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Belgium

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The Belgian/Hong Kong Tax Treaty A Unique Channelling Tool

On December 10, 2003 Belgium signed an agreement with Hong Kong for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital.

Belgium is the first, and for the time being, the only EU-country that has signed an agreement with Hong Kong. For Hong Kong it was the first-ever signed agreement.

The application is for taxes due at source on income credited or made payable as of January 1, 2004 and for Hong Kong for any year of assessment beginning on or after April 1, 2004. The agreement bears a strong resemblance to the OECD model. This agreement is binding on the Kingdom of Belgium and the Hong Kong Special Administrative Region of the People's Republic of China. It applies to the territory of the Hong Kong Special Administrative Region, including Hong Kong Island, Kowloon, the New Territories and the waters of Hong Kong.

The term 'resident' needs special attention in this agreement. The aim of item 2, subsection 2 of the Protocol is to assure that Belgium construes the second sentence of Article 4, §1 in conformity with the OECD commentary on Article 4. According to that commentary, a person who is liable for tax in Hong Kong on the basis of his domicile is not excluded from the

scope of the Agreement on account of the fact that he is taxed on a territorial basis in Hong Kong. Companies in Hong Kong which are not taxed on their income from foreign sources are resident of Hong Kong if they are incorporated in the Hong Kong Special Administrative Region – if they have their central management and control in the Hong Kong Special Administrative Region. In that respect, those companies benefit from the advantages of the Agreement.

This means that 'offshore income' from a Hong Kong resident is within the scope of this agreement, the same as any other income of the Hong Kong resident company and is liable for tax based on the standard Hong Kong rate (This would mean that it would be judged adequate and sufficient if the Hong Kong resident does have some 'onshore income').

The dividend distribution made by a Hong Kong company will provide similar advantages as a dividend received by a EU company from another EU company under the rules of the Parent Directive. This means that the received dividend is tax exempt. In order to have received dividend tax exempted, most countries require the distributed dividend to have been subject to tax (subject to tax clause) or at least subject to 'normal taxation'.

Due to the fact that the regular corporate tax rate in Hong Kong is equal to 17,5%, the Belgian authorities do qualify a dividend received from Hong Kong as a 'normal and subject to tax clause' dividend, even if the origin of the income in Hong Kong was 'offshore income'.

The Belgian tax exemption on received divi-

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dends is limited to 95%. However this dividend is ready for re-distribution in the EU under the Parent Directive conditions.

It is clear that this agreement between Belgium and Hong Kong is a great opportunity and a unique vehicle to 'bring home' realised profits.

Brazil

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Transfer Pricing

This is a typical issue related to Brazilian statutory reporting. Related parties may set cross border transaction (imports and exports) prices and allocate their taxable income to the countries involved. Transfer pricing laws control these allocations by fixing maximum tax deductible costs and expenses, and minimum taxable revenue for these transactions.

A party is related to a Brazilian company if, among other things:

- It is a non-resident head office, branch or parent company
- it has a non-resident individual or corporate entity which is a controlling shareholder or an affiliated company
- it is a Brazilian company's exclusive distributor or
- the non-resident individual or company has a Brazilian company as its exclusive distributor.

Most of our clients encounter difficulties in relation to calculating a transfer price and applying the appropriate tax deduction to Imports. Imports of services, goods or rights are in this case deductible against income tax and social contribution on profits only in some cases. If the expense does not exceed the highest price from the three calculation methods, tax authorities will allow the expense. If the import transaction price exceeds the transfer price, the taxpayer must add the surplus to the income tax and social contribution on net profits assessments.

There are three methods to calculate transfer pricing:

Comparable Uncontrolled Prices (PIC) – the average price of goods, services and rights which are similar or equivalent to goods, services and rights available in the Brazilian market.

Resale Price Less Profit (PRL) – the average resale price of goods, services and rights less unconditional discounts, taxes and commissions on sales, and a profit margin of 60% if the imported goods, services and rights are used to produce other products of the same nature. If the imported goods are not assembled or processed, merely resold, than the profit margin is set at 20%.

Cost Plus (CPL) – The cost of producing equivalent or similar goods, services or rights in the country where they were originally produced will be increased by the amount of taxes and fees levied on the export transaction, and by a 20% profit margin on the total cost.

Depending on the type of company many customers use the PRL method, because it uses an average price, and there is no need to compare the prices of products.

