfer pricing documentation, especially in terms of the descriptions used in the functional analysis, as well as the method and manner for calculating transfer prices. However, it can also cause an additional risk to those taxpayers who do not adjust their transfer pricing documentation in accordance with the guidelines. In such cases the tax authorities may not admit the documentation, as not meeting legal standards.

Tri-party Agreements
The new regulations implemented also provide possible dispute resolution procedures to avoid double taxation including three countries.

Analysis of the changes
It is worth mentioning that, in practice, despite the lack of specific legal provisions, Polish taxpayers have already somehow introduced the OECD guidelines into their transfer pricing policies in the past, as it was their way of dealing with the loopholes in the law existing at that time. Nevertheless, the new regulations will require taxpayers’ to adjust their tax policy for transfer pricing and to include the revised provisions in preparing future transfer pricing documentation.

The amendment introduces substantive provisions and accordingly, there is a risk that it will affect both tax procedure and control. The tax authorities may adopt a formal interpretation of the provisions, consequently requiring taxpayers to present documentation that fulfils the requirements set in the currently binding transfer pricing regulations.

The good side is that the implemented changes may be considered as a slight hint, when it comes to predicting what areas may soon fall into the tax authorities’ specific circle of interest. As a result, taxpayers have been given time to make improvements in previously prepared transfer pricing documentation to bring it into line with the Ordinance.

Contributed by:
Katarzyna Klimkiewicz-Deplano, Advicero Tax Sp. z o.o., Poland
kklimkiewicz@advicero.eu

Romania
Permanent establishment - new rules in Romania
On 1 July 2013 new regulations were introduced as amendments to the Romanian Fiscal Code in respect of the fiscal status of permanent establishments (Law no. 168/2013 that approves Government Ordinance no. 8/2013).

The provisions of this Law came into effect from 1 June 2013, with the exception of those provisions related to the consolidation of the fiscal results of permanent establishments which will enter into force from 1 July 2013.

From 1 July 2013, non-resident legal entities carrying out their activities in Romania through several permanent establishments (PEs) shall establish one of the permanent locations as the permanent location designated to meet tax obligations (PE). The PE designated by the non-residents shall consolidate the
income and expenses for all their PEs in Romania.

Before this date, each permanent establishment of the same foreign entity had separately declared its fiscal result and paid or carried out the fiscal loss on an individual basis. The result was that a permanent establishment of a foreign entity could have paid corporate income tax and another permanent establishment of the same foreign entity may have had a loss that it could not use immediately. Several Court cases had been launched on this subject but no local regulations were available.

Following this new fiscal regulation all existing PEs were required to close their current fiscal period by 30 June 2013 and to calculate, declare and pay their corporate income tax for the period 1 January 2013 - 30 June 2013, no later than 25 July 2013. Tax losses incurred in previous periods which have not been recovered as of 30 June 2013 will be transferred to the designated PE and will be recovered in the remaining periods, as follows:

• the loss incurred for the period 1 January 2013 - 30 June 2013 will be taken into consideration when calculating the fiscal result for the period 1 July 2013 – 31 December 2013, the second half of 2013 is not regarded as a separate fiscal period
• 2013 will be regarded as one fiscal year for the purpose of recovering the losses incurred prior to 2013.

The taxable income at the level of the designated PE shall be determined using transfer pricing rules when identifying the market price of a transfer made between the foreign legal person and its PEs. When the PE does not have an invoice for the expenses allocated by the main office, the other supporting evidence must include information concerning the actual costs and reasonable allocation of these costs to the PE using the transfer pricing rules.

Where there is already fixed headquarters in Romania that satisfy the fiscal obligations related to VAT and at the same time represents a PE for the purposes of corporate income tax, it will become the designated PE under these new rules.

Penalty percentage for transaction in a country with which Romania has not concluded a treaty for the exchange of information - new rules in Romania

A 50% tax rate is applicable from 1 February 2013 for income received in a country with which Romania has not concluded a treaty for the exchange of information, as provided under the law, but only if the income is received in relation to transactions that are classified as artificial under the provisions of Article 11 (1) of the Fiscal Code.

