



# BAKER TILLY INTERNATIONAL

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SECTOR

## International **TAX INSIGHT**

April 2010

### EDITORIAL

Welcome to the April issue of International **TAX INSIGHT**, a quarterly publication highlighting cross border tax developments which may affect those doing business in global locations.

In this quarter's issue we feature news of tax developments in Belgium, Cyprus, Germany, Ireland, Seychelles, Spain, the United Kingdom (UK) and the United States of America (USA), and we report on Baker Tilly International's recent Asia Pacific Tax Forum in Singapore.

The tax information given is intended as a brief overview and may not cover all circumstances. Readers should seek professional advice before taking any action. Baker Tilly International firms worldwide will be pleased to advise further. To locate your nearest firm, please see the Worldwide Directory at [www.bakertillyinternational.com](http://www.bakertillyinternational.com).

**Bill Hogan**

*Director of taxation, Baker Tilly International*

### BELGIUM

#### **New Reporting Obligations for Payments to Tax Havens**

With effect from 1 January 2010 Belgian companies and foreign companies operating in Belgium through a permanent establishment must report in their annual tax returns all payments that they make to tax haven entities if they aggregate to more than €100,000 in the year.

Both direct and indirect payments are covered by this new regulation, with further clarification awaited as to what is meant by indirect payments.

Tax havens are defined in two ways. Firstly, any country which is considered by the OECD Global Forum on Transparency and Exchange of Information to have failed to implement substantially and effectively the OECD's exchange of information standard is a tax haven. Secondly, the term applies also to any country listed in a Royal Decree which has still to be enacted and which will be updated every two years. The list will include automatically any country which does not have a corporate income tax, or which does have one but with a rate lower than 10%. A provisional listing shows that there are some 30 countries which come into this category.

Failure to comply with this reporting obligation will result in there being no tax relief for the payments made.

Payments which are duly reported will provisionally qualify for tax relief, but in the event of a tax audit it will be necessary to demonstrate that each of the payments was made in the course of an "actual and genuine transaction" and that there was no tax avoidance motive. Any payment for which this cannot be done will not be tax deductible.

### CYPRUS

#### **Tax Reductions for Investment Income**

Changes to income tax and to the special defence contribution tax, retroactive to 1 January 2009, will benefit finance companies and other companies with interest income, companies undertaking portfolio investment, and corporate investors in collective investment schemes.

Interest received by Cypriot companies otherwise than in the course of a trade has previously been subject to the special defence contribution tax, at 10%, and as to one-half of it to income tax, also at 10%. This gave an effective rate of tax overall of 15%. The charge to income tax has now been abolished, reducing the effective rate of tax to 10%.

Dividends received by Cypriot companies from abroad have generally been exempt from tax provided the holding represents at least 1% of the share capital of the paying company. This 1% requirement has now been removed, so companies involved in portfolio investment will benefit. Exemption remains conditional on the paying company deriving not more than one-half of its income from investments and on its being taxed locally at a rate of at least 5%.

Corporate investors in collective investment schemes have previously been subject to the special defence contribution tax at 15% on buy-backs and redemptions of their units on the grounds that they constitute deemed dividends. This interpretation will no longer apply, and such disposals will now be exempt from tax. Interest received by collective investment schemes is subject to income tax at 10% after deducting all expenses and is exempt from the special defence contribution tax.

## **GERMANY**

### **Removal of Tax Barriers to Group Restructurings**

The new coalition government, with Angela Merkel continuing as leader, has brought in tax reforms designed to facilitate restructurings and reorganisations within groups of companies where these are seen as desirable as a stimulus to economic growth.

The reforms touch upon three areas – the real estate transfer tax, the carrying forward of losses for tax relief against future trading profits, and the thin capitalisation rules.

Real estate transfer tax is charged, generally at 3.5% but at 4.5% in Berlin and Hamburg, on transfers of real estate, and in some circumstances on transfers of shares in companies which own real estate. Effective from 1 January 2010 the tax will not be charged on transfers between affiliated companies in the course of certain categories of reorganisation which are approved under German or European laws. For this purpose affiliated companies are defined as a parent company and its 95% or more owned subsidiaries, and for the tax exemption to apply the parties to the transfer must have been affiliated for at least five years prior to the merger and must continue to be affiliated for at least five years after it.

Companies which incur trading losses can generally carry them forward for relief against future trading profits, with a maximum set-off in any one year of €1m plus 60% of taxable income in excess of that sum. Losses can also be relieved against profits of the previous year, up to maximum profits of €511,500. Where however there is a change of ownership of more than 50% of the shares of a company there can be no further carrying forward of losses for future relief, with any losses unrelieved at that point being forfeited. Previously this rule applied even if there was no change in the ultimate beneficial ownership of the company, and

this was a barrier to restructuring operations. From 1 January 2010 there will be no restriction on the carrying forward of a company's losses for future relief where the company's shares are transferred between wholly owned subsidiaries of the same parent company.

