Welcome to the third Edition (November 2009) of PKF International Tax Alert, a publication designed to summarise key tax changes around the world. This publication is issued three times per year in soft copy format only and can also be found on the PKF International website www.pkf.com

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Canada – Recent International Tax Developments

Tax Treaties - Tax Information Exchange Agreements

United States

1 January 2010 will be the effective date of significant aspects of the Fifth Protocol changes to the Canada-US Tax Treaty that will affect cross-border business between the two neighbours. These changes are highlighted under a separate heading below.

Greece and Turkey

Canada has signed a bilateral tax treaty with the Hellenic Republic (Greece) on 29 June 2009 and followed that up by signing a tax treaty with the Republic of Turkey on 14 July 2009. These treaties will enter into force once the respective governments have notified the other that the ratification process has been completed. The Greek treaty will limit the rate of withholding to 5% for dividends between affiliated companies, to 15% for dividends in all other cases, to 10% for interest, and to 10% for royalties. The Turkish treaty will limit the rate of withholding to 15% for dividends between affiliated companies, to 20% for dividends in all other cases, to 15% for interest, and to 10% for royalties.

Netherlands

In September 2009, the Canadian Department of Finance announced that negotiations to update the tax treaty with the Netherlands were to commence in early October.

Tax Information Exchange Agreements

Canada signed its first Tax Information Exchange Agreement (TIEA) with the Netherlands in respect of the Netherlands Antilles in Vancouver on 29 August 2009. Canada is negotiating other TIEAs with other jurisdictions who have indicated they are committed to the Organisation for Economic Co-operation and Development (OECD) standard for the exchange of tax information. The standard, set by the OECD, encourages member countries to enter into TIEAs with non-treaty jurisdictions to combat tax evasion and the use of tax havens. In support of the standard, Canada introduced incentives in its 2007 budget to have non-treaty counties to enter into TIEAs with Canada, and required that all new treaties and revisions to existing treaties include the OECD standard.
By 29 August 2009, Canada had entered into TIEA discussions with Anguilla, Aruba, Bahamas, Bahrain, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Saint Kitts and Nevis, Saint Lucia, and Turks and Caicos.

Generally, a TIEA must be concluded within 60 months of the start of negotiations or active business earned by controlled foreign affiliates of a Canadian taxpayer in that non-treaty jurisdiction will be taxed in the Canadian parent on an accrual basis (foreign accrual property income). On a more positive note, active business income earned by a foreign affiliate resident in a country that has concluded a TIEA will be added to the exempt surplus pool. Dividends paid by a foreign affiliate from exempt surplus are exempt from Canadian tax when received by the Canadian corporate shareholder.

**Important Canada–US Tax Treaty Changes Effective 1 January 2010**

The Fifth Protocol to the Canada-US Tax Treaty signed in September 2007 contains provisions that will first have effect on 1 January 2010.

**Services – Deemed permanent establishment**

Canadian and US corporations and other enterprises (including individuals) carrying on service businesses in the other country will want to be aware of the change to the Canada-US Treaty that deems them to have a permanent establishment in that other country if either of the following two tests is met:

- Where services are performed in the other country by an individual who is present in the other country for an aggregate of at least 183 days in any 12 month period and, during that period or periods, more than 50% of the gross active business revenues of the enterprise consists of income derived from the services performed in that other country by that individual; or
- Where services are provided in the other country for an aggregate of at least 183 days in any 12 month period with respect to the same or connected project for customers who are either residents of the other country or maintain a permanent establishment in that other country and the services are provided in respect of that permanent establishment.

For calendar-year taxpayers, this deemed permanent establishment rule comes into effect from 1 January 2010. Days, services and revenues occurring or arising before 2010 should be ignored. For non-calendar year taxpayers, this rule applies to the taxpayer’s third taxation ending after 15 December 2008.

The day count differs between the two tests. The first is simply a presence test and would count non-working days, vacation and weekends. The second test counts only days on which services were provided. The second test aggregates the days for multiple individuals while the first test focuses on one individual.

The first test is objective and will probably apply most commonly to sole proprietorships or small enterprises. It is based on one individual’s physical presence and a gross revenue test. The second test is more subjective as it requires the consideration of whether the activities pertain to the same or connected project and an assessment of the customer or client’s tax status in the other country. The second test can also apply to sole proprietorships or small enterprises but it will be a more common challenge for large enterprises with several or many cross-border employees.

The Technical Explanation to the Fifth Protocol provides that the determination of whether projects are connected should be made from the perspective of the enterprise providing the services not the customer, based on all facts and circumstances.
The Fifth Protocol indicates that projects will be considered connected if they constitute “a coherent whole, commercially and geographically”. The Technical explanation outlines the following factors as relevant to the consideration of commercial coherence:

- Whether the projects would have been concluded under a single contract in the absence of tax planning considerations
- Whether the nature of the work involved under the different projects is the same, and
- Whether the same individuals are providing the services under the different projects.

The Technical Explanation indicates that there would be a lack of geographic coherence in the case of a bank hiring a consultant to complete separate audit projects at multiple bank branches in different cities. This interpretation should serve to limit the scope of the connected-projects test.

**Changes Affecting Fiscally Transparent Entities**

The Fifth Protocol introduced a new “look-through” regime for determining the eligibility of certain flow-through entities (FTEs), such as US LLCs and Canadian ULCs, for treaty benefits.

Prior to the changes, Canada did not recognize US LLCs as eligible for treaty benefits where, as is the usual case, the LLC had not elected for US tax purposes to be taxed as a corporation. The new regime for LLCs came into effect for source withholdings on 1 February 2009. For other income tax purposes, such as capital gains and business profits taxation, the new regime became effective for taxation years commencing after 2008. These rules are generally favourable in their effect but it is important for LLCs and other FTEs such as partnerships and US S Corporations to review their detailed cross-border status with their tax advisors. Payers of amounts to FTEs that are subject to non-resident withholding tax should ensure that they are complying with the new withholding requirements. In June 2009, the Canada Revenue Agency (CRA) released for public comment various draft forms in connection with a new declaration process designed to assist Canadian payers in determining whether to apply a treaty-reduced rate of withholding tax for payments to non-resident recipients – Forms NR301, 302 and 303. These forms provide guidance in terms of the CRA’s heightened expectation of payers and related due diligence requirements.

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China – Tax Collection and Anti-avoidance is still the focus

Anti-Avoidance and Tax Administration Measures

After introduction of several tax enforcement measures in the second quarter of 2009, the State Administration of Taxation (SAT) provided additional details in Q3 2009 on the area of focus, imposing stricter administrative measures and tightening the criteria for enjoying tax preferential treatment. The new rules issued cover not only Corporate Income Tax (CIT), but also Value Added Tax (VAT), Individual Income Tax (IIT), Land Appreciation Tax (LAT) and Tariff.

Areas of Focus
The SAT re-emphasised the importance of tax collection and reminded local tax bureaux to pay particular attention to the following:

- **Industries:**
  - Agency and professional intermediaries
  - Pharmacy production
  - Pharmaceutical retailing
  - Financing for construction of highway
  - Chain hotels
  - Construction and installation
  - Property development and real estate.

- **Types of transactions:**
  - Services, such as management, design, certification and consultation, performed by overseas employees sent by non-resident companies to China
  - Big projects contracted by non-resident companies
  - Transfer of equity interests in companies incorporated in the People’s Republic of China (PRC)
  - Repatriation of dividends and interest from the PRC resident companies to non-resident companies.

- **Characteristics of taxpayers:**
  - Overseas incorporated companies controlled by the PRC companies
  - Fast expanding companies with low profitability or incurring losses for long period
  - Companies with cross-region branches
  - Companies with limited functions and risks.

Most of the industries, transactions and taxpayers had been specified as tax audit targets or areas on which tighter enforcement measures had to be imposed previously. This shows the determination of the SAT to collect more taxes from these taxpayers.

The SAT also advised the local tax bureaux to pay more attention to the deductibility of expenses, timing and fair value of revenue. The local tax bureau should analyze the tax deductible salary costs with IIT information, amount of reported revenue with VAT information. Moreover, the local tax bureau should put more effort on companies with significantly higher expenses compared with the industry average, asset losses and non-monetary revenue.

Cross-Border Secondment Arrangement

In the past, it was common practice for foreign companies to second their employees to the PRC affiliate companies to take up management or technical positions. The salary costs of these overseas employees are usually paid by the foreign companies which will recharge the PRC affiliate companies without markup. The PRC affiliate companies could remit the salary costs after paying the IIT of these overseas employees.

Local tax bureaux recently conducted a special tax review on the secondment arrangement for manufacturing or services companies, with an emphasis on automobile manufacturers. The objective of the tax review was to ensure that the provision of services by overseas employees sent by non-resident
companies in the PRC was not reported as “employee secondment arrangement” to avoid tax. The former should be subject to business tax and CIT, in addition to the IIT of the seconded employees, if the provision of services constitutes a permanent establishment in the PRC.