As provided under GO 8/2013, artificial transactions mean transactions or a series of transactions that have no economic effect and would not normally be used in the context of normal business practices, their main purpose being to avoid taxation or obtain tax advantages that otherwise could not be granted.

Withholding tax will apply to income derived by non-residents from services “of any type” rendered in Romania, as well as services rendered outside Romania, the latter being limited to “management services, consultancy in any field of activity, marketing services, technical assistance services, research and design services in any field of activity, advertising services irrespective of the form in which they are realised, as well as services rendered by lawyers, engineers, architects, notaries, accountants and auditors”. Income derived from international transport and ancillary services are non-taxable.

Contributed by
Luminita Ristea, CRG Nexia, Romania
luminita.ristea@crgnexia.ro
Singapore’s competitive tax regime

Singapore has a very favourable tax regime, to attract both inbound investment into Singapore, as well as to encourage outbound investment.

Many factors have contributed to this tax-friendly environment and this article examines some of the more pertinent ones.

Singapore adopts a modified territorial basis of taxation, i.e., taxpayers in Singapore are assessed on income of a revenue nature that is sourced in Singapore and foreign sourced income that is sourced outside Singapore but received in Singapore.

Foreign sourced dividend income, foreign sourced branch profits and foreign sourced service income are accorded tax exemption under the foreign sourced income exemption (FSIE) scheme provided that the following conditions are met:
1. the headline tax rate of the foreign jurisdiction from which the income is received is at least 15%
2. the income is subject to tax in the foreign jurisdiction from which it is received
3. the Inland Revenue Authority of Singapore (IRAS) is satisfied that the tax exemption will be beneficial to the person resident in Singapore.

Where the above conditions are not met, it is possible to apply for exemption with the IRAS on a case-by-case basis. Where the Singapore resident recipient of the income is not entitled to the FSIE scheme, the resident company may still claim bilateral or unilateral tax credits for the tax suffered on such foreign sourced income.

Apart from its low headline corporate tax rate of 17% which is significantly lower than most countries, there is also an extensive list of tax incentives designed to further reduce the already low headline corporate tax rate. There are two categories of tax incentives, being administered by:
- The Singapore Economic Development Board under the authority of the Economic Expansion Incentive (Relief from Income Tax) Act
- various other governmental bodies granted under the Singapore Income Tax Act (SITA).

Examples of Singapore’s tax incentives include the:
- Financial Sector Incentives Scheme
- Headquarters (HQ) Programme (which comprises of the Regional Headquarters (RHQ) tax incentive and International Headquarters (IHQ) tax incentive)
- Global Trader Programme

Even without special tax incentives, the effective corporate tax rate is significantly lower than 17% for companies with low chargeable income, after taking into account the full and partial tax exemption for chargeable income below SGD300,000. To top it up, there is a further 30% corporate income tax (CIT) rebate, capped at SGD30,000, for the Years of Assessment 2013 to 2015.

As an illustration, if a company’s chargeable income is SGD800,000, its effective tax rate is only 10%. A qualifying new start-up company’s effective tax rate for the same chargeable income is even lower at 9% for the first three years after incorporation.

<table>
<thead>
<tr>
<th>Chargeable income before exemption</th>
<th>Partial exemption SGD</th>
<th>Full exemption SGD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exemption</td>
<td>(152,500)</td>
<td>(200,000)</td>
</tr>
<tr>
<td>Chargeable income</td>
<td>647,500</td>
<td>600,000</td>
</tr>
<tr>
<td>Tax @ 17%</td>
<td>110,075</td>
<td>102,000</td>
</tr>
<tr>
<td>Less: 30% CIT rebate (Capped at SGD30,000)</td>
<td>(30,000)</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Net tax payable</td>
<td>80,075</td>
<td>72,000</td>
</tr>
<tr>
<td>Effective corporate tax rate</td>
<td>10%</td>
<td>9%</td>
</tr>
</tbody>
</table>
There is no capital gains tax regime in Singapore. Gains from the disposal of investments would ordinarily constitute capital gains if the company disposing of these investments can substantiate that they are held for a long-term strategic reasons and are not in the course of an investment dealing business.