Finally there has been some relaxation of the thin capitalisation rule, designed to prevent multinationals from financing their German subsidiaries with excessive debt to equity ratios, that interest payments are deductible only up to 30% of EBITDA (earnings before interest, tax, depreciation and amortisation). It is now provided, with some retrospective effect, that where interest payments are less than 30% of EBITDA the unutilised capacity can be carried forward for future use. This too could benefit restructuring programmes.

## **IRELAND**

### **Introduction of Transfer Pricing Regulations**

The Finance Act 2010 introduces transfer pricing regulations for the first time in Ireland.

When trading transactions take place between an Irish resident company and a connected company abroad it will be a requirement that they are priced on an arm's length basis, determined in accordance with the principles set out in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Any failure to comply could result in the tax authority in Ireland making an adjustment to the company's reported trading result in its tax return, increasing the taxable profit and the tax liability. Most types of intra-group transactions will be covered, including goods, services, and the licensing of intangible assets. The legislation will generally not apply to intra-group financing arrangements, for example interest-free loans.

The new rules will not apply to Irish resident companies which are members of groups which come within the definition of being small or medium-sized. In order to do that the group worldwide must have not more than 250 employees and either an annual sales turnover equivalent to not more than €50m or assets equivalent to not more than €43m. In applying these tests the other economic interests of controlling individual shareholders must be taken into account.

Commencement is set for accounting periods beginning on or after 1 January 2011.

There is an important exemption from the legislation for intra-group trading arrangements for which the terms and conditions were settled in contracts agreed before 1 July 2010. This gives a window of opportunity to international groups to review and to document before then their pricing policies for group transactions involving their Irish member companies.

## SEYCHELLES

### Introduction of Foundations

Foundations can now be formed in Seychelles following the passing of the Foundations Act 2009.

Foundations are hybrid entities with characteristics drawn from both companies and trusts. Generally they are used for holding investments, and in appropriate circumstances they can be suitable vehicles for the ownership of trading companies, for international charities, and for private wealth management.

Applications to register a Seychelles foundation must be made through a locally licensed foundation service provider to the Seychelles International Business Authority. Minimal initial capital is required, and the re-domiciliation of foreign foundations is permitted. A foundation is governed by its charter and administered by a council of one or more members, which can include corporate bodies. There is no requirement for the charter to show the names of beneficiaries.

Seychelles foundations may not own immovable property in Seychelles but otherwise they can be formed for any legitimate purpose.

Foundations are guaranteed exemption from taxes in Seychelles for a minimum of 20 years.

## SINGAPORE

### Baker Tilly International Asia Pacific Tax Forum

Baker Tilly International's annual Asia Pacific Tax Forum was held this year at the Mandarin Oriental Hotel in Singapore on 8 April. Chairman of the Forum, Theo Sakell of Baker Tilly Pitcher Partners in Australia, welcomed delegates, who included representatives from clients of Baker Tilly International's member firm in Singapore, Baker Tilly TFWLCL, and of member firms elsewhere in the region.

Mrs Chia-Tern, deputy commissioner of the Inland Revenue Authority of Singapore, gave the keynote address on international tax treaties and exchange of information arrangements.

Speakers from Baker Tilly International member firms then covered subjects as diverse as tax reform in China, transfer pricing developments in India and Japan, financing strategies for inbound investment into the US, and tax planning considerations for businesses expanding abroad.

Next year's Asia Pacific Tax Forum is scheduled for Melbourne in April.

## SPAIN

### Amortisation of Financial Goodwill on Acquisition of European Companies to End

One of the distinctive features of Spanish corporate tax law is the

facility for Spanish companies in defined circumstances to claim tax relief for part of the consideration paid when they acquire the shares of foreign companies. The tax deductible proportion is that attributable to goodwill, calculated as being the difference between the amount paid for the shares of the target company and the corresponding value of its underlying assets. For the provision to apply a minimum acquisition of 5% of the shares in the company is necessary. Amortisation of the relevant amount is then spread equally over 20 years, so 5% of it can be deducted each year in calculating the taxable profits of the purchasing company.

Since 2007 the European Commission has been investigating this practice following protests from other EU member states that in the purchase of EU companies it constitutes a form of state aid which distorts competition and is therefore contrary to EU regulations. The key to the complaints has been that the law is discriminatory. Relief is given only for the purchase of shares in foreign companies, not Spanish companies.

The Commission has now concluded that Spain is indeed in breach of its EU obligations in giving tax relief to Spanish companies on the acquisition of shares in companies elsewhere in the EU. The Spanish government has decided that it will not appeal against the decision and is now modifying the tax relief provisions so that they will no longer apply to EU acquisitions.

The matter does not end there however. The Commission has ordered the government to recover from Spanish companies any tax relief which has been granted to them in relation to EU acquisitions after 21 December 2007, the date the Commission's investigation was announced. It is not clear at the time of writing whether tax relief in relation to EU acquisitions before then will be allowed to continue for the remainder of the stipulated 20 year period.