Cyprus

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Double Taxation Agreement

After negotiations the Cyprus and Israel governments are expected to sign an agreement for the avoidance of Double Taxation a few months from now. According to the chairman of the Cyprus Chamber of Commerce and Industry, Cyprus will proceed with the signing of this agreement with Israel this summer. It is worth noting that there are in place agreements with 40 other countries.

The Chairman of the Israeli Chambers visited Cyprus to review the economic relations between the two countries and examine the prospects for their strengthening. After the meetings, the two countries realized that the prospects for cooperation are good not only in trade and tourism, but also in technology sectors.

France

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Tax exemption on salaries for expatriates

The French income tax exemption regime for expatriates was enlarged and of immediate application, from the 2006 revenues. This regime relates exclusively to salaried persons having a French place of residence, employed by an EU firm and working outside France, as well as outside the employer's country.

The total exemption is granted where the three following conditions are met :

- the tax paid abroad is at least 2/3 of the French corresponding tax that the salary would have supported in France,
- the expatriation duration is at least 183 days on a 12 months continuous period (120 days for a commercial prospecting mission) and
- the business and job activity must be either in relation to building sites, or concerning prospecting, research and extracting natural resources, or shipping navigation.

To conform with the EU legislation, the French nationality condition was abandoned and any person having a home in France can take advantage of this tax exemption, all other conditions being effective.

Germany

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Prospects of German Transfer Price Documentation

When transacting cross-border business with affiliated enterprises, companies generally settle accounts with them on the basis of so-called transfer prices. Since the determination of these transfer prices can be a steering instrument for shifting profits, the financial administration increasingly tends to focus on reviewing the adequacy of these transfer prices. Until recently, companies that were requested to submit papers and documents to the public auditor, did not have to fear any sanctions when they submitted useless material or none at all. To counteract this

tendency, the legislation anchored far-reaching obligations to present documentation in Section 90 para 3 and Section 162 para 3 and 4 Fiscal Code (AO) for business years that commenced after December 31, 2002.

Content, essentials and scope of these obligations to present documentation are set down in detail in an ordinance, the Ordinance on Profit Allocation Recording (GAufzV), which entered into force with retroactive effect as of June 30, 2003. In addition, extensive administrative directives were passed on April 12, 2005, which comment on the duty to make inquiries and the duty to co-operate. Any failure to comply with the requirements for proper documentation, will lead to severe sanctions pursuant to Section 162 para 3 and 4 Fiscal Code (AO).

Already now, public auditors demand submittal of transfer price documentation for their audit of the business years as of 2003. Many companies are not prepared for that and they run the risk of being unable to submit the required papers and documents in due time or to submit anything at all. In addition to the pressure of time created thereby (60-day period), information deficits due to staff fluctuations or loss of papers and documents add difficulty to the subsequent preparation of documentation. But if records are set up in a timely manner, the sanctions of Section 162 para 3 and para 4 Fiscal Code (AO) as well as calculation errors and incorrect documentation can be avoided.

As regards aspects related to business economics, the preparation of a transfer price documentation also affords great opportunities. The systematization involved will lead to greater transparency for the entrepreneur and will help to identify inefficiencies and erroneous allocations and will uncover structural options as well.

Ireland

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Recent Tax Treaty Developments

A new treaty between Ireland and Canada entered into force on 12 April 2005. The

revised agreement applies as of 1 January 2006. Parliamentary procedures to bring into force a new treaty with Chile and a protocol amending the existing treaty with Portugal were completed by Ireland in December 2005. Subject to the necessary parliamentary procedures being completed by Chile and Portugal in 2006, it is expected that they will become effective for tax periods in 2007.

New treaties with Argentina, Egypt, Kuwait, Malta, Morocco, Singapore, Tunisia, Turkey and Ukraine are being negotiated. Existing treaties with Cyprus, France and Italy are in the process of re-negotiation.

Holding Companies

Recent legislation has enabled Ireland to compete strongly with existing holding company locations within Europe. Irish companies are now acting as a European/Regional holding or intermediate holding companies. These legislative changes relate to the treatment of capital gains, foreign dividends and foreign interest:

Capital Gains Tax (CGT) on Share Disposals

Irish holding companies are allowed an exemption from capital gains tax on the disposal of shares in their subsidiaries. The exemption is subject to a number of conditions. To be regarded as a holding company, the company must hold at least 5% of the shares of another company.