The determination of whether a gain or loss from the disposal of equity investments constitutes revenue or capital gains are based on consideration of the facts and circumstances of each case. The factors considered are drawn from established case law principles.

Effective from 1 June 2012, Singapore has provided a tax exemption for the gains or profits derived from the disposal of equity investments. Section 13Z of the SITA provides the exemption on the gains or profits derived from the disposal of equity investments, provided the following conditions are met:

- the investment disposed are ordinary shares in another company
- the disposal of share investments are made during the period between 1 June 2012 and 31 May 2017 (both dates inclusive)
- if immediately prior to the date of the share disposal, the divesting company has held at least 20% of the ordinary shares in the investee company for a continuous period of at least 24 months.

However, the exemption will not apply to:

- a divesting company which is an insurer, where gains or profits from the disposal of shares are included as taxable income in section 26 of the SITA
- gains from the disposal of shares in an unlisted investee company that is in the business of trading or holding Singapore immovable properties (excluding property development)
- the disposal of shares by a partnership, limited partnership or limited liability partnership where one or more of the partners is a company or are companies.

Repatriation of dividends from a Singapore company is not subject to any additional Singapore tax consequences. Singapore adopts the one-tier corporate tax system under which corporate profits are taxed at the corporate level. The corporate tax paid is a final tax and dividends distributed thereafter by tax resident companies are exempt in the hands of their shareholders, regardless of whether they are individuals or companies, locals or foreigners. In addition, Singapore does not impose withholding tax on dividends.

There is also no thin capitalisation and Controlled Foreign Corporation (CFC) rules in Singapore.

Singapore also has a comprehensive and established foreign tax credit system. This means that Singapore tax resident companies can either benefit from the wide network of double taxation agreements (DTAs) that Singapore has signed with many countries, or alternatively they can claim unilateral tax relief for all types of income earned from non-treaty countries. Treaty benefits include a reduced withholding tax rate and exemption on certain classes of income (e.g. dividend, interest, royalties and profits from international shipping and air transportation) derived from a treaty country.

The adoption of a Mutual Agreement Procedure (MAP) in Singapore’s treaties offers a dispute resolution channel in the event of transfer pricing adjustments. MAP enables the IRAS to communicate with the tax authorities of the respective treaty countries to resolve disputes relating to transfer pricing adjustments for the purpose of eliminating double taxation.

The residence status of a company is determined by the location where the control and management of the business is exercised. Control and management is vested in the Board of Directors and the place of residence is normally taken to be the location where the Board meets.

Singapore has a very stable tax regime with an advance ruling system that provides certainty to investors. Under the Advanced Ruling System, the IRAS will provide a written interpretation of the SITA in relation to how certain issues that arise from an arrangement are to be treated for income tax purposes. The advanced ruling is binding on the IRAS to apply the relevant provisions of the SITA in accordance with the ruling.

While Singapore wishes to attract holding companies to establish a presence in Singapore, it should be noted that the IRAS does not condone the use of Singapore’s DTA network by entities with little commercial substance. The IRAS aim is to curb the misuse of tax treaties and does so by placing emphasis on the rationale for the location of the holding company in Singapore and the ultimate beneficial ownership of investments.
In the event that the IRAS is of the view that there is a misuse of tax treaties by entities with little commercial substance, the IRAS may invoke the anti-avoidance regulations under Section 33 of the SITA to disregard certain transactions and arrangements.

With its strategic location, excellent financial infrastructure and pro-business and stable political environment, coupled with a friendly and competitive tax regime, Singapore is ideally positioned to be the hub for global companies to obtain access into emerging markets in Asia.