However, some real secondment arrangements may be deemed as provision of services if secondment agreement and other related documentation, such as reasons for not employing the overseas employee directly by the PRC affiliated companies, is not properly maintained. This will increase the tax costs of real secondment arrangements. Local tax bureaux are allowed to apply a deemed profit margin for the calculation of CIT payable in respect of the services provided by the seconded employees.

Companies with limited functions and risks

The SAT emphasises that companies established by foreign investors with limited functions and risks, such as processing trade, contract manufacturing (major raw materials provided by the customer), distribution functions or contract research and development functions, should earn a reasonable profit margin corresponding to the functions and risks assumed. This implies that loss-making limited function companies will become targets for transfer pricing investigation. Loss-making limited function companies are required to submit contemporaneous documentation for related party transactions, regardless of whether normal related party transaction thresholds are met (please refer to Issue Two of 2009 for details).

Formalizing the Application Procedures for Entitlement of Tax Treaty Benefits

After promulgation of the rule specifically for dividends payable by PRC resident companies, detailed administrative rules to claim treaty benefits on other types of income were introduced. Residents of tax treaty countries have to comply with the administrative rules in order to enjoy the treaty benefits.

Requirement of different types of income derived by treaty resident is as follows:

<table>
<thead>
<tr>
<th>Type of income</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>Submission of application and approval required</td>
</tr>
<tr>
<td>Interests</td>
<td></td>
</tr>
<tr>
<td>Royalties</td>
<td></td>
</tr>
<tr>
<td>Capital gains</td>
<td></td>
</tr>
<tr>
<td>Business income of permanent establishments</td>
<td>Information submitted for filing only</td>
</tr>
<tr>
<td>Independent and dependent personal services</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
</tr>
</tbody>
</table>

Moreover, where an eligible taxpayer has not applied for treaty treatment and overpaid tax, it is NOT allowed to re-open the application for treaty treatments after three years from the date the tax was paid.

Establishing Nationwide Database for Individual

The SAT has required the local tax bureau of all regions to submit details of the IIT taxpayers, withholding agents, amount of income and tax payment to develop a natural person taxpayers database (DATABASE). The DATABASE could help the SAT:

- To analyze remuneration of the same job position in different companies/industries and average remuneration in different regions
- To compare the tax returns submitted by withholding agent with the information reported by IIT taxpayer
- To monitor whether IIT of individuals (PRC citizen and foreigners) who have multiple income sources or who receive salary income from more than one place, have been paid on time and correctly.
This nationwide DATABASE will help the tax bureau to identify individuals who have multiple income sources or who receive salary income from more than one place (including foreigners who temporarily work for companies in different locations in China) during a fiscal year and collect IIT on income not reported these individuals.

**Value Added Tax (VAT)**

*Tightening Administrative Measures of VAT Refund*

In order to enhance control over the practice of “VAT Refund upon Levy” and related tax frauds, tax bureaux will review the sale fluctuation ratios and the effective VAT rate of the VAT payer before approving the tax refund. Provincial tax bureau will set the benchmark to determine what is considered an abnormal sales fluctuation ratio and effective VAT rate. If the ratios are considered abnormal, the tax refund application may be denied and a follow-up tax audit may be conducted.

*Increase of Export VAT Refund Rates*

PRC government raised export VAT refund rates for a variety of goods, such as sewing machines, steel structures, ceramics products and corn starch, from 1 June 2009 in order to stimulate export.

**Individual Income Tax**

Besides building a nationwide DATABASE for IIT taxpayer, several new tax rules were issued to restrict the entitlement of IIT preferential treatment (such as stock based compensation to employees), or to strengthen the tax administrative measures.

**Restrictions on IIT Preferential Treatment**

- **Directors’ fees**

  In the past, directors’ fees are generally categorized as “labour services” and were taxed separately from employment income at IIT rate of 20%-40%. This practice will result in a lower tax liability if the marginal IIT rate of a director’s employment income is higher than applicable IIT rate of director’s fee. This practice is banned if a company director is also an employee of that company or one of its related parties. The fees paid to that director shall be taxed as employment income at marginal IIT rate.

- **Monthly tax allowance**

  The monthly tax allowance for non-PRC citizens for IIT purposes is RMB 4,800, compared with the tax allowance of RMB 2,000 per month for PRC citizens. The new rule restricts the entitlement of higher tax allowance to those PRC citizens who:

  - have obtained long-term or permanent residency status in a foreign country and have actually resided in that country for at least 18 months within a period of two consecutive years; or

  - have not obtained long-term or permanent residency status in a foreign country but who have obtained the legal right to reside for no less than five consecutive years and have actually resided in that country for at least 30 months within that five-year period.

**Administration and Collection of IIT from Transfers of Equity**

In order to strengthen the administration and collection of IIT on income generated from transfers of equity, the local tax bureau at the location of the company whose equity is being transferred is assigned to:

- examine the correctness of the reported taxable income from the equity transferred
- assess whether the transaction is done on arm’s length basis
- evaluate the fair value of the equity transferred for tax purpose and deem a fair taxable income if the reported price is unreasonably low.
The company for which the equity is being transferred should file a form with its local tax bureau to report change of individual shareholders before the transfer of equity has been completed.

After the completion of the equity transfer, the transferor or the transferee should file an IIT return with the local tax bureau and apply for a tax clearance certificate. Without the tax clearance certificate, the subsequent registration with the local office of the State Administration of Industrial and Commerce (SAIC) for the change in equity ownership will not be processed.

All these measures are to ensure that all equity transfer transactions are reported to the responsible tax bureau which will assess the taxable income critically.

**Land Appreciation Tax (LAT)**

**Speeding up LAT Clearance**

Property development companies may be required by the tax bureau to settle LAT if one of the following events occurs:

- 85% of a property project, in terms of area, is sold (or even if less than 85% sold but the remaining saleable area has all been leased out or held for self use)
- The pre-sale permit has been issued for more than three years
- The taxpayer has applied for tax de-registration
- Other situations set by the provincial tax bureau.

The new rule is to attack the practice of keeping minimal area of a property project unsold in order to defer the final clearance of LAT.

**Tariff**

**Collection Measures of Customs Duties**

In order to safeguard the collection of customs duties, the PRC Customs could take the following measures if a taxpayer is likely to transfer or hide dutiable goods or other assets:

- require the taxpayer to provide collateral
- instruct the bank of the taxpayer to freeze the amount of bank deposit equal to the duties due kept in the bank account or
- detain the goods or other assets of the taxpayer of the same value of the duties due.

If duties are not paid within three months after the due date, the PRC Customs could dispose of the dutiable goods, detained goods or assets or instruct the banks of the taxpayer to settle the duties unpaid.

**Tax Preferential Policies and Incentives**

**Tax Incentive for Technology Advanced Service Enterprises (TASE)**

Services companies that provide:

Information Technology Outsourcing (ITO), Business Process Outsourcing (BPO) or Knowledge Process Outsourcing (KPO) could enjoy the following tax preferential policies for the period from 1 January 2009 to 31 December 2013:

- Reduced CIT rate of 15%
- Deduction of employee education expenses up to 8% of total salaries and wages (normally 2.5%) for CIT purpose
- Business tax exemption for offshore outsourcing service income.

TASE must be established in the 20 pilot outsourcing service cities, including Shanghai and Beijing, stipulated in the tax rule. Sales generated from ITO, BPO and KPO must account for more than 70% of the
total sales and the aggregate annual sales from offshore outsourcing service to overseas customers should account for at least 50% of the total sales of that year. The TASE must possess relevant international qualifications with more than 50% of employees holding a college degree or above.

**Financial Subsidies for Regional Headquarters in Beijing**

In order to encourage foreign multinational companies to establish regional headquarters (RHQ) in Beijing, Beijing municipal government provides the following subsidies to the RHQs:

- If the registered capital of newly established or relocated RHQs in Beijing on or after 1 January 2009, or existing RHQs which increase capital to RMB100 million or more, the RHQs are entitled to one-off financial subsidies of RMB 5 million to RMB 10 million (for registered capital not less than RMB 1 billion)
- From Year 2009, RHQs reaching certain annual revenue for the first time are entitled to one-off financial subsidies as follows:

<table>
<thead>
<tr>
<th>Annual revenue RMB</th>
<th>One-off financial subsidies RMB</th>
</tr>
</thead>
<tbody>
<tr>
<td>100 million (100 million included)~500 million</td>
<td>1 million</td>
</tr>
<tr>
<td>500 million (500 million included)~1 billion</td>
<td>5 million</td>
</tr>
<tr>
<td>Over 1 billion (1 billion included)</td>
<td>10 million</td>
</tr>
</tbody>
</table>

The aforementioned one-off financial subsidies will be paid over three years (40% in the first year, 30% in the second year and 30% in the third year) and total of each category of subsidy granted will be restricted to RMB10 million.