Foreign Dividend Income

The Irish tax system taxes the receipt of foreign dividends at a rate of 25%, but allows this liability to be reduced, in certain circumstances, by the foreign underlying tax already paid on this income. There is a unilateral tax credit for underlying foreign tax provided there is a 5% shareholding relationship between the companies. In addition, "Onshore pooling," allows the foreign dividends to be pooled together, before they are offset against the Irish tax liability. The tax credits do not need to be utilised in the year that the dividend is received. They can be carried forward indefinitely or offset against Irish tax on future foreign dividends.

Foreign Trading Interest

Irish tax legislation provides for foreign tax credit relief for withholding tax suffered on trading interest earned from non double tax treaty jurisdictions. Credit relief is allowed for the lower of

87.5% of the foreign tax borne or the Irish corporation tax attributable to the income. A new provision in Finance Act 2006 allows, where part of the foreign tax suffered is deducted as an expense in arriving at taxable income, a further amount to be deducted as a credit from tax payable on other relevant income. The additional amount is 87.5% of the foreign tax deducted. This new provision applies only to trading interest received from a 25% subsidiary resident in a country with which Ireland has a double tax treaty.

Italy

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Participation Exemption

One of the main changes in the tax regulation that have recently been approved in Italy deals with the tax exemption in case of transfer of shareholding by a company.

Firstly, it has been reduced the exemption on capital gains from 100% to 95%.

Furthermore the exemption percentages have been reduced to 91 per cent with effect from 12th December 2005 and to 84 per cent with effect from 2007.

The minimum holding period for enjoying the exemption's benefit is 18 months (before was 12 months).

Goodwill Depreciation

A new tax rule, which has been in force since December 2005, has modified the percentage of amortisation of goodwill recorded among the assets. Particularly, the deductible amount in each fiscal period has been reduced to one eighteenth of the goodwill value (prior to this law the percentage was set to one fifth).

This new allowance is applicable for the tax period in progress at the date of entry into force of the law and in respect of goodwill value paid before 2005 and not yet fully depreciated.

Deductibility of Finance Lease of buildings' payments

A new provision has changed the method for deduction of finance lease of buildings' payments from the lessee's income.

The general rule provides, in case of movable assets, that the contract's duration must be not less than half of the depreciation period recognised by the tax provision for the business carried on by the enterprise.

The same rule is now applicable for real estate (buildings): in any case, for real estate the minimum period can not be less than eight year and can not exceed fifteen years.

Business Assets' Revaluation

The Finance Act 2006 provides the possibility of reappraising the business assets' value recorded into the Financial Statements for the Fiscal Year in progress on 31st December 2004. The value of these assets can be revised in the Financial Statements for the subsequent year, the approval date of which is after 1st January 2006.

In consequence to the revaluation is due a tax calculated on the differential between the stepped up value and the historical cost of the assets.

The tax rate is 12 per cent for depreciable assets and 6 per cent for non-depreciable assets; it must be paid in a single instalment by the deadline stated for the income taxes referring to the Fiscal Year during which the revaluation has been made.

The amount of revaluation has to be set aside in a specific Shareholders' Equity reserve.

Changes in Local Tax on Productive Activities (IRAP)

IRAP was introduced in the Italian fiscal system as of year 1998, with a rate of 4.25%.

Its main characteristic is the non deductibility of some costs such as financial expenses and personnel costs.

This tax is under judgement before the European Court of Justice for violation of a European Directive that obliges member States not to introduce taxes on added value different from VAT. The award, which is expected before the summer 2006, causes great expectations because IRAP

means more than 30 billion Euro per year for the Italian State.

Also for that reason, Italy is currently trying to progressively eliminate this tax and, at the same time, has promoted a series of possible deductions from IRAP taxable base.

One of the mentioned deductions is the cost of new hires in an amount not exceeding Euro 20,000 per new employee hired, within the limit of the aggregate increase of personnel cost.

In order to be entitled to deduct the cost of new hires an entity must have increased the number of open-term contracts compared to their average number in the previous Fiscal Year for the three years subsequent to that in progress on 31st December 2004.

On 7th December 2005, the deduction received the approval of European Commission and took effect.

Malaysia

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Disallowances of tax losses and capital allowances

Effective from the year of assessment 2006, companies will not be allowed to carry forward their unabsorbed tax losses and capital allowances to be utilized against their future taxable profits if there is a substantial change (more than 50% change) in the ordinary share capital of the relevant company.

The introduction of the disallowances of losses and capital allowances seek to prevent taxpayers from acquiring into such companies to take advantage of the brought forward unabsorbed tax losses and capital allowances to shelter its future profits.

The provision will however, impact negatively on genuine acquisition of business interests by investors.