Contributed by
Simon Poh, Nexia TS Tax Services Pte. Ltd, Singapore
simonpoh@nexiats.com.sg

Inheritance tax: new rules for deducting liabilities

In an era when legislative changes are often revealed months in advance and then only introduced after long periods of consultation, the spring Budget often seems to deliver few surprises. Not so in the case of the new provisions to restrict the scope for deducting liabilities for Inheritance Tax (IHT) purposes, which were not predicted and which have a wide reach and impact.

Historically, when calculating IHT, the value of a liability would be deducted from the value of the asset on which it was secured, regardless of whether the borrowing was actually used to finance that asset or, indeed, whether the debt was ever actually repaid. Under the new rules, which took effect on 17 July 2013, it is now necessary to restrict this deduction for liabilities which are:
- attributable to excluded property
- attributable to relievable property (if incurred on or after 6 April 2013)
- not discharged after death.

The new rules will potentially affect non-UK domiciled individuals, transfers involving Business Property Relief (BPR), Agricultural Property Relief (APR) or Woodlands Relief (WR) and situations where a debt of an estate is waived or left outstanding.

Liabilities attributable to excluded property
This is relevant for non-UK domiciled individuals, for whom non-UK assets are excluded from the charge to IHT.

Historically, IHT planning for non-UK domiciled individuals has often involved securing borrowing against UK property and using the loan finance to purchase assets offshore. The offshore assets are excluded property and thus not liable to IHT. The value of the UK property was reduced by the loan amount, so the arrangement was extremely IHT-efficient.

The impact of the new rules is that such loans will only be deductible for IHT purposes to the extent that the funds can be matched with property which is subject to IHT.

Liabilities attributable to relievable property
Relievable property is property which qualifies for BPR, APR or WR, which can reduce the value liable for IHT by 50% or 100%, or defer an IHT liability. This provision will therefore affect businesses and farms, but also those who have funded IHT-efficient investments such as Alternative Investment Market (AIM) or Enterprise Investment Scheme (EIS) share portfolios via loans, mortgages or equity-release schemes.

Before these new rules, individuals would borrow against non-relievable property such as the family home and use the loan finance to fund relievable property, such as the family business and benefit from relief for the loan against the value of the residence, in addition to the relief already due on the relievable property. Loans put in place prior to 6 April 2013 should still be deductible for IHT purposes, but difficulties will arise when they come to be refinanced.

The rules for loans after 5 April 2013 provide that, where the debt is attributable to financing relievable property, it must be deducted against the value of the relievable property even if it is actually secured on chargeable property.

Liabilities not discharged after death
The new rules provide that a liability can only be taken into account on death if it is genuinely settled out of the estate’s funds.
This provision will catch many family arrangements where a debt is left outstanding to preserve cash flow or to allow a surviving spouse to continue to live in the family home (for example, nil-rate band discretionary trust debts).

There is an exemption from the restriction if there is a commercial reason for not repaying the loan on death; for example, if the debt does not actually fall due until some later date. If this condition is met then the liability could possibly be deducted even if the debt were subsequently waived, although clearly there would need to be a genuine intention to repay the loan on death.

The impact of the new rules
Although the new rules are purportedly aimed at contrived and artificial schemes, they will also catch many common and straightforward arrangements. Funding one’s own business with a debt secured on the family home is not unusual and the tax burden on such estates may now increase substantially.

This also comes at a time when many people are grappling with the new Annual Tax on Enveloped Dwellings (ATED) provisions. Any non-UK domiciled individuals unwinding corporate structures to escape ATED and hoping to mitigate the resulting IHT exposure by way of debt arrangements may need to think again.

HMRC has published guidance on its interpretation of the new rules which may be useful. Solutions will depend on individual circumstances though and those affected should review their arrangements and where restructuring is needed, should seek appropriate advice.

Contributed by
Lucy Woodward, Saffery Champness, UK
lucy.woodward@saffery.com

Uruguay

Uruguay on the path to transparency

In recent years Uruguay has carried out a series of reforms seeking to create credibility and confidence with foreign investors, to combat money laundering and to comply with international/OECD standards of transparency of information.