- Newly established or relocated RHQs or its research centre in Beijing are entitled to the following financial subsidies for leasing, purchase or construction of office premises:
  - A one-off financial subsidy for office property self-constructed or purchased in the amount of RMB 1,000 per square metre (capped at 5,000 square metres)
  - Financial subsidy for the first three years, equivalent to 30%, 20% and 10% of each year’s rental.
- One senior executive of the RHQ is entitled to cash award, which is linked to the amount of his/her IIT paid, for the first three years starting from the year following the granting of the RHQ status.
Double Taxation Agreement (DTA)

New or Revised Agreements for the Avoidance of Double Taxation Signed
DTA with the Macao Special Administrative Region of the PRC was revised and DTA with the Federal Democratic Republic of Ethiopia was signed. The main clauses are summarized as below:

<table>
<thead>
<tr>
<th></th>
<th>Macao</th>
<th>Ethiopia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>5% / 10%</td>
<td>5%</td>
</tr>
<tr>
<td>Interests</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Royalties</td>
<td>7%</td>
<td>5%</td>
</tr>
<tr>
<td>Capital gain on alienation of shares of a company which 50% or more of the company assets comprise of the immovable property</td>
<td>Taxing rights in the treaty country where the immovable property locates if at any time within three years before the alienation.</td>
<td>Taxing rights in the treaty country where the immovable property locates.</td>
</tr>
<tr>
<td>Capital gain on alienation of shares of a company other than above</td>
<td>Taxing rights in the treaty country where the company is tax resident if at any time within 12 months before the alienation, the transferor’s share of total share capital ≥25%</td>
<td>Taxing rights in the treaty country where the transferor is tax resident.</td>
</tr>
</tbody>
</table>

Guidance on Royalty Clauses under DTA

SAT clarifies that if rental payments associated with the use of (or the right to use) industrial, commercial or scientific equipment (excluding immovable property) is defined as “royalty” under a DTA, withholding tax rate (usually lower) applicable to royalty income should be applied.

In addition, provided that service provider does not constitute a permanent establishment in China, withholding tax rate for royalty income could be applied to service income if all of the following conditions are met:

- The results generated from the service fall within the definition of royalty clause in a DTA
- The results remain the property of the service provider
- The service recipient only has usage rights to the results.

More Supplementary Rules, Detailed Implementation Rules/ Guidelines on CIT Law

Tax Deductibility of Expenses
- Advertising and Promotional expenses
  Detailed implementation rules of the CIT stipulate that the deductible amount of qualified advertising and promotional expenses (A&P expenses) incurred shall not exceed 15% of sales of a fiscal period. If the amount of A&P expenses exceeds the upper limit, it has to be carried forward to the following fiscal years for deduction.

  The SAT raises the upper limit of deductible A&P expenses for manufacturers of cosmetics, pharmaceuticals and beverages (excluding alcohol) to 30% of annual sales for the period from 1 January 2008 to 31 December 2010.

  On the other hand, A&P expenses of tobacco manufacturers are not deductible for CIT purposes until the end of 2010.
Contributions to Supplementary Pension Funds and Supplementary Medical Insurance Fund.

The contributions to supplementary pension funds and medical insurance funds are individually capped at 5% of the employees' total salary and wages for CIT deduction purposes.

Further Guidance on Special Tax Treatment for Corporate Restructuring

Local tax bureau in Beijing issued guidance to clarify the list of documents and information required for application for the special tax treatment (please refer to Issue Two of 2009 for details on new tax rule for corporate restructuring). This provides good reference for corporate restructuring exercise in other locations in the PRC as the rule announced by the SAT has not clarified the information required to be submitted.

Information required to be provided:

- types of restructuring
- completion date of the restructuring
- details on the persons involved and the treatment of the asset transfer, swap, debt settlement, employee settlement, the sum paid to the government for the acquisition of land use rights or the transfer of land use rights in the restructuring
- requirements for the special tax treatment fulfilled
- explanation of the commercial purpose of the restructuring
- considerations of the transaction
- evaluation report provided by professional intermediaries
- tax bases of relevant assets or liabilities before and after the restructuring
- arrangement for assumption of any outstanding tax issues and liabilities after restructuring
- other relevant information.

Documents required to be provided:

- agreement for relevant restructuring transaction
- related agreement approved by the board of directors and the general meeting of shareholders
- approval documents issued by the relevant government authorities.

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Germany – Taxation of the transfer of functions

Stricter rules of taxation of intercompany cross-border transfers of functions were already introduced in early 2008. A transfer of functions is the transfer or making available of an asset etc together with the associated risks and opportunities by an enterprise to a related enterprise in order to enable the receiving enterprise to perform the same functions which had formerly been performed by the transferring enterprise whose ability to perform these functions is restricted after the transfer.

The following transactions are not deemed to be a transfer of functions:

- duplication of functions, i.e. where within a period of five years the transferring enterprise's ability to perform the function is not materially restricted or where a restriction is not the direct economic result of the transfer
- mere supply of services or the sale or making available of assets if they are unconnected with the transfer as regards the timing and the economic reasons
- mere secondment of an employee if it is unconnected with the transfer as regards the timing and the economic reasons
- transactions which are generally not considered to be a transfer of functions eg if the transfer is immaterial and of short duration and where the effect on the profits is irrelevant.

The most important feature of the new rules is that the calculation of the proper transfer price must be based on the transfer package as a whole and not on the individual assets. In addition to the assets, the package also comprises the risks and opportunities and any other benefits attached to them. A first step in calculating the transfer price on the basis of a functional analysis and a budget is to determine:

- the lower limit acceptable to the transferring enterprise (notional seller) and
- the upper limit acceptable to the receiving enterprise (notional buyer)

by way of discounting profit potentials at interest rates which adequately reflect the functions and risks. Within the limits so agreed, the transfer price must be fixed at an amount which is most likely to meet the arm's length principle. This may be the average value if no other amount can be agreed upon.

Where significant intangible assets or benefits are transferred and where the actual development of profits over the first ten years materially deviates from the development of profits on which the calculation of the transfer price was based, the transfer price is, in principle, to be adjusted retroactively.

The taxpayer is required to co-operate with the tax authorities and must be able to provide comprehensive written documentation of:
• the facts and circumstances
• the calculation and assumptions (and reasons for the assumptions) underlying the transfer price
• the method used in determining the transfer prices of current trading transactions after the transfer of the functions and reasons why it was applied.

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Hungary – New Tax Legislation and Accounting Rules from 2010

The Hungarian Parliament has adopted the changes of the tax acts effective from 1 January 2010.

Crisis management
The rate of corporate income tax will be increased from 16% to 19%, while the 4% solidarity surtax of companies is repealed.

Most corporate income tax base modifying items will be abolished, except for the deductions related to construction, royalties, R&D, employment and reported shares (the profit on the sale of such shares is tax-exempt). Companies that have already reported shares above 30% to the Tax Authority may report any other shares without restrictions for the proportion.

According to the new definition of uncollectible receivables, 20% of receivables expired for more than a year will be deductible from the tax base.

Development reserves made before 2009 can be released within six years instead of the standard four years.

Incentives for employment
The rates of personal income tax are to be decreased to 17% up to an annual taxable income of 5 million HUF (15 million from 2011), and 32% above this limit. However, it will be charged on a wider tax base, which will then include the social security contribution as well.

Most of the personal income tax exemptions will be abolished, including the exemption for insurance, costs of education, and supplementary fees to pension or health insurance funds. The currently exempt benefits in kind are also going to be taxed, except for social benefits. A new discount rate of 25% will be applied to, for example, vacation vouchers, travel passes and hot meal vouchers.

The following decreased rates of social security contributions will apply to employers from 2010:

<table>
<thead>
<tr>
<th>Social Security Fund</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension Insurance Fund</td>
<td>24%</td>
</tr>
<tr>
<td>Health Insurance Fund</td>
<td>2%</td>
</tr>
<tr>
<td>Labour market contribution</td>
<td>1%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>27%</strong></td>
</tr>
</tbody>
</table>

Changes in the taxation of property
A new, value-based tax will be introduced on property worth at least 30 million HUF. The annual payable tax will be 0.25% up to 30 million, 0.35% of the value up to 50 million HUF and 0.5% on the part of the value above the limit. The tax will be based on the market price of the property. Similar tax will be introduced on certain tangible assets (boats, planes, luxury cars).

From 2010, if a foreign shareholder sells or otherwise disposes of its share in a property owning company, it will be deemed as subject to corporate income tax, and will be taxed on the transaction. The profits of private individuals on the sale of a property owning company will be taxed at 25%. Companies will qualify as property owning companies if properties account for at least 75% of the market value of their assets.

The rates of duty on the acquisition of property will be significantly decreased from 1 January 2010. However, the acquisition of shares in property owning companies will also be subject to the duty.

To mitigate the effects of the crisis, leaseback transactions (i.e. selling and leasing back the property, and buying back at the end of the lease period) will receive temporary exemption from the duty.
Measures against tax evasion
The pre-tax profit will be increased by the after-tax profit of the controlled foreign companies (CFC) less the dividend paid, in proportion to the ownership share. In case of individuals, the same amount will be deemed as income, and taxed at the standard 17/32% rates.

Companies can reduce their corporate income tax base by the dividend received from CFC that is accounted as revenue (but this may not exceed the above increase of tax base).

