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The International Comparative Legal Guide to:

Corporate Tax 2011

A practical cross-border insight to corporate tax work

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EDITORIAL

Welcome to the seventh edition of *The International Comparative Legal Guide to: Corporate Tax*.

This guide provides the international practitioner and in-house counsel with a comprehensive worldwide legal analysis of the laws and regulations of corporate tax.

It is divided into two main sections:

One general chapter. This chapter outlines the UK taxation of overseas branches.

Country question and answer chapters. These provide a broad overview of common issues in corporate tax laws and regulations in 49 jurisdictions.

All chapters are written by leading corporate tax lawyers or tax advisors and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor, Graham Airs of Slaughter and May, for all his assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.co.uk

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UK Taxation of Overseas Branches

Slaughter and May

Graham Airs

On 27 July 2010 the UK Treasury released a discussion document on foreign branch taxation. This explores the possibility for changing the UK tax rules on the taxation of profits from permanent establishments of UK companies outside the United Kingdom, basically by introducing an exemption from UK tax for those profits. Although the document is called a discussion document, it seems that the Treasury is determined to introduce new rules from 2011.

An exemption for profits derived from overseas branches sounds simple. But, somehow, UK corporate taxation never is; and it appears clear from the discussion document that any new rules introduced on the taxation of profits from foreign branches will be anything but simple.

The problem is that the Treasury will not want to encourage UK taxpayers to move income-generating activities out of the United Kingdom. So the Treasury will want to limit the exemption to income that has been taxed elsewhere. That leads to the complications that are further explained below.

Why?

For most UK groups the current system of taxation of overseas profits is perfectly acceptable. Although UK tax is imposed on profits earned anywhere in the world, credit is given for tax imposed on those profits in overseas jurisdictions. Furthermore, just as profits earned overseas are included in a UK company's taxable profits, losses incurred overseas are also taken into account in calculating a UK company's taxable profits. So relief is given in the United Kingdom for overseas losses.

That means that a UK company starting a new venture overseas can begin operations though a branch, claiming relief against UK tax for any losses incurred in the start-up phase, and then, once those overseas operations become profitable, transfer them into an overseas subsidiary. The profits earned by the overseas subsidiary, as such, will not then be within the UK tax net; and any repatriation of those profits by way of dividend will (since the introduction of the similarly over-complicated UK dividend "exemption") almost certainly be exempt from tax when those dividends are received in the United Kingdom.

So, for most people, the need for change may not be evident.

In particular, there is no EU reason driving change. It is true, as just noted, that the taxation of profits earned overseas by a UK group differs according to whether those profits are earned in an overseas branch or an overseas subsidiary. If they are earned in a branch, the results of that branch are incorporated into the calculation of the UK company's taxable profits; but if they are earned in an overseas subsidiary, those profits should not be subject to tax in the United Kingdom. However, that is perfectly acceptable in the eyes of the European Court of Justice, as the judgment in X Holding BV (Case C-337/08) shows [see Endnote] – although, as the well-known judgment in Marks and Spencer (Case C-446/03) shows, that is subject to a qualification requiring a Member State, in certain circumstances, to give relief for losses incurred by overseas subsidiaries.

Banking, Insurance and Oil and Gas

The Treasury discussion document reveals that relatively few UK businesses operate outside the United Kingdom through foreign branches. Given the UK corporation tax advantages of conducting profitable overseas operations through subsidiaries, explained above, that is not surprising. It seems from the Treasury discussion document that the businesses that do make significant use of branches tend to be large companies in the banking, insurance and oil and gas exploration sectors.

It seems to be banking and insurance companies that are driving this change. Regulatory and commercial reasons, especially the efficient allocation of capital (in the case of banks) and developments in solvency rules (in the case of insurance companies) drive banks and insurance companies to operate through larger commercial entities, with branches, rather than subsidiaries, abroad. It is these sectors, it seems, that have inspired the proposal for change.

The oil and gas exploration sector, whilst also affected, seems likely to be less enthusiastic. There, the main reason for operating through branches overseas, as opposed to subsidiaries, seems to be the desire to obtain relief in the United Kingdom against UK tax for losses incurred abroad. A simple exemption system would, of course, prevent that; indeed, the Treasury acknowledges that, given the choice, oil and gas companies would be likely to opt out of any such system. Hence the discussion in the discussion document (explained below) about the possibility of exempting profits but still allowing some tax relief for overseas losses.