With this in mind, last year Parliament approved a law that established an important change in the level of regulation of commercial societies, probably the most important change in the last decade.

The law (Law no. 18930) entered into force on 1 August 2012, and created a registry of equity holders of bearer shares, issued by entities resident in Uruguay. The registry is under the regulation and control of The Uruguayan Central Bank (BCU).

The registration mechanism is split into two stages; in the first instance, the holders of bearer securities must present to the company/entity an affidavit containing the required information. Then, the entity must provide this information to the BCU in a sworn statement signed by representatives of the entity.

The BCU shall provide a certificate of presentation of information, which will form part of the formal books of the entity and which will be retained by it.

The deadline for registration of existing bearer shares was 31 May 2013. Subsequent sworn statements are required to be submitted within 30 days of any changes being made.

Not submitting this information has consequences both for the shareholders and for the entities. For the shareholders they will have difficulties in exercising their rights as shareholders (for example, receiving dividends). They also may be punished with a fine up to USD20,000.

For the entities that do not fulfill their obligation to present and preserve the affidavits of the holders, there will be a fine of up to USD20,000. Alternatively, they may forfeit their good standing with the tax authorities.
The shareholder details will not be publicly available. To access this detail, the following will be required:

- a resolution of the General Director of the fiscal agency
- resolutions of the Central Bank of Uruguay and the National Secretariat on anti-money laundering of assets
- a resolution from the appropriate court
- a resolution of the Transparency Board and the Public Ethics Board.

At the same time, the law provided holders with a simpler process of changing from bearer status should they wish to do so.

With the authorities offering these two alternatives, to either register the shares or to register their ownership, the law is increasing the level of transparency under the law and identifying who are the ultimate beneficiaries of the entities.

At the time of the adoption of the law, it was estimated that in Uruguay there existed between 40,000 and 50,000 entities with bearer securities and it was thought that 50% of holders would choose to register their details and the other 50% would choose to register the shares. Although the deadlines have recently expired, there are no official figures confirming what has actually happened.

One aspect that has to be considered by the holders deciding on whether or not to change from bearer status, was the tax impact. While the change from bearer to registered shares has no tax consequence, the sale of registered shares by their holder does.

The taxation consequences of a disposal of registered shares will depend on whether the holder is an individual or an entity and whether they are resident or non-resident:

- resident individuals: pay income tax (IRPF) at a rate of 12% on 20% of the sale value of shares
- non-resident individuals and non-resident legal persons: pay non-resident income tax (IRNR) at a rate of 12% on 20% of the sale value of the shares
- resident legal persons: the income obtained by the transfer shall be treated as business income and subject to the tax on the business income (IRAE)

Contribute by
Fernanda Normey, Normey, Peruzzo y Asociados, Uruguay fnormey@npyas-nexia.com.uy

---

**USA**

### Bilateral safe harbours for low-risk distributors

On 15 March 2013 the U.S. Internal Revenue Service (IRS) announced that it was seeking public comments regarding the development of a model memorandum on bilateral safe harbours with regard to arm’s length compensation for routine distribution functions. This initiative to adopt a safe harbour regime for low-risk distributors is undertaken as part of the U.S. IRS Advance Pricing and Mutual Agreement Program (APMA).

#### Organisation for Economic Cooperation and Development (OECD) background

The recommendations regarding the use of safe harbours were initially outlined by the OECD in Chapter IV of the 1995 OECD Transfer Pricing Guidelines. On 6 June 2012, the OECD issued a discussion draft for proposed revisions on safe harbours in Chapter IV of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the “Chapter IV draft proposed revision”). The Chapter IV draft proposed revision to the safe harbour provisions is intended to alleviate transfer pricing compliance burdens of smaller taxpayers and taxpayers involved in less complex transactions.

The Chapter IV draft proposed revision includes a draft sample Memorandum of Understanding (MOU) addressing certain “low risk” functions and providing guidance to treaty partners for implementing safe harbours on a bilateral basis.