The amendment introduces a kind of withholding tax on companies resident in countries without a double taxation treaty with Hungary. The tax is payable on the interest, royalty and service fee received at a rate of 30%. The services subject to withholding tax include management, consulting, advertising, public opinion polling and business agency activities. The same legislation applies to private individuals.

Changes in the Accounting Act
Due to the changes in the Accounting Act, all enterprises can choose to do bookkeeping and preparation of the annual reports in euro. Companies must change the accounting policy and deed of foundation accordingly before the first day of the business year.

From 2010, companies are entitled to prepare the annual reports in a currency other than euro if more than 25% of their financial assets and liabilities, and more than 25% of the costs, revenues and expenses are incurred in that currency.

Other changes
Commercial accommodation services are subject to the discount rate of VAT (18%) from 9 July 2009.

The rate of simplified entrepreneurial tax will be increased to 30% from the present 25%.

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Important amendments in Income Tax

In the Budget of July 2009, many amendments were proposed in India’s Income Tax Act. Certain important and relevant amendments are as follows:

Tax rates Changes

- In the case of individuals, the basic exemption limit has been increased, giving marginal tax relief to all individuals. Surcharge on income tax (which worked out to an effective rate of 3%) has been withdrawn on all persons other than companies and firms.

- Minimum Alternative Tax applicable on the book profits has been increased from 10% to 15%.

- With effect from 1 April 2010 (AY 2010-2011), a new section 115WM is inserted to abolish fringe benefit tax. Consequently, it is also proposed to restore the taxation of the fringe benefits as perquisites in the hands of the employees.

Export Benefits

- Tax benefit to units set up in Free Trade Zone under sections 10A and 10B have been extended up to assessment year 2011-2012.

Change in Transfer pricing law

- At present there is a safe harbour of 5% up to which variation are permitted in pricing when more than one comparable are thrown up by the TP Study. The variation margin of 5% was applied on the average of prices of comparables. The provisions of the law are amended to apply the permissible 5% on the price charged by the assessee rather on the average of prices of comparables.
Important Judgments

Tribunal Judgments
Payments for leasing satellite transponders are royalty:

In this era of Information and Communication Technology (ICT), an important question arises as to whether or not the services rendered by the satellite companies, through the transponders located at Geostationary satellites (also known as communication satellites), can be treated as royalty. (The transponders are utilised for beaming TV signals in ‘footprint area’ and also for transmission of internet data.)

In this case, the satellite companies provided to the telecasting companies the use of transponders in their satellite, whereby the telecasting companies could uplink and downlink the telecast of their programmes through the transponders. The nature of the programme and its time of telecast depended entirely upon the telecasting companies. The consideration was paid by telecasting companies to the satellite companies for providing the right to use the transponders.

It was held by the Tribunal that:

- The services rendered by the assessee through their satellites for telecommunication or broadcasting amounts to “process.”
- It is not necessary that the services rendered must be through “secret process” only. Even services rendered through simple process will also be covered within the meaning of ‘royalty’.
- In the case of satellites, physical control and possession of the process can neither be with the satellite companies nor with the telecasting companies. The control of the process by either of them will be through sophisticated instruments either installed at the ground stations owned by the satellite companies, or through the instruments installed at the earth stations owned and operated by telecasting companies.
- The payments received by a satellite company from a telecasting company is on account of use of process involved in the transponder, and it amounts to royalty within the meaning of Section 9(1)(vi) of Income Tax Act, 1961. It also amounts to royalty within the meaning of respective Articles of DTAA.

Non-resident supplying equipment outside India has no taxable income in India

The assessee, a German company, executed various contracts in India for many decades. During the relevant year, the assessee executed a contract with BPL for execution of the cellular mobile project on CIF basis for a total consideration of about USD 20 million (approx Rs 746 million). The Assessing Officer (AO) came to the conclusion that since the assessee was present in India for many decades and the contract with BPL was executed over a period far more than six months, and the assessee had sent its technicians for executing projects in India who were paid through its Indian subsidiary, it could be said that the assessee had a PE in India.

The contention of the tax payer was that:

- It did not have any employees stationed in India for carrying out any activity on its behalf. Some of its employees that were deputed to its Indian subsidiary - Siemens (India) Ltd. - were on the rolls and under the supervision of the Indian company.
- All the onshore operations were the responsibility of the Indian company, who was engaged in ensuring supplies and the availability of know-how whenever required. It was further clarified that for such services, there was no separate recovery by the assessee company and the charges were recovered by the Indian company directly from the customers.
It did not have any taxable income from this contract as per India’s Income Tax Act and hence there was no question of going into DTAA with Germany. It was stated that the assessee had supplied the equipment to BPL outside India and the payment was also received outside India. It was pointed out that the ownership of equipment was to be delivered to the carrier at the port of the shipment and the equipment was to become the absolute property of the purchaser free from any encumbrances at the time of delivery at the port of shipment only.

Hence, the assessee did not have any PE in India and hence no income was taxable.

The Tribunal Authority ruled the following:

- The contract between the assessee and BPL was for supply of equipment on principal to principal basis, and since the assessee did not have any PE in India, the question of supply of equipment being attributable to the PE did not arise.
- If there is no tax liability as per domestic law then the DTAA cannot create it.
- The assessee received the payment outside India. The offshore supply of equipment from abroad, means that the supply of goods is made outside India.
- The local activity with respect to the installation was carried out by the Indian subsidiary in its independent capacity.

**Advance Ruling**

Managerial services provided by a technology company are not ‘technical service’ under DTAA between India and USA

The Applicant (Invensys Systems Inc), a US based company, was engaged in the business of manufacturing process control instruments, and providing related engineering, research, technology, and consortium services etc. It entered into an agreement, called the Cost Allocation agreement, with an Indian company- Invensys India, which was a part of Invensys group.

Applicant provided services of the following categories to the Indian company:

- Environmental health safety
- Human resource support and learning and development initiatives
- Assistance on key projects
- Assistance in relation to finance, internal audit treasury and tax
- Corporate, secretarial, and legal support.

The Applicant raised invoices on Indian company for the above services for the amounts worked out on the basis of the agreement. No personnel of the applicant visited India for assistance to Indian company and the Applicant had no permanent establishment (PE) in India.

The question was whether the nature of the above services could be brought within the definition of technical or consultancy services and made taxable in India.

On analysis, it was determined that these services are of managerial nature. To classify them as ‘technical’ or ‘consultancy’ services, the basic requirements of clause (b) of article 12(4) of the DTAA between India and USA - that the service should ‘make available technical knowledge, experience, skill’ - needs to be fulfilled, which is not true in this case. Hence these services are not taxable in India.

Even if some services can be construed to be in the nature of ‘shareholder activities’ which are normally taxable, in the absence of a PE, they would still not be taxable in India.
Profits from business not covered under DTAA are taxable in India – Indo-Swiss DTAA
The Applicant, a Swiss company, transported cargo from Indian ports to foreign ports. The question was (a) whether it had a Permanent Establishment (PE) in India in relation to this transportation activity, under the provisions of the India-Switzerland DTAA, and (b) if there is no PE, then whether income from such charter of vessels is not liable to tax in India under the DTAA.

It was determined by the Appellate Authority that:

- The applicant’s profits from international shipping operations are not covered under the Indo-Swiss DTAA. The rationale of the treaty negotiators to keep shipping profits outside the DTAA was that Switzerland, being a land-locked country, is not expected to have shipping companies operating from its land.
- Hence, the freight income received by the applicant for carrying the cargo from the Indian ports to the foreign ports by deploying chartered vessels is liable to be taxed in India under the provisions of Sec 172 of the Income Tax Act of India.

Court Judgments

Business expenses not allowed as a deduction in the absence of any business
The assessee was a French company that entered into a contract with ONGC, India, for the drilling operation in oil exploration. It finished its contract and after that did not get another one for six years. In this slump period, the assessee earned only interest income on its income tax refund. The assessee filed its tax return claiming administrative expenses as deduction out of this interest income. Now the question was whether these expenses can be allowed as deduction u/s 71 of the Income Tax Act. The High Court ruled that these expenses cannot be allowed as deduction because the assessee was not doing any business in India during this slump period. The High court ruled that:

- In this lull period, just by having correspondence with ONGC from its Dubai office, the assessee could not claim that it was doing business in India.
- Although ‘lull in business’ does not mean that the assessee has ceased its business, in the absence of a permanent office or any other office in India and without any contract in execution during the relevant period, it cannot be said that it was in business in India.
- A business connection cannot be considered as equivalent to a permanent establishment.

Supervision charges are not commercial profits under DTAA between India & Sweden
Assessee, a Swedish company, entered into an agreement with VSNL, India, to provide consultancy services in implementation of India-UAE Submarine Cable System Project. Part (a) of the said agreement related to planning and technical studies prior to placing turnkey contract with the submarine system manufacturers, and part (b) of the agreement related to supervising the installation of all terminal equipments and cables in the terminal buildings, and also to supervise the overall testing and commission activities. Now the question arose whether supervision charges received by the assessee for the part (b) of the agreement could be treated as commercial profits which are exempt from income tax as per the provisions of DTAA between India and Sweden. The Court held that:

- As per the provisions of Article III (3) of DTAA 1958, the management charges are not to be treated as commercial profits. Therefore, the management charges received by the assessee, whether relating to the business management or technical management would be outside the scope of DTAA 1958.
As per the agreement between the assessee and VSNL, the assessee was not only to render technical consultancy services under clause (a) of the agreement, but also provide supervision services under part (b) of the agreement. The fees payable in respect of the above activities are nothing but the management fees which are specifically excluded from the purview of industrial & commercial profits as per Article III (3) of DTAA 1958.