Netherlands

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Dutch Court: 30% facility also applicable to supervisory board members

According to the rules of the Dutch wage taxes expats living in The Netherlands can enjoy a tax reduction of 30% of their taxable income. The employee has to prove that he has special skills and that those kind of employees are (hardly) not available on the Dutch labor market.

A working experience of 2,5 years is required.

Executive summary

On 12 December 2005 the Court in 's-Hertogenbosch decided that members of a supervisory board (raad van commissarissen) are entitled to the '30% tax facility'. The 30% tax facility is the special expatriate tax regime in the Netherlands, which allows expatriates to exclude 30% of their employment income from Dutch taxation. This decision differs from one taken on 6 September 2004, when it was decided that the 30% facility was not applicable to supervisory board members. However, it is not yet final and may be overturned by the Dutch Supreme Court.

Background

Under on the former 35% facility, which was applicable until 1 January 2001, supervisory board members were explicitly excluded from the 35% facility because the facility applied only to employees from a civil law perspective. Unlike members of the executive board or board of directors, supervisory board members are not regarded as employees from a civil law perspective.

Recent judgement of the Dutch Court

In its decision of 12 December 2005 the court ruled that the 30% facility could be applied to supervisory board members given the wording of the Dutch wages tax act. Under Dutch wages tax rules, supervisory board members are treated as notional employees and are not explicitly excluded from the 30% facility. In the decision of 2004, a taxpayer had argued that he was comparable to an employee and should therefore qualify based on the general principle of equality, an argument which was rejected by the Court. However in the 2005 case, a taxpayer based his arguments on the wording of the law and regulations, which was accepted by the Court.

In general, the facility has three main benefits:

- 30% of the income from current employment can be paid as a tax free allowance;

- If the taxpayer lives in the Netherlands, he or she is generally not taxed on income from investments;

- Fees for international schools for the employee's children can be paid or reimbursed by the employer tax-free.

- The maximum duration of the facility is ten years. Generally, periods in which the employee has previously worked or lived in the Netherlands are deducted from the facility's duration.

Conclusion

It is not yet clear whether the Ministry of Finance intends to appeal against the decision to the Dutch Supreme Court, so it remains possible that the current judgement might be overturned. However, in order to protect their position, relevant supervisory board members recruited from abroad who have not already worked in the Netherlands for ten years, should submit a request for the application of the 30% facility now.

Portugal

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According to the Portuguese tax law, companies with annual income under 150,000€ may have a special Corporate tax rate of 20% over the taxable income.

The taxable income corresponds to 20% or 45% of annual Income, depending on whether the company sells goods or it renders services, with the minimum amount of 5,402.60€. So, the companies within this regime will pay the minimum corporate tax of 1,080.52€ (20% x 5,402.60€).

This is a very simple system, especially interesting for foreign companies that want to have a representation in Portugal with annual income under 150,000€, and with expected costs of activity lower than the non

taxable income (80% for trade companies and 55% for service companies).

Singapore

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Inland Revenue Authority (IRAS) Circular on Transfer Pricing Guidelines

To help taxpayers in the conduct of transactions with related parties, IRAS has on 23 February 2006 issued a Circular on "Transfer Pricing Guidelines".

Through these Guidelines, IRAS hopes that taxpayers can better understand the conditions for arm's length pricing and hence take steps to reduce the risk of double taxation from unilateral transfer pricing adjustments which may be made by the tax jurisdictions.

The Circular sets out the view and requirements of IRAS for taxpayers to demonstrate compliance with the arm's length principle, provides guidance on the application of such principle and the recommended preparation and maintenance of documentation to demonstrate compliance with the arm's length principle.

Besides elaborating IRAS's position, it also provides guidance on the application of "Mutual Agreement Procedures (MAP)" and on "Advance Pricing Arrangements (APA)".

An APA is a binding agreement between a taxpayer and one or more revenue authorities agreeing upfront on what constitutes an arm's length price for specific transactions. An APA determines, in advance of related party transactions, an appropriate transfer pricing methodology to fix the arm's length range for pricing certain transactions over a specified time period.

MAP serves as an avenue in most tax treaties (DTAs), which enable the competent authorities to resolve instances of double taxation arising from the application of the DTA between the two Contracting States.

It is important when requesting MAP relief or an APA to provide good quality documentation besides giving full co-operation to IRAS.