#### Post-announcement developments from OECD

The OECD’s Chapter IV draft proposed revision received generally favourable feedback of the business community. The final guidance was approved on 16 May 2013 by the OECD Council (the “OECD May 2013 final guidance”). The OECD May 2013 final guidance remained largely unchanged compared to the Chapter IV draft proposed revision, indicating that sample MOUs are providing a starting point for competent authorities and emphasising that safe harbours could benefit both taxpayers and tax administrations.

The OECD’s sample MOU on low-risk distribution services (the “sample LRD MOU”), included in the OECD May 2013 final
guidance, defined qualified transactions, a qualified enterprise (QE) and suggested that the arm’s length remuneration for the qualifying transaction should be determined in accordance with the transfer pricing rules of the treaty partners.

According to the sample LRD MOU, qualified transactions between the QE and an associated enterprise resident in the other contracting state “shall be (i) the rendering of marketing and distribution services... and/or (ii) the sale of products to unrelated customers purchased by the qualifying enterprise from an associated enterprise”.

Furthermore, a QE should meet certain criteria, including conducting business predominantly in the state of residency, entering into an agreement with the associated enterprise before the relevant taxable year (“the LRD Agreement”) and limiting its research and development and engineering expenses as well as marketing expenses to a certain percentage. A QE “shall not engage in manufacturing or assembly functions with regard to the products it markets and distributes”. The LRD Agreement should specify that the associate enterprise assumes risks related to marketing and distribution activities of the QE and should remunerate the QE for these activities based on the MOU between the competent authorities of the contracting state of the QE and an associated enterprise.

QE’s activities should be also subject to certain limitations based on the industry, net sales, total assets, percentages of transactions other than qualifying transactions and the materiality of the prior transfer pricing audit adjustments.

Post-announcement developments at the IRS
A sample MOU suggests using as the appropriate profit level indicator, the QE’s net income before tax over total net sales. The treaty partners should determine the applicable range of the operating results as part of the MOUs between their respective countries.

At the 2013 OECD International Tax Conference that took place in Washington Samuel Maruca, transfer pricing director in the IRS Large Business and International Division (“IRS LB&I Division”), said that “although the United States is pleased that momentum is growing behind the concept of bilateral and multilateral safe harbours” it will take time to work out practical issues between multiple trading partners.

The issue of transfer pricing safe harbours was further discussed by John Hughes, a senior manager of the IRS LB&I Division, APMA Program, and Bill Morgan, a senior economic adviser to Maruca, in the National Association for Business Economics webinar on 8 July 2013. Hughes and Morgan are driving the initiative within APMA to design safe harbours for low-risk distribution functions.

Among the goals for developing safe harbours, discussed on the 8 July IRS webinar, the objective is to ease administrative burden and provide more certainty for taxpayers, which is in line with the OECD’s May 2013 final guidance. The IRS also wants to better utilises its own resources and resources of the treaty partners, and to “streamline audit and issue resolution processes”. Hughes indicated that the IRS is planning to use the OECD’s sample LRD MOU as the starting point for multiple treaty partners.

Hughes, referring to low-risk distributors as “routine” distributors, said that the IRS is considering an elective safe harbour regime that taxpayers would be able to adopt. Most likely an option to select safe harbour will not be available for large taxpayers, which is analogous to the OECD May 2013 final guidance. The IRS is considering an option of making an election of the safe harbour regime by filing a notice, if not initially then eventually outside of the APA process.

Morgan also indicated that even though the OECD May 2013 final guidance addresses quantitative criteria for low-risk distributors, the IRS is not intending to develop a “bright-line test”. In order to meet routine distribution criteria and make a safe harbour election, the taxpayer would be required to provide both quantitative and qualitative evidence, including not only current but also historic company data as part of quantitative evidence.

In addition, during the 8 July IRS webinar the IRS addressed a comment to its model memorandum regarding safe harbours with respect to start-up limited risk distributors having high ratios of marketing expenses to net sales. This is just one of the examples supporting the IRS conclusion that the safe harbour regime should take into account not only quantitative but also qualitative criteria. Hughes responded that “this consideration mitigates in favour of initially having a streamlined APA process”. Morgan’s response was that the substance over the form of the transactions should be considered under the arm’s-length principles and “to the extent that the company is compensated under a Berry ratio - effectively a markup on those costs over time - the economic ownership of any valuable intangibles is not part of the tested party’s return.”