Therefore, the technical supervision charges received by the assessee being management charges, are not commercial profits, and are therefore excluded from the provisions of the DTAA.

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ISRAEL – INCOME TAX ORDINANCE AMENDMENT 169

Companies

By degrees, the rate of company tax will be reduced from 2009-26%, to 18% by the year 2016.

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Rate of tax (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>26</td>
</tr>
<tr>
<td>2010</td>
<td>25</td>
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<tr>
<td>2011</td>
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<td>2013</td>
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<td>2014</td>
<td>21</td>
</tr>
<tr>
<td>2015</td>
<td>20</td>
</tr>
<tr>
<td>2016</td>
<td>18</td>
</tr>
</tbody>
</table>

Individuals

The intervals between the tax brackets will be reduced and the top marginal rate will be reduced from 46% in 2009 to 39% by the year 2016.

Tax on Dividends

There is a 12% withholding tax on dividends distributed to individuals, during the period from 1 October 2009 to 30 September 2010, on profits accumulated until 31 December 2002 (instead of 20% or 25% as before).

This provided that the shares which gave rise to the dividend were acquired before 1 January 2003 (subject also to further conditions).

National Insurance and National Health

The monthly ceiling for social security payments was doubled from the previous NIS 38,415 to NIS 76,830. The change is effective from 1 August 2008 to 31 December 2009 and relates to both employees and the self-employed.

Dividend income is exempt from the social security payment.

VAT

There is a comprehensive change in the system of reporting by both individuals and companies registered for VAT to the Israeli tax authority, when making payments.

The tax authority will issue tax numbers to all individuals and companies registered for VAT by means of the internet (online).

The individuals and companies registered for VAT will submit their returns electronically, according to the tax numbers issued to them, to the Israeli tax authority.

There will be a change in the format of the periodic electronic report to be submitted by individuals and companies registered for VAT.
Law for the Encouragement of Capital Investment

A management body has been established to grant benefits for tourist attractions, and in the field of renewable energy.

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ITALY – Tax Update

Due to the global turmoil that has also heavily hit the Italian economy, the government has introduced a range of tax incentives aimed at helping enterprises. The main measures introduced by Decree 78/2009, which have already been approved by Parliament, are listed below.

**Tax Breaks Granted to New Investments (so-called “Tremonti-ter” Rules)**

Investment in new machinery and equipment from 1 July 2009 to 30 June 2010 is entitled to a 50% tax relief of the amount of said investments, bringing a reduction to the income tax base. In addition, the ordinary assets depreciation on the gross amount of investments is also allowed. Should such a deduction give rise to a loss in the tax return, the latter can be carried forward to offset the taxable income of the following five fiscal years.

**De-taxing of increases in share capital**

Corporations and partnerships (“società di persone”) whose share capital is increased by individuals between 5th August 2009 and 5th February 2010 will be eligible for a special tax allowance. The tax relief would be 3% of the capital increase, up to a cap of 500,000 Euro, this giving rise to a maximum yearly deduction of 15,000 Euro. The benefit applies for five fiscal periods only.

**Tax amnesty for offshore assets (tax shield)**

Decree 78/2009 has reintroduced the tax shield for the third time, already enacted in the Italian tax system in 2001 and 2002, to allow the repatriation and the regularisation of offshore investments and assets held by Italian residents as of 31 December 2008 in violation of the fiscal monitoring rules and as a consequence of the relevant income not shown in tax returns. This provision can be applied to the investments and assets held outside Italy as of 31 December 2008.

Taking benefit from the tax amnesty is upon:

- payment of a lump sum equal to 5% of the asset value as of 31 December 2008 which covers all the tax periods up to 31 December 2008 to be made from 15 September 2009 to 15th December 2009
- a special "confidential" return being filed with an Italian bank or other financial intermediary summing the assets to be declared and not disclosed to the Authorities.

Decree nr.78 has doubled the penalties provided for the violation of the fiscal monitoring rule (so-called Form RW). The new penalty ranges from 10% to 50% of the offshore assets value.
CFC rules: extension

Pursuant to Decree 78/2009, the field of application of CFC rules has been extended. This states that profits earned by a CFC located in a tax haven country have to be imputed to the Italian resident parent/individual regardless of any dividend distribution. Afterwards, the assessments profit imputation can be avoided if the ultimate Italian parent company is able to prove that its subsidiary carries on its industrial or commercial activity in the market of the State or territory in which it is located (previously it was sufficient that the CFC business be performed in the State or territory of the tax domicile).

The companies can apply for a ruling to prove that the subsidiaries were not established in order to gain a tax advantage, otherwise not allowed.

Offsetting of yearly or quarterly VAT credit

New rules referring to the recovery procedure of VAT credits have been introduced with effect from 1 January, 2010.

The offsetting of VAT credit against other taxes, duties and social contributions for amounts over €10,000.00 will only be allowed after the 16th day subsequent to when the VAT return or quarterly claim is filed. The offsetting, however, must be preceded by a formal request to the VAT Authorities.

EU Cross-Border VAT Changes

A package of important VAT changes will be effective as of 1 January 2010. These changes will affect the rules on:

a) place of supply of services
b) reverse charge
c) Intrastat form.

From 1 January 2010, the basic “place of supply” rule for supplies to “VAT registered persons” will be that such supplies are deemed to be made where the customer is established. The reverse charge will apply to purchases of services which must be shown on Intrastat forms by following the so-called “reverse charge” procedure.

VAT reimbursement claimed by foreign entities

Since 25 September 2009, VAT refunds claimed by non-Italian resident VAT registered entities having a P/E, formally registered in Italy, have to be filed by the latter only.

Claims processed via an Italian VAT representative or via direct identification by the non-Italian resident Company will no longer be viable.

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JORDAN – TAX UPDATE

“Jordan is committed to building a dynamic free economy that functions in the context of an environment attractive to investments, which is the result of a comprehensive and ongoing process of reform that leads to more openness to the global economy.”

His Majesty King Abdullah II ibn Al Hussein

For many years Jordan has been promoting the country as a place to do business for many reasons such as:

- Unique and strategic location
- World class infrastructure and communications
- Qualified and competitive Human Resources
- International Agreements accessing a market of one billion customers
- Existence of Free Zones, Industrial Estates and Qualifying Industrial Zones (QIZs)
- Comparative investment environment
- Comparative advantages of competitive economic sectors and sub sectors.

The following paragraphs recapitulate the incentives provided for both foreign and domestic investors doing business in Jordan.

Free Zones

Jordan’s Free Zones were established to promote export-oriented industries and transit trade; to attract domestic and foreign direct investment; and to spur economic growth and job creation.

Free Zones accommodate processing industries, in addition to trading, warehousing, and other activities. Commodities and goods of various origins are deposited in the Free Zone areas for storage and manufacturing, without payment of the usual excise fees and taxes.

Free Zones accommodate enterprises that introduce new industries, utilise modern technology, complement domestic industries, use local raw materials or manufacturing parts, upgrade the skills of local workers, and produce goods with limited availability in the domestic market.

Incentives offered by Free Zones include:

- Exemption from income taxes for exported goods, goods in transit trade, as well as profits gained from the sale or transfer of goods inside the Free Zone.
- Exemption from income and social service taxes on salaries and allowances of non- Jordanian employees involved in projects established in the Free Zones.
- Exemption from custom duties, taxes, and other fees on imported goods, or on those goods which have been exported (with the exception of services and rent charges).
- Exemption from licensing fees and taxes on land and buildings, and other construction setups in the Free Zones.
- Full repatriation of capital and profits generated from operations in the Free Zones.
- Exemption from custom duties for goods produced in the Free Zones and offered for domestic market consumption. This exemption is limited to the cost of materials and manufacturing expenses, provided this value is approved by the Free Zone Committee.

Industrial Estates

The Jordan Industrial Estates Corporation (JIEC) is a semi-governmental corporation that was established in 1984 with both public and private ownership.
Its catalytic role is to contribute to the development of small and medium-sized industries (SMIs) by providing comprehensive and integrated industrial estates. In 1996, the JIEC inaugurated its Centre of Excellence which will function as an incubator for new enterprises and as a catalyst for the interaction between industry and academia.

Three of the operating public industrial estates also hold QIZ (see the Qualifying Industrial Zones paragraph) status, which allows exporters of goods manufactured in these zones to benefit from duty-free and quota-free access to the US market.