Definition of Branch Profits

Of those parts of the discussion document that are devoted to explaining just how any exemption system would work, about three-quarters of them are dedicated to the definition of the branch profits that would benefit from any exemption.

The discussion document identifies two broad options.

One is to define branch profits for the purposes of the exemption by

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reference to the United Kingdom's individual tax treaties with various overseas territories (the United Kingdom has an extensive network of over 100 double tax treaties).

The alternative would be to define foreign branch profits for the purposes of the exemption in accordance with the rules in UK domestic law that define the profits of overseas companies that are subject to UK corporation tax as being attributable to a permanent establishment in the United Kingdom.

The use of UK domestic rules ought to lead to a result which would be quite similar to the use of definitions from individual tax treaties, because both the United Kingdom's tax treaties, and its domestic rules, are based on OECD principles. However, there are some detailed differences.

These differences might be exacerbated by the new business profits article (Article 7) incorporated into the 2010 update of the OECD Model Treaty. The new Article 7 recognises internal interest payments for non-financial concerns, and internal royalties for all concerns, whereas UK domestic rules do not. If it is assumed (as the discussion document appears to assume) that the new Article 7 will not be incorporated into UK domestic law, the differences between a definition of foreign profits by reference to treaties and by reference to UK domestic law will be increased. In particular, the UK domestic law measure of profits (disregarding internal interest payments and royalties) would be greater than the measure of overseas profits for the purposes of treaties, and so the measure of overseas profits that could be taxed in the other territory. That would mean that any UK exemption (if it applied to profits as defined in accordance with UK domestic law) would extend to profits that had not been taxed overseas – and that would be anathema to the UK Treasury.

Capital Attribution

One related issue is that of capital attribution, which is part of the process for determining the amount of interest for which a branch of a bank or of an insurance company may obtain tax relief. The issue is that of determining how much capital ought to be attributed to a particular branch, as opposed to the company's "head office".

The two options put forward in the discussion document are what are referred to as the "capital allocation" approach, where the relevant share of the total assets of the financial institution as a whole, weighted for risk according to regulatory requirements, is attributed to the branch; and the "thin capitalisation" approach, which is based on the principle that the capital to be attributed to a branch should be comparable to that which would be held by a separate legal entity which is of a size, and conducts a business, similar to that of the branch in question.

These options are developed further in Annex A to the discussion document. In the case of banks, the discussion document explains that both the "capital allocation" and the "thin capitalisation" approach are approved by the OECD, and that, in most cases, as applied in the United Kingdom, they in fact produce similar results. The discussion document seems to lean towards a "capital allocation" approach, to the extent that there are differences, explaining that this is "routed in and utilises" the "Basel" regimes, which are familiar to UK banks and to overseas tax authorities.

As far as insurance companies are concerned, the Annex explains that the authorised OECD methodologies are an allocation approach and an adaptation of the thin capitalisation approach, and that the approach taken in the United Kingdom utilises simplified versions of these approaches. Given, however, that a thin capitalisation approach (based on a greater number of hypothetical legal entities than actually exist) is capable of requiring a theoretical allocation of more assets than a single legal entity actually holds, the discussion document concludes that the "capital allocation" approach would be the most appropriate methodology should an exemption regime be adopted.

Anti-avoidance

Of course, as with any so-called simplification of the UK tax system, there have to be anti-avoidance rules.

Given, however, that the United Kingdom (like most other jurisdictions) has rules designed to prevent UK groups accumulating profits in subsidiaries incorporated in tax havens – the controlled foreign company rules – it is not unreasonable for the Treasury to propose, as the discussion document does, that profits that would have been subject to UK tax had they been in a foreign subsidiary, so that the controlled foreign company rules apply, should also be subject to UK tax if, instead of being generated through an overseas subsidiary, they are generated through an overseas branch.

One of the issues that the discussion document puts forward for consideration in this context is whether any exemption system should extend to territories with which the United Kingdom has not concluded a double tax treaty (bearing in mind that the United Kingdom has concluded double tax treaties with 116 countries and territories). It would be perfectly possible (at least, as long as the United Kingdom retains its treaties with all Member States of the EEA) to restrict any new exemption system to profits generated by branches in jurisdictions with which the United Kingdom has a treaty, retaining the current system of taxation in the United Kingdom (with credit for any overseas tax paid on the same profits) for profits generated by branches in other territories.