USA
Conclusion
Over the past two decades safe harbour rules have only been adopted by several jurisdictions worldwide. By endorsing safe harbours the OECD and the IRS have taken a vital step toward simplification of transfer pricing compliance globally. The development of bilateral safe harbours should provide the implementation framework for multiple treaty partners. The IRS LB&I Division is trying to manage expectations of taxpayers emphasising that there is still a long way to go before the safe harbour regime for low-risk distributors will be developed and implemented.

Contributed by
David Slemmer and Yelena Belaks, CohnReznick, USA
david.slemmer@cohnreznick.com and yelena.belaks@cohnreznick.com

Notable changes proposed
In this draft circular, Vietnam’s tax authority introduces a three year rule for the application of DTA. In particular, the draft provides that if the taxpayers apply for a retrospective DTA application for a period covering more than the past three years, the dossiers won’t be accepted unless it is provided for under a specific treaty. For cases provided for under a specific treaty, the Vietnam tax authority will retain the right to make a final decision over the DTA application, on a case-by-case basis.

For example, if a taxpayer submits a DTA application dossier for the years from 2007 to 2013, to the Vietnam tax authority on 1 October 2013, Vietnam’s tax authority should only accept the DTA application for three years, ie 2011 – 2013. For the years 2007 – 2010, Vietnam’s tax authority will consider, for instance, whether to allow the taxpayer to credit its foreign tax paid against the tax payable in Vietnam.

The draft circular also re-defines the creation of a permanent establishment (PE) in situations where a foreign company is a resident of a contracting state with Vietnam and establishes a subsidiary in Vietnam (which could be a joint venture, 100% foreign-owned enterprise, export processing enterprise, etc). That subsidiary will become a PE in Vietnam of the overseas entity if:

• it usually negotiates on behalf of the overseas company or enters into a contract in its own name but which binds the foreign company
• it usually represents the foreign company delivering goods in Vietnam
• the overseas company holds the rights to take decisions on the facilities or technology of the subsidiary in Vietnam
• the overseas company and its subsidiary in Vietnam enter into a related party transaction, which is determined by the tax authority as not in accordance with an arm’s length principle.

Once issued, this draft circular shall replace Circular No. 133/2004/TT-BTC which was issued by the MOF on 31 December 2004 and which currently provides detailed guidelines for the application of DTAs with respect to taxes on income and property between Vietnam and other countries.

Contributed by
Nguyen Dinh Du, NEXIA ACPA – Tax & Corporate Service, Vietnam
nguyen.dinh.du@nexiaacpa.com

Vietnam
Government proposes a tightened policy on anti-avoidance
Having experienced more than five years of trying to minimise the impact of the international crisis, the Vietnam Ministry of Finance (MOF) and its taxation arm, the General Department of Taxation (GDT), have recently launched a series of enforcement actions as well as making changes to the country’s tax law, all with the common purpose of targeting anti-avoidance. After renewing the transfer pricing regulations, the MOF and the GDT jointly issued a draft circular revising the provisions, for the application of Double Taxation Agreements (DTA).

The draft circular was published at the end of May 2013 and sought comments both from government authorities and taxpayers. However, at the date of writing, the draft circular is still on the desk of the drafting departments without a specific timeframe for it being finalised.
Tax Link serves two purposes. It provides a forum for updating our clients and contacts on developments in tax legislation around the globe and for highlighting the range of tax services available from Nexia member firms. In addition, Tax Link serves as a notice board to inform member firms on the activities of the various tax committees and focus groups within the Nexia network.

This update was edited by Mike Adams, Tax Director at Nexia International. If you require further information or would like to contribute articles for future editions, please contact:

Mike Adams Mike.adams@nexia.com

www.nexia.com