Industrial estates offer the following incentives to investors:

- 100% exemptions for two years of income and social services tax for industrial projects located within industrial estates owned and managed by JIEC.
- Total exemption from buildings and land tax.
- Exemption or reduction on most municipal fees.
- 100% exemption of taxes and fees on fixed assets for the project, fixed assets for expansion or modernization, and on spare parts

### Qualifying Industrial Zones (QIZs)

QIZs are areas that have been accorded a special status designated by the governments of Jordan and the US, whereby products manufactured in these zones can be exported to the US with payment of duty or excise taxes, and without the requirement of any reciprocal benefits.

In addition, there are no quotas on products manufactured in Jordan and exported to the US as a result of these and other facilities offered by the government of Jordan. Investors are able to economize between 15%-35% on the cost of production.

### Aqaba Special Economic Zone Authority (ASEZA)

The Aqaba Special Economic Zone (ASEZ) was launched in 2001 as a duty-free, low tax multi-sectoral development zone encompassing the total Jordanian coastline (27 km), the sea-ports of Jordan, an international airport and the historical city of Aqaba with a current population of 90,000 people. It encompasses an area of 375 Km² and offers global investment opportunities in a world-class business environment ranging from tourism to recreational services, from professional services to multi-modal logistics, from value-added industries to light manufacturing.

A package of incentives offered by ASEZA includes:

- Traded goods are exempted from customs taxes and fees, except for cars; (yet qualifying registered firms may import cars duty and tax free).
- Business activities are subjected to a 5% corporate tax with the exceptions of banking, insurance and land transport which will be subjected to the prevailing tax rates in Jordan.
- Full exemption from social services tax 7% sales tax for selected finished consumer goods and hotel and restaurant services.
- 10% land transfer tax, of which 6% is paid by the buyer and 4% by the seller
- Exemption from land and building taxes on used property.
- No restrictions on repatriation of capital and profits.
- Businesses registered and operating in the ASEZ also enjoy similar incentives provided to the rest of the country such as 100% foreign ownership in tourism, industry and a vast majority of services, in addition to full repatriation of capital and profits and liberal foreign currency regulation.
- Registered entities benefit from preferential access Jordan possesses with the EU, the United States through the QIZ and FTA, and the numerous Arab countries through protocols and free trade agreements.
Investors can lease the land in the ASEZ for a period of 50 years, renewable in certain conditions, or purchase it for particular projects, which include hotels, health, educational, residential and commercial buildings.

**Classes of Free Zones**

The free zones in Jordan are categorised into two classes as follows:

**Public Zones:** the following free public zones are currently in existence in Jordan:
- Al-Hassan Industrial Estate
- Al-Hussein Bin Abdullah II Industrial Estate
- Aqaba Industrial Estate
- Ma’an Industrial Estate.

**Private Zones:** the following free private zones are currently in existence in Jordan:
- Ad-Dulayl Industrial Park
- Al-Tajamouat Industrial Park
- Cyper City Park
- Al-Qastal Industrial Park
- Al-Zay Ready Wear
- Al-Mushatta Qualifying Industrial Estate
- Jordan Gateway Project
- Al-Hallabat Industrial Park
- KADDB industrial Park.

**Corporate Income Tax**

In case the investor(s) decided to do business in Jordan and was not subject to any tax exemption, then the investor will be subject to one of the following Corporate Income Tax Rates (per sector):

Corporate Income Tax rates are deducted from taxable income as follows:

- 15% for Mining, Industry, Hotels, Hospitals, Transportation, Contractual Contracting
- 35% Banks and Financial Companies
- 25% Leisure and Recreational Compounds, Conventions and Exhibition Centres, Insurance Companies, Exchange Companies and Financial Services, Telecommunication, Business Services, Trade Companies, Others.
- 0% for Agriculture Projects.

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Malaysia – Recent Developments

There have been some interesting tax developments both domestically and internationally over the last few months which are summarised below.

Double Tax Agreements (DTAs)

**Malaysia – Brunei**
Malaysia and Brunei signed an Avoidance of Double Taxation Agreement on 5 August 2009, the details of which are not yet available. The DTA has yet to be gazetted.

**Malaysia – Iran**
The Malaysia-Iran DTA which was signed several years ago is now effective. The effective dates for income tax / withholding tax and petroleum tax is as follows:

<table>
<thead>
<tr>
<th>Dates</th>
<th>Income tax and withholding tax</th>
<th>Petroleum tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 January 2006</td>
<td>1 January 2007</td>
</tr>
</tbody>
</table>

The withholding tax rates applicable are as follows:

- Royalties – 10%
- Technical fees – 10%
- Interest – 15%

**Malaysia – United Kingdom**
Malaysia and United Kingdom have signed a protocol on 22 September 2009 which will have the effect of bringing the Exchange of Information Article of the current DTA in line with the OECD requirements.

**Malaysia – Turkmenistan**
The Malaysia-Turkmenistan DTA has been gazetted on 18 June 2009.

The withholding tax rates applicable are as follows:

- Royalties – 10%
- Interest – 10%
- Technical fees – No specific Article dealing with technical fees.

Public Rulings

The Malaysian Inland Revenue Board (IRB) has recently issued the following Public Rulings


This new Public Ruling which is effective from year of assessment 2008 will supersedes the PR 5/2006 issued on 31 May 2006. The key points covered by this PR include:

- A deduction for Professional Indemnity Insurance (PII) premium expense which was previously only given where the purchase of a PII policy is a requirement under the profession’s by-laws or statute is now extended to all professionals carrying on the business of his profession.
- Where a deduction has been allowed on the PII premium, any insurance proceeds/ compensation received are taxable. However, any subsequent payout from the insurance proceeds/compensation is not allowed a tax deduction.
Highlight – Budget proposal 2010

The budget proposal 2010 was announced on 23 October 2009. New updates relating to major tax changes and tax incentives will be highlighted in the next quarter.

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Together with the extensive treaty network the participation exemption is one of the most important and attractive elements of the Dutch tax legislation for foreign investors. The combination of the treaty network and the participation exemption provide foreign investors a way to collect profits from operating companies around the world in their Dutch holding company and to distribute these profits in a tax friendly manner.

Up to the 1 January 2007 the participation exemption could be claimed in most of the cases.

Before 2007 the participation exemption could not be claimed if the Dutch holding company had the intention to hold the foreign subsidiary as an investment (intention test).

Effective from the 1 January 2007 the rules for applying the participation exemption changed because of the introduction of:

(i) the participation settlement and
(ii) replacing the intention test with three more objective tests.

Applicability of the participation settlement means that under certain conditions profits from the sub, which could be collected “tax free” before 2007 due to the participation exemption, are now taxed with the standard Dutch CIT rate (20%-25,5%) at the Dutch holding company. The local CIT paid (with a minimum of 5%) can be deducted from the Dutch CIT to be paid by the Dutch holding company.

The participation settlement is applicable in case the sub qualifies as a low taxed investment company. The sub qualifies as a low taxed investment company in case all three conditions mentioned below are met:

(i) 50% or more of the assets of the sub qualify as “free” investments (among others assets not necessary for the business operations of the sub); and
(ii) the local CIT rate is less than 10% to be calculated on a tax base similar to the Dutch one (so a standard rate of 10% or more combined with a small tax base is not sufficient to avoid the qualification as low taxed investment company); and
(iii) the sub is not a real estate company.
Recently a legislative proposal was submitted in which it is proposed to amend the legislation regarding the participation exemption in such a way that the intention test is reintroduced and the three conditions mentioned before are modified. The aim is to provide a clear set of rules as to whether the participation exemption applies. The new legislation will cause the return to the more favourable regime that was in force up to 2007. If the legislative proposal passes this will implicate that a sub will qualify as a low taxed investment company if:

(i) the Dutch holding company holds the sub as an investment; and  
(ii) generally (so no continuous test anymore) 50% or more the assets of the sub qualify as free investments (real estate does not qualify as free investment); and  
(iii) the local CIT rate is less than 10% and no special tax regime, like for example a tax holiday, a very small tax base due to a deductible notional costs etc, is applicable (a Dutch like tax base is not needed anymore).

To summarise, if the legislative proposal passes (planned date of commencement 1 January 2010) the participation exemption will be applicable if:

(i) the sub is not held as an investment; or  
(ii) less than 50% of the sub’s assets qualify as free investments; or  
(iii) the local CIT rate is 10% or more and no special tax regime applies.

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OMAN – NEW INCOME TAX LAW

A new Income Tax Decree no.28/2009 has been published in the official gazette on 1 June 2009 which will be effective from tax year beginning 1 January 2010, which replaces the earlier Law of Income Tax on Companies no.47/1981 and its amendments and the Profit Tax Law on Commercial and Industrial Establishments no.77/1989. It also cancels provisions in any other law which contradicts the new Income Tax Decree no.28/2009.

Year of application

The new Income Tax Decree will apply from tax year beginning 2010. For example, in case of a company with financial year ending 31 January 2010, the tax year for that company would be 2010, and therefore the new decree will apply to the entire income earned by that company from 1 February 2009 to 31 January 2010.

Income Tax Rates

Earlier as per old Tax Decree, Omani establishments and companies registered under GCC state laws were taxed at following rates:

- First RO.30,000 of taxable income of the company - Tax free.
- Balance taxable income over RO.30,000 - Taxed at a flat rate of 12%.