An alternative would be to extend the exemption to all territories. If foreign branch profits were then to be defined in accordance with double tax treaties, that definition would have to be adopted in the case of jurisdictions with which the United Kingdom does not have a treaty, and the discussion document suggests that the definition in the OECD Model Treaty (including the new text of Article 7 in the 2010 update) could be used for that purpose.

But the United Kingdom's controlled foreign company rules are not restricted to subsidiaries in jurisdictions with which the United Kingdom does not have a treaty, and so the discussion document also considers ways in which an equivalent result could be achieved for overseas branches in this context as is the case with overseas subsidiaries. Three options are put forward. The first would limit the scope of the exemption by providing that it was not to apply to profits that would be subject to the controlled foreign company rules were the overseas branch a foreign subsidiary. The second is a variation on this approach, which would limit the scope of the exemption by reference to anti-avoidance rules that reflected the principles of the controlled foreign company rules (but without applying them directly).

The third option, which the discussion document suggests might be more complicated to apply in practice, would be to allow the exemption to apply to all profits (or, at least, all profits generated by branches in jurisdictions with which the United Kingdom had a double tax treaty), but then tax under the controlled foreign company rules any branch profits that would have fallen within those rules had the branch been a subsidiary.

Clearly, this is one particular area where the principle is reasonably easy to grasp, but the practical detail might be a little more difficult to apply. That is particularly the case at the present time, given the Government's continued commitment to reform of the controlled foreign company rules, which will result in some interim measures

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in 2011 and a more thorough reform in 2012.

The controlled foreign company rules are less relevant to small companies than to larger groups. The discussion document suggests that, instead of trying to apply the controlled foreign company rules to them, they should instead be made the subject of a "generic anti-avoidance rule". It also suggests that it is unlikely that any exemption for overseas branch profits would extend to overseas branch profits of a small company in a territory with which the United Kingdom does not have a double tax treaty (even if it did extend to profits of larger companies in such territories).

And, just in case all of these rules do not provide sufficient protection for the Treasury, the Government will apparently be considering further whether any other anti-avoidance rules are required.

Other Scoping Issues

Although the discussion document is primarily concerned with the exemption or taxation of income profits generated by overseas branches, it also suggests that an exemption regime might extend to exemption for capital gains arising from assets used by a branch (as is apparently the case with the exemption regimes in France, Germany and the Netherlands). (That would be consistent, of course, with the approach taken by the OECD Model treaty, which permits such capital gains to be taxed by the territory in which the branch is located.)

It is noted, however, that there would be some complications involved in extending an exemption to capital gains. First, the Government would want to consider the introduction of a transitional rule retaining its rights to tax gains that had accrued (but were unrealised) when the exemption was introduced. Secondly, many capital assets (including intangible assets) might be used partly by a branch and partly by the company's "headquarters", so that any capital gain would need to be apportioned before an exemption could be applied. Thirdly, the United Kingdom's current rules allowing intra-group transfers of capital assets without payment of tax on any inherent gain would need to be modified to prevent assets pregnant with gain being transferred into a branch in which they could be realised on the basis that the gain would then be exempt.

Another issue considered relates to shipping and air transport businesses, the overseas branches of which are generally exempt from tax in the territories in which they are located. To exempt the profits of overseas branches of UK shipping and air transport businesses from UK tax as well would mean that they were not taxable anywhere. Accordingly, the discussion document proposes that where a treaty exempts the profits of an overseas branch from taxation in the jurisdiction in which the branch is located, any new exemption from UK tax would not extend to those branch profits.

The discussion document also considers the interaction between any new exemption and the United Kingdom's rules giving relief from double taxation. It correctly notes that, to the extent that an exemption applies to profits defined by reference to a double tax treaty, there would be no place for double taxation relief for overseas tax paid on those profits; by definition, those profits could not be subject to double taxation (because they would be exempt from UK tax).

Similarly, where profits were eligible for branch exemption, there would be no need for the United Kingdom's rules giving unilateral relief from double taxation to apply to them.

Losses

Clearly, a straightforward exemption system would mean that neither profits nor losses earned or incurred by overseas branches would be brought into account in calculating the UK tax liabilities of the company concerned. For some sectors, however, such as the oil and gas exploration sector, that would mean that an exemption system would be significantly worse than the current system (under which the profits of overseas branches are taxed in the United Kingdom but with credit for any overseas tax paid on them).