Switzerland

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Canton Obwalden introduces degressive tax rates for wealthy taxpayers

A change in the tax law of the Canton Obwalden, close to Lucerne and Zug, has been implemented as of January 1, 2006 to increase fiscal competitiveness. Tax rates for individuals have been reduced significantly, and new degressive rates for taxable income over 300,000 CHF (about 250,000 USD) have been introduced. As an example, the total tax rate (federal, cantonal and community) for married couples are now 23.8% on a taxable income of 500,000 CHF (416,000 USD) and 23.2% on a taxable income of 1,000,000 CHF (832,000 USD). This move follows other cantons in Switzerland, which have also reduced and in some cases introduced degressive tax rates.

Canton Obwalden and Valais introduce lower corporate income taxes

Among other cantons, the cantons of Wallis and Obwalden have reduced as of Jan. 1, 2006, the corporate income taxes for companies to increase fiscal competitiveness. As a result of these reductions, these cantons have become some of the most advantageous locations for companies to operate in. The total tax (federal, cantonal and community) on income is new 13.1% in Obwalden and 12.2% (on the first 100,000 CHF taxable income) respectively 21.6% (on the portion of taxable income above 100,000 CHF) in Valais.

Recent Tax Treaties Developments

United Kingdom: A Protocol modifying the Swiss – British Tax Treaty was initialled on January 18, 2006. The main amendments are the full deduction of taxation at source on dividends paid to companies with substantial participation and to pension funds, an extension of exchange of information (to include tax frauds and holding companies) and the taxation of pension income and the deductibility of pension scheme contributions.

Austria: A Protocol modifying the Swiss – Austrian Tax Treaty was signed on March 21, 2006. The main amendments concern taxation of employment income, exemption of taxation at source on licences (applicable only to Austria, as Switzerland does not impose taxation at source on licenses), postponement of capital gain tax when leaving Austria and finally the extension of exchange of information (to include tax frauds and holding companies).

Finland: A Protocol modifying the Swiss – Finnish Tax Treaty was signed on April 19, 2006. The main amendments are firstly the full deduction of taxation at source on dividends paid to companies with substantial participation and to pension funds and secondly an extension of exchange of information (to include tax frauds and holding companies).

EU Tax at source on interests: first results

The tax at source on interests paid to individuals resident in the EU is applicable from July 1, 2005 on the basis of the agreement between Switzerland and the EU equivalent to the EU Directive on Interests. Switzerland levies according to such agreement a 15% tax on interest paid to EU residents (to be increased to 20% in 2008 and to 35% in 2011), same as Austria, Luxembourg, Belgium, Liechtenstein and other non-EU countries (the remaining EU countries have agreed to a full exchange of information). Payment of this tax was due by March 31, 2006 for the first period July 1 – December 31, 2005. According to a preliminary notice of the Federal Tax Administration a total amount of 138 mio CHF was paid for this period.

United States

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Court Disallows Tax Deduction for Interest Accrued to Related Foreign Lender

The United States Court of Appeals for the Seventh Circuit upheld Treasury Department Regulations that disallowed a current tax deduction for interest expense accrued, but not yet paid, to a related foreign lender.

Generally, a taxpayer may not accrue and deduct an expense payable to a related party who uses

the cash method of accounting until the related party recognizes the income from the transaction. This rule effectively requires the accrual basis taxpayer to use the cash method as to the transaction with the related party.

The application of this concept is more difficult when the related party is a foreign taxpayer. Unless the amount ultimately paid to the foreign taxpayer is income that is effectively connected with a United States trade or business, the foreign taxpayer will never pay U.S. tax on this income.

Through a provision of the Internal Revenue Code, Congress instructed the Treasury Department to issue regulations to apply the matching principle discussed above to cases where the related payee is a foreign person. Subject to certain exceptions, the regulations required taxpayers to use the cash method of accounting in determining the time to claim a deduction for amounts owed to a related foreign person.

The taxpayer challenged the validity of the regulation, a difficult task given that when Congress makes an express delegation of authority to issue regulations, those regulations are respected unless they are arbitrary, capricious or manifestly contrary to the statute. The court, framing its analysis as one of statutory construction, upheld the disallowance of the interest deduction.

This issue now appears to be well-settled. It is interesting to note that the Tax Court, when first confronted with this issue, had ruled in favor of the taxpayer. That decision was reversed by the Court of Appeals for the Third Circuit, which ruled in favor of the Internal Revenue Service. Although the Tax Court was not bound by the Third Circuit decision in the present case, it reversed its earlier interpretation and sided with the Internal Revenue Service. This time, its decision was upheld on appeal.