However, branches of foreign companies were taxed at a rate between 5% and 30% depending upon the taxable income bracket in which taxable income of that company falls. For example, if taxable income of a foreign company is RO. 120,000, it had to pay tax at the rate of 30% on its taxable income i.e. RO.36,000. The new Income Tax Decree removes this disparity between Omani companies including GCC companies, and foreign companies. Accordingly, now foreign companies will be taxed on the same basis as that of Omani companies and GCC companies which is as under.

- First RO.30,000 of taxable income of the company - Tax free.
- Balance taxable income over RO.30,000 would be taxed at a flat rate of 12%

This will assist in propelling the economic development and growth of Sultanate of Oman at a much faster pace as now it will be more attractive for the foreign companies to invest in Oman.

Business Income (changes in definition of business income)

The definition of business income will now include:

- Gains on sale of goodwill, intangible assets i.e. trademarks, etc.
- Income earned from capital gains will also be taxed at normal tax rate.
- Assets exchanged in event of mergers and acquisitions and group restructuring will be taxable.
- Income earned overseas by a PE (permanent establishment) in Oman will be taxed in Oman.

Corresponding tax credit in Oman will be given to the extent of Omani tax i.e. 12% or foreign tax paid on that income whichever is lower.

- The term Royalty has been defined very extensively and will now cover amongst other things, rental of equipment and transfer of technical know how
- Dependent agency concept has been introduced to tax foreign companies in Oman if they carry out business in Oman through a dependent agent.
Withholding Tax

Presently, under old Tax Decree, withholding tax of 10% is applicable on following categories of payment made to foreign companies who do not have PE in Oman:

- Royalties
- Fees in return for management
- Rent of equipment, machinery and devices
- Amounts in return for transfer of technical know-how
- Amounts in return for research and development.

As per the new Income Tax Decree, withholding tax is applicable on following three categories of payment:

- Royalties
- Fees paid for research and development
- Management fees.

However, the term Royalty has been now extensively defined which includes rental of equipment and transfer of technical know how, so effectively there is no change in the criteria of withholding tax rule.

Allowance of Expenses as deductible expense

- Expenses incurred before registration, incorporation and commencement of business shall now be allowed as a deductible expense.

- Depreciation

  A major change in depreciation under the new Income Tax Decree is the introduction of the concept of pooling of assets. According to this concept, all assets coming under a certain category would be depreciated by applying depreciation rate as specified in the new Income Tax Decree on written down value method, which would be computed as under:

  - Opening net written down value
  - Add: additions made during the year
  - Less: Sale proceeds during the year.

Consequent to the above change in the depreciation methodology, there will be no balancing charge or balancing allowance i.e. there will be no profit or loss on sale of assets for tax computations. Earlier, under old Tax Decree, depreciation was allowed on straight line method. Now, as per the new Income Tax Decree, it will be allowed on written down value method on all assets except for depreciation on Buildings, Aircraft and Ships which would continue on straight line basis. The depreciation rate on First class building is 4% and on Second class building, Aircraft and Ships is 15%.

The depreciation rates have remained the same for all assets, except for depreciation rates for Computer and Software which is now revised from 15% to 33.33%, and on Drilling rigs which will now be allowed at the rate of 10%.

Thin Capitalisation

Thin capitalization concept has been introduced i.e. in case of companies which are under-capitalised and are therefore funded through loan from shareholders and related parties, there will be a limitation on allowance of deductible interest expense for which a separate rule will be published.
Tax Exemptions

- Under new Income Tax Decree, tax exemption given to public utility projects under old Tax Decree is withdrawn.

- Under the old Tax Decree, educational institutions and private hospitals were exempted from income tax for indefinite period, which under new Tax Decree will be exempted only for a period of five years and renewable for a further period of five years on meeting certain specified criterias.

- All other provisions relating to income tax exemption continues as before.

Tax Losses

The old rules for carrying forward of tax losses will continue. However, some minor modification has been made i.e. the order of setting off losses is now prescribed in the new Income Tax Decree.

Avoidance of Double Taxation

- Under the new Income Tax Decree, companies which are liable to pay income tax on their overseas income will be entitled to corresponding tax credit to the extent of Omani tax rate of 12% or the foreign tax rate whichever is lower, even in those cases where there is no Avoidance of Double Tax Treaty between Government of Sultanate of Oman and Government of that foreign country.

- Where there is an Avoidance of Double Tax Treaty between the Government of Sultanate of Oman and Government of that foreign country the overseas income of Omani company will continue to get tax credit at lower of Oman tax rate i.e. 12% or tax paid abroad.

- Tax credit can be claimed within 2 years of payment of income tax overseas.

Service PE concept

Under old Income Tax Decree, foreign companies were taxed in Oman for services rendered in Oman through their employees who had stayed in Oman for a short duration say less than 30 days, though they were not registered with Ministry of Commerce & Industry. The new Income Tax Decree introduces a service PE concept which would mitigate this problem as 90 days threshold limit has been fixed i.e. a foreign company with no fixed place of business in Oman will not be subject to Omani income tax under the new Income Tax Decree if their representatives come to Oman for a period of less than 90 days in a period of 12 months.

Leasing companies

The new Income Tax Decree provides that loan loss provisions to the extent specified by Central Bank Regulation would be allowed as a deductible expense to all banking companies as defined in the banking law, to be extended to all the leasing companies. Thus, all leasing companies under new Income Tax Law would be entitled for loan loss provisions to be allowed as a deductible expense.

Related Party Transactions

In the old Tax Decree, the transactions with related parties were investigated very closely and are restricted under Article 11 of the old Tax Decree. Under the new Income Tax Decree, transactions with related parties will continue to be investigated closely. However, the benchmark of arm's length has been introduced i.e. it would be compared with a transaction with any other independent third party. Under the new Income Tax Decree, if an adjustment in taxable income has been made under anti-avoidance regulation, the other company can request a corresponding adjustment in its assessment within one year.
Important Regulatory Matters

The following important changes are being made in the new Income Tax Decree:

- Tax department will issue rules specifying certain criteria for tax payers to be registered with income tax department and file their returns.
- Rules for assessment of companies will also be made.
- Notice will be deemed to have been served 15 days from the date of issue of letter / assessment order i.e. earlier an objection had to be made within 45 days from the date of the assessment order and not from the date when order was deemed to be served.
- Certain categories (small companies) will be exempted from tax registration, filing of tax returns and submission of audited accounts. Rules for the same will be published shortly.
- Deadline for payment of taxes and filing of response will be extended to next working day if the deadline falls on a public holiday.
- Limitation of 10 years has been introduced in cases where no returns have been filed.
- Under old Tax Decree, limit for decision on objection was three months extendable for a further period of three months. The same is being increased to five months which can be further extended to another five months.
- It will be mandatory now to pay tax on items which are not disputed before filing objection.
- Principal officer of the company cannot be away from Oman for more than 90 days.
- An Omani agent may be considered as a principal officer in case of a foreign principal doing business in Oman through an Omani agent.
- Under old Tax Decree, income tax department was not permitted to take any further action after the verdict is given by the Tax Committee. However, now within a period of two months, tax department can approach the Tax Committee for any apparent mistakes / incorrect application of Income Tax Decree.
- The new Income Tax Decree provides for issuance of executive regulations which is expected during next few months, which will include amongst other things, rules for allowance of head office overhead expenses, transfer pricing rules, and rules for filing and assessing of tax returns.

[The above note should not be construed as conclusive tax advice as it is based on limited extract of translation in English. Before acting on the above note, a professional opinion should be taken.]

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Romania- Recent Tax Changes

Increase of the local tax rates

Government Decision no. 956 regarding the level of taxable values, local taxes and other such taxes, as well as the fines applicable starting fiscal year 2010 has been published. It provides an increase of approximately 20%.

Amendments on Fiscal Code regarding: corporate income tax, personal income tax, tax on income obtained from Romania by non-residents, VAT and excise duties

The amendments to the Fiscal Code shall be applicable from 1 January 2010, with few exceptions.

The most important changes to the Fiscal Code are the following:

1. Amendments on the corporate income tax

   European company

   The concept of European Company or co-operative European company, which represents legal entities with headquarters in Romania, but incorporated according to the European legislation has been introduced. These legal entities shall be subject to corporate income tax in Romania for the taxable income obtained from any source, in Romania, as well as from abroad.

   Annual corporate income tax returns and dividend tax

   There are changes in the deadlines for:

   - the submission of annual corporate income tax return and
   - the payment of dividend tax.

2. Amendments on the personal income tax

   There are provided changes in the deadlines for the submission of the Tax Statement and regarding the payment of dividend tax.

3. Amendments on the income obtained from Romania by non-residents (Withholding tax)

   Starting from 2010, interest and/or dividends paid to pension funds as defined under the legislation of the EU Member State shall be exempted from tax.

   In addition, starting from 2010, in order to apply the most favourable provisions of the EU legislation, non-residents will have to provide to the income payer a tax residency certificate as well as a self statement on the fulfilment of certain conditions.

   30 June of the current year for the previous year shall become the deadline for submission of the return regarding the taxes withheld by the income payers.