The discussion document recognises this. It also recognises the fact that, although there might be some form of terminal loss relief as part of a branch exemption regime (much as the Marks and Spencer ruling has effectively led to the possibility of claiming relief for terminal losses incurred by EEA subsidiaries), that is unlikely of itself to assist.

One of the options that the discussion document considers is that of allowing a company to make an election that the new exemption system should not apply to it (and the "Impact Assessment" that accompanies the discussion document recognises, at paragraph 3.3, that some sectors, such as oil and gas, would then choose to opt out of the proposed new regime). Such an election could be made permanently binding upon the company that makes it or, if capable of being revoked, would need to be accompanied by rules to reverse loss relief previously given under it (to the extent that the losses had not already been matched by taxable branch profits). The election might also be binding on other companies in the same group; and it would need to apply also to any company to which the branch business were transferred.

An alternative put forward by the discussion document would be to allow loss relief generally (in combination with an exemption for branch profits), but then to "clawback" the loss relief once the foreign branch moved into profit. One way of doing that might be to tax subsequent profits to the extent necessary to reverse loss relief given earlier. The discussion document suggests that this might be done either subject to double tax relief for any foreign tax imposed upon those profits, or without any such double tax relief being allowed, and asks how beneficial these options would be to business (it would seem easy to guess which of them business would prefer).

The discussion document then goes on to consider the position of companies that are carrying forward losses at the date of the introduction of branch profit exemption. Without more, the introduction of an exemption for overseas branch profits would allow such a company to carry forward past losses incurred in that branch to set against future profits generated in the United Kingdom (it would obviously have no need to set those losses against future profits generated in the overseas branch), and this is not something that the Government would wish to happen. Furthermore, the discussion document suggests that there might be a case for applying a "clawback" mechanism for past branch losses (for which relief would have been claimed in the United Kingdom) to the extent that those losses would have been set against profits generated by the overseas branch had those profits not been exempt from UK tax.

Three options are put forward. One would involve the cancellation of brought-forward losses on the introduction of an exemption regime (although this would not apply to companies who opted out of the exemption regime, were such an option to be made available). The second option would be to provide that a company could not claim the benefit of the new exemption system until any losses previously incurred in the same branch had been set against profits earned in that branch. The third option would be to

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"clawback" losses for which relief was given before the introduction of an exemption system "to the extent that the mechanism would apply if exemption rules had always been in place" (see above).

Although it is not a point made in the discussion document, any of these rules, to the extent that they involve comparing losses incurred in the past with profits earned in the future, would be likely to run into difficulties in defining just what the "branch" was in which the losses were incurred and just what the "branch" is in which profits are earned. Businesses grow and contract; and groups transfer activities in between branches and in-between subsidiaries. But there is no recognition in the discussion document of how the Treasury would intend to counteract a reorganisation of a group's business so that profits were earned in an "entity" other than the branch in which losses had previously been incurred; or how they would identify a past loss-making branch with a current profit-earning activity where the relevant business might, literally, have changed out of recognition.

Conclusion

Although the idea of an exemption for overseas branch profits sounds simple, its implementation is likely to be anything but. (For comparison, the so-called dividend "exemption" introduced in the Finance Act 2009, was enacted in a schedule extending for ten pages, which introduced 23 new sections into the Corporation Tax Act 2009 and which will require amendment in the forthcoming Finance Bill.)

Given that it appears that its introduction is driven by banks and insurance companies, that no other sectors have any particular need for it, and that British industry will require it to be modified by coupling it with some form of loss relief (as is available under the current system), it is not clear why any new exemption system could not be limited to the banking and insurance sectors.

Unfortunately, as is the case with most "consultations", the Treasury and HMRC have apparently already decided that there will be a new exemption system from next year; and so we can expect it to take up a considerable part of the first Finance Bill of 2011.

Endnote

See paragraph 40 – "[A]s permanent establishments situated in another Member State and non-resident subsidiaries are not….in a comparable situation with regard to the allocation of the power of taxation, the Member State of origin is not obliged to apply the same tax scheme to non-resident subsidiaries as that which it applies to foreign permanent establishments".

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Chambers UK, 2010

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Chapter 2

Albania

Alketa Uruçi

Jonida Skendaj

Boga & Associates

1 General: Treaties

1.1 How many income tax treaties are currently in force in Albania?

There are 29 income tax treaties currently in force in Albania. New treaties are under negotiation or are signed and in the process of ratification.

1.2 Do they generally follow the OECD or another model?

Income tax treaties currently in force in Albania generally follow the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Under the Albanian Constitution, tax treaties must be ratified by the Parliament. A treaty ratified by the Parliament becomes part of Albanian legal system after publication in the Official Gazette of the Republic of Albania and prevails over any law which differs from the treaty's provisions.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Albanian income tax treaties do not contain "limitation of benefits" clauses.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No, the tax treaties prevail over the domestic laws.

2 Transaction Taxes

2.1 Are there any documentary taxes in Albania?

There are no documentary taxes.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Value Added Tax (VAT) is applicable to all taxable supplies of goods and services. The rate is 20%, except for exports of goods and certain exports of services, which are zero-rated.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Albanian legislation provides for some supplies which are exempted from VAT, such as:

- sale and lease of immovable properties (exceeding 2 months);
- financial services;
- supply of gold from Bank of Albania and second-tier banks;
- postage stamps;
- supplies of not for profit organisations engaged in religious or philosophical purposes, or not for profit organisations which have the status of "public benefit" and apply prices lower than the market prices;
- educational services (starting from 1 October 2010);
- supply of services and goods by/between certified contractors and their subcontractors engaged in the research and development of hydrocarbon operations;
- medicaments and packaging of medicaments;
- printing of newspapers, sale of newspapers, magazines, books and supply of advertisement services from written and electronic media;
- gambling, casino and hippodromes;
- identity cards;
- international services rendered outside the Albanian territory by a taxable person; or
- importation of goods by NATO and its own bodies in the framework of operations and pursuant to international agreements.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

VAT is fully recoverable:

- VAT paid in relation to: (i) all taxable supplies carried out for the taxpayer during the fiscal period by other taxpayers; or (ii) all importations of goods carried out by the taxpayer during the fiscal period, where such supplies or importations have been carried out for the purpose of taxable supplies carried out or to be carried out by the taxpayer; and

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- any tax credit allowed in case of bad debts, in compliance with the legal provisions.

In any case, no tax recoverability is allowed, in no circumstances, for expenses that are not entirely and solely for the purpose of the business activity.

Further, no tax recoverability is allowed for the following cases:

1) fuel expenses, unless certain conditions are met;
2) accommodation, travel and *per diem* expenses;
3) vehicles expenses, unless certain conditions are met;
4) fuel expenses used for passenger vehicles;
5) marketing and promotional materials; and
6) all services related to the aforesaid expenses.

The Albanian taxpayer is entitled to benefit the VAT reimbursement (VAT paid in excess) if the taxpayer has carried forward a VAT credit for three consecutive months, and the VAT credit requested for reimbursement exceeds the threshold of ALL 400,000.

2.5 Are there any other transaction taxes?

Excise tax is applied to a limited number of goods such as tobacco, alcoholic drinks, soft and fresh drinks, derivatives of petroleum and coffee. For goods produced in Albania, the excise tax is calculated on the sale price of goods. For imported goods this tax is calculated on the customs value including import duty. Excise tax is not applied when goods are exported.

Tax is levied either as a percentage rate or per unit stamp duty, depending on the goods.

2.6 Are there any other indirect taxes of which we should be aware?

A tax is levied upon the transfer of Albanian-situs immovable property by companies whether Albanian or foreign.

Taxable transfers include the sale and donation. In the case of a sale, the taxable base is the gross proceeds realised; in the case of a donation, it is the value of the property as assessed by the immovable property registration office. No deductions are allowed. The seller and the donor are the persons liable for the tax.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends and profit shares of a resident company/partnership paid to non-resident companies are subject to a final withholding tax on the gross amount at the rate of 10%, unless a tax treaty provides for a lower rate.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid to non-resident companies are subject to a final withholding tax on the gross amount at the rate of 10%, unless a tax treaty provides for a lower rate.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Interest paid to non-resident companies is subject to a final withholding tax on the gross amount at the rate of 10%, unless a tax treaty provides for a lower rate.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The thin capitalisation rules limit the deduction for interest paid on a loan to the amount of interest paid on the loan not exceeding four times the company's net assets (i.e. debt/equity ratio of 4:1). The rules apply to all loans taken, except for short-term loans (less than one year).

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

No there is not.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Please refer to the above question 3.4. The debt subject to the thin capitalisation rule comprises the total of the debts regardless of the source of such debt.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Interest paid in excess of the annual average second tier banks' interest rate is considered as non-tax deductible.

3.8 Does Albania have transfer pricing rules?

Transfer pricing adjustments may be made if conditions set in a transaction between associated persons differ from those that would be made between independent persons. Two persons are deemed to be associated if the activities of one person are controlled by the other or if one person acts in accordance with the instructions, requests or decisions of the other. In particular, the following are regarded as associated persons: (a) spouses; (b) a legal entity and any person who owns, directly or indirectly, at least 50% of the shares or voting rights in that entity; and (c) two or more legal entities if a third person owns, directly or indirectly, at least 50% of the shares or voting rights in each entity.

The instructions of the Ministry of Finance provide that transfer pricing adjustments may be made only by a commission of the General Tax Department; thus, the tax authorities must submit all transfer pricing cases to that commission. The instructions also state that, in applying the transfer pricing rules, the commission should refer to the 1995 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The general corporate profit tax is levied at a rate of 10%.

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4.2 When is that tax generally payable?

The profit tax return is due by 31 March of the year following the tax year. The tax is computed under the self-assessment system.

Advance payments of tax are due monthly. The payments for each month from January to April are equal to one twelfth of the profit tax due according to the latest assessment (e.g. tax year 2008 for 2010). The payments for the remaining months are equal to one eighth of the profit tax paid in the preceding tax year (e.g. tax year 2009 for 2010), less payments made in January to April.

In certain situations, the tax authorities may adjust the amount of the advance payments if, according to their estimation, the profit tax for the current year would exceed the tax paid in the preceding year by more than 10%.

Advance payments of tax are creditable against the final tax liability. Any excess may be deducted from tax arrears or, on request, from future tax liability, or may be refunded.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The determination of the taxable base starts with the profit shown in the profit and loss account. The profit calculation should be made according to the accounting legislation in force and the relevant instructions issued by the Ministry of Finance.

In calculating the taxable base the following expenses are considered:

- expenses incurred for generating the operational profit;
- insurance premiums;
- depreciation allowances;
- interest (excluding certain situations as established by law); and
- bad debts when the following conditions are simultaneously met:
  - (a) the corresponding amount has been included earlier as income;
  - (b) the bad debt is cancelled in the accounting books of the taxpayer; and
  - (c) all possible legal action to collect payment has been undertaken.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The following are examples of items that are not deductible:

- the cost of acquisition and improvement of land (capitalised);
- the cost of benefits in kind (tax-free for the recipient);
- interest in excess of the annual average bank interest rate;
- interest paid for loans exceeding on average four times the amount of net assets value during the taxable period (such rule is not applicable for banks, insurance companies and financial lease companies);
- private pension premiums;
- damage and waste related to production, transportation and storage in excess of the rates determined by law;
- dividends;
- the profit tax itself;
- penalties and fines;
- expenses in respect of technical, consulting and management services provided by non-resident entities, and not paid in the relevant tax period (such expense become deductible should the company pay the amount of withholding tax related to such services during that tax period);
- personal consumption expenses;
- representation and reception expenses when they exceed 0.3% of the annual turnover;
- sponsorship expenses when they exceed 3% of profit before tax and sponsorship expenses for press publishers when they exceed 5% of the profit before tax;
- expenses for salaries and other compensations deriving from employment relationship, in case the payment is not performed through banking system; and
- expenses resulting from transactions performed in cash for amounts exceeding ALL 300,000 for each purchase.

4.5 Are there any tax grouping rules? Do these allow for relief in Albania for losses of overseas subsidiaries?

There are no tax-grouping rules in Albania.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No it is not.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Property tax is levied annually on all residents and non-residents who own agricultural land or buildings in Albania. Agricultural land is classified into ten groups and taxed at rates varying from ALL 700 to 5,600 per hectare. Buildings are classified according to their use and taxed at rates ranging from ALL 5 to 200 per m2. A 50% tax credit is available for tax due on buildings located in rural areas. The local municipality may modify the tax rates set by the law. In addition, it decides on the payment schedule of the tax and on reductions for immediate payment