Meanwhile the Commission has now moved on to consider the tax relief given to Spanish companies on the acquisition of shares in companies outside the EU. There is a possibility that this too infringes the EU rules aimed at securing fair competition between member states.

Negotiations continue between Spain and the EU to agree upon and to implement a regime in this field that is compatible with EU regulations.

## UK

### Former Thin Capitalisation Rules Judged to be in Breach of EU Law

The UK changed its approach to thin capitalisation in 2004 when it incorporated new rules on thin capitalisation into its general transfer pricing legislation. The old regime is of more than academic interest however. Several EU based international groups which were denied tax relief under the former rules for loan interest payments made by

their UK member companies have been pursuing the UK taxing authority HM Revenue & Customs (HMRC) through the UK and EU courts on the grounds that the rules were not in accordance with EU law. For many of the groups the stakes are high, with potential tax repayments of millions of pounds riding upon a successful outcome. The High Court in the UK has now ruled in their favour, though HMRC may appeal.

Thin capitalisation is deemed to occur when a subsidiary company is perceived to have disproportionately high intra-group debt funding compared with its equity share capital. With interest but not dividends generally qualifying for tax relief, national tax authorities have a vested interest in keeping a cap on the debt to equity ratio of companies under their jurisdiction, and in many countries there are legislative powers to restrict tax relief for loan interest payments in appropriate circumstances.

The UK rules prior to the change in 2004 were attacked as being discriminatory. Foreign-owned UK resident companies could have their tax relief for loan interest disallowed but not UK-owned UK companies. For EU based groups this, it was claimed, infringed the EU freedom of establishment principle, which prohibits EU member states from putting up barriers to the EU being a level playing field when it comes to choosing where to locate a new company.

The European Court of Justice upheld the complaints, adding that the discrimination could be justified only if it was necessary to deter artificial tax avoidance. EU based groups which can show a commercial justification for the funding arrangements for their UK subsidiaries ought not to have been subject to restrictions on their tax relief.

The High Court in the UK has now accepted and endorsed this view, and subject to any appeal by HMRC this paves the way for tax repayments to those affected.

## **USA**

### **New IRS Guidance on FBAR Filing Requirements**

In accordance with the Bank Secrecy Act any US person, as defined, having a financial interest in, or signature authority over, a foreign financial account with a balance at any time in the calendar year of more than US\$10,000 must file a form TD F 90-22.1, Report of Foreign Bank and Financial Accounts, (FBAR), with the Internal Revenue Service in Detroit, Michigan. The forms for the calendar year 2009 are generally due for filing not later than 30 June 2010.

Although there are no taxes directly associated with the FBAR it is a key source of information for the IRS in their monitoring of the requirement that US citizens and tax residents must report and pay tax on their worldwide income. There are potentially severe penalties for failing to file an FBAR when one is due, ranging from US\$10,000 for inadvertent omissions up to the higher of

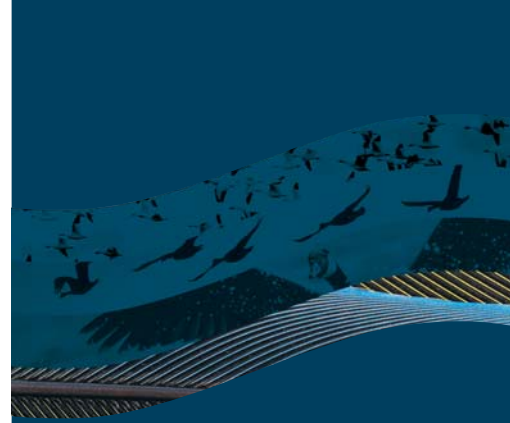
US\$100,000 and 50% of the account balance in the case of wilful default.

In the run up to the FBAR reporting season for 2009 the IRS has issued three important relaxations of the rules.

The first concerns the definition of a US person for this purpose, which has traditionally encompassed US citizens, residents, domestic corporations, partnerships, estates and trusts. In relation to the 2008 form, due for filing in June 2009, it was announced initially that the definition would be extended to include any person "in or doing business in" the US. This caused consternation internationally, as it implied that any foreign corporation with trading interests in the US would have to disclose details of all of its bank accounts around the world. As a result the IRS suspended the extended definition so far as the 2008 form was concerned, but the position for subsequent years remained unclear. With the release in late February of its Notice 2010-16 the IRS has resolved this uncertainty, at least for the 2009 form. The suspension of the extended definition is to remain in place, so those who are only "in or doing business in" the US are again outside of the filing requirement this year.

Secondly in its Notice 2010-23, released at the same time, the IRS has extended the 2009 filing deadline for those with signing authority over a foreign account but no financial interest in it. Instead of 30 June 2010 this will now be 30 June 2011.

Finally, and also in Notice 2010-23, the IRS has modified for 2009 the requirement that those with a financial interest in or signature authority over a foreign commingled fund must file an FBAR. For this purpose they will regard only mutual funds as commingled funds. Other types of fund, including significantly foreign hedge funds and private equity funds, will be excluded.



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