4. Amendments on the value added tax

   The changes to Fiscal Code were approved as a result of the obligation to transpose into the national legislation and apply, starting with 1 January 2010, the provisions of the European Directives amending Directive 2006/112/CE regarding the common VAT system.
These European Directives are:

a) Directive 2008/8/CE regarding the place of supply of services;
b) Directive 2008/9/CE regarding VAT reimbursement to persons established in EU;
c) Directive 2008/117/CE regarding the fight against tax fraud related of Community operations.

In addition to the changes above in purpose of harmonization of Romanian legislation of the EU VAT Directives, there are other amendments, like:

- definition/ redefinition of some concepts
- VAT chargeable event and chargeability
- person liable to pay VAT
- deduction right
- the turnover for small enterprises
- registration in VAT purpose
- mandatory requirements regarding invoices format
- reverse taxation for import of goods.

5. Amendments on the excise duties

These amendments were introduced as a result of the obligation to transpose in the Romanian legislation the Directive 2008/118/CEE regarding the general arrangements for excise duties which repeals Directive 92/12/EEC.

The main amendments are referring to:

a) Certain definitions and concepts, like:

- ‘Member State’ and ‘territory of a Member State’, ‘Community and ‘territory of the Community’, ‘third territories’
- release for consumption
- registered consignee
- registered consignor
- person liable to pay the excise duty for the non-harmonised excises related to the moment when the chargeability of the excise duties may occur
- electronic administrative document for the Intra-Community movement of excisable products that are placed under an excise duty suspensive regime
- Detailed provisions regarding the functioning of the EMCS – the European computerised system – designed to monitor the intra-Community movements of excisable products placed under the excise duty suspensive regime and of the various procedures allowed by the system.

b) The elimination of certain products from the scope of the excise duties

All the excisable products for which the excise duty was established in a percentage rate will be eliminated from the scope of the non-harmonised excise duties.

The only remaining exceptions are: green coffee, roasted coffee and soluble coffee.

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Singapore – Tax Update

The Inland Revenue Authority of Singapore (IRAS) has been stepping up its efforts to improve tax compliance as well as to adopt international tax practices in Singapore. In this issue, we take a look at some of these recent developments that may be important to companies in Singapore as well as their overseas associates.

Voluntary Disclosure Program

Under the Income Tax and Good and Services Tax Acts, penalties are imposed for errors made in the tax returns. The penalties can be up to two times of the tax undercharged. In addition, where the error is made without reasonable excuse or through negligence, a fine and/or a jail term may also be imposed.

The IRAS launched a voluntary disclosure program in March 2009 to encourage taxpayers to come forward voluntarily in a timely manner to get their tax matters right. Under the program, IRAS will waive the penalty if the disclosure is made within one year from the statutory filing date or impose a reduced penalty (5% p.a. for Individual and Corporate Income Taxes and 5% for GST and withholding taxes) for taxpayers that meet the qualifying conditions.

As participation in the voluntary disclosure program is a one-off, taxpayers may want to consider conducting a health-check on their tax compliance so that they can utilise this program fully.

Transfer Pricing

Over the last three years, the IRAS has taken progressive steps to introduce transfer pricing (TP) and the arm’s length principle to taxpayers.

- IRAS issued transfer pricing guidelines for the first time in February 2006. The purpose of the guidelines is to give “guidance to Singapore taxpayers on applying the arm’s length principle and the recommended preparation and maintenance of documentation to demonstrate compliance with the arm’s length principle”. It is also stated in the same circular that “Singapore’s tax legislation does not contain a specific provision stipulating the use of the arm’s length principle for related party transactions”.

- In July 2008, IRAS issued the Transfer Pricing Consultation circular in conjunction with the launch of its transfer pricing reviews of taxpayers. The objectives of the TP consultation is to enable IRAS to assess the level of compliance and to identify areas where IRAS can further facilitate and advise taxpayers on good TP practices. IRAS is now conducting its second round of TP consultation with taxpayers.
• In February 2009 IRAS issued a supplementary guide to provide further guidance and application of 
the arm’s length principle to related party loans and related party services. Please refer to the Issue 2, 
International Tax Alert – Asia Pacific region for more details.

• Singapore is now in the process of legislating the arm’s length principle for related party 
transactions in the Singapore Income Tax Act. This will give the IRAS the basis for making adjustments 
if it is of the opinion that the arm’s length principle is not applied appropriately by the taxpayer.

With this increasing emphasis on TP in Singapore, companies that have transactions with their foreign 
related parties may want to consult their tax advisors on how they should manage this emerging risk area.

**Exchange of Information for Tax Purposes**

Singapore endorsed the new internationally agreed OECD Standard for the exchange of information for tax 
purposes in February 2009 and introduced legislation in June 2009 intended to comply with the standards. 
As of 14 October 2009, Singapore has signed agreements with ten of its existing treaty partners to adopt the 
standard. Following these amendments, Singapore will be able to extend further co-operation on information 
exchange through its double tax agreements (DTA), and hopes to negotiate and conclude further DTAs.

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Slovak Republic – Proposed Changes in Tax and Accounting Law

There are proposed changes in tax and accounting law that, if passed by the Slovak Parliament, would be effective from 1 January 2010. The most significant changes for non-resident companies investing in the Slovak Republic are listed below.

A draft amendment of the Value Added Tax Act (No. 222/2004) would bring Slovak VAT law closer to the provisions of Council Directive 2006/112/EC on the common system of value added tax. Under the proposed legislation, if a taxable person not registered for VAT purchases services from or sells services to a non-resident in another Member State where tax is paid through the reverse charge method, that taxable person would be required to register for VAT before the service can be received or rendered, respectively.

The amendment also provides general rules for the place of supply of services. In the case of a VAT-registered company, this is where the buyer has its registered office while for a non-registered company it would be the place where the seller has its registered office. Current provisions in Section 16 of the VAT Act on the inter-Community transport of goods and services constitute an exception to these general rules.

In a proposed amendment to the Income Tax Act (No. 535/2003), the thin capitalization provisions that were to have become effective on 1 January 2010 will be pushed forward to a later date. The current economic crisis has been cited as a reason for extending the effective date of these provisions. In addition, the period for carrying forward and applying tax losses would be extended from five to seven years.

In a proposed amendment to the Accounting Act (No. 431/2002), goodwill will no longer have to be amortised over five years, as is the case with development costs, but the amortisation period will be set separately by the company in its depreciation schedule. Any goodwill that arises before 31 December 2009 would be posted in accordance with current regulations, i.e. to be amortised over five years. In accordance with a prior amendment to the Accounting Act, a company’s formation costs are no longer considered an intangible asset, effective from 1 March 2009, and have to be fully amortised in the 2009 balance sheet.

Please note that these changes, other than the provision on formation costs, have not yet become part of Slovak law and may be subject to further amendment by Parliament before they become effective.

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New Changes to the US-Taxation of Foreign Lending in the US

Brief Summary of New IRS Advice

A memorandum of general legal advice issued by the Internal Revenue Service (IRS) to its field operations on 22 September 2009 concludes that a foreign corporation which uses a US corporate agent to originate loans made to US borrowers may be considered to be engaged in a US banking or financing business and its interest income from the loans may be taxable to the foreign corporation as income effectively connected with the conduct of a US trade or business (ECI). This in turn may cause the foreign corporation to be subject to regular US corporate income tax rates and, potentially, to a second-level US branch profits tax, on such ECI.

The memorandum assumes that the foreign corporation has no office or employees itself in the US but engages a US corporation (which may be an independent contractor) to solicit potential borrowers in the US and negotiate loan terms and perform credit analyses. However, the foreign corporation itself must finally approve and execute loan documents outside the US. The memorandum also assumes these activities are considerable, continuous and regular. The memorandum does not address a foreign corporation whose country has an income tax treaty with the US.

Key Questions

Several important questions are not addressed, including:

- How much US activity is sufficient to constitute a US trade or business, beyond one or two isolated loans?
- Can financing arrangements so originated fall outside the conduct of a banking or financing business, rather constituting trading in securities for the foreign corporation’s own account because, for example, they include equity components, and so be exempt from US income taxation unless effected through the corporation’s own US office?
- Does the secondary purchase of US debt rather than loan origination – such as investment in distressed US debt - fall within the memorandum’s analysis?
- If the foreign corporation’s country has an income tax treaty with the US, will such activity result in business income attributable to a permanent establishment of the corporation in the US, which is generally required in order for such income to be taxable by the US under a treaty?
Observations on the Future

- The memorandum notes that foreign persons may have used other strategies to originate loans in the US and offers to assist field operations in the legal analysis to develop these cases. Accordingly, foreign taxpayers should carefully consider their structures for originating US loans.

- The ECI issue addressed in the memorandum is just one of numerous issues that arise in structuring US loan origination by foreign investors. Moreover, both ECI and other issues arise in structuring secondary purchases of distressed and other US debt by foreign investors. Existing IRS guidance on most of these issues is almost non-existent, so the IRS may be undertaking to develop a framework for analysing and resolving more of such issues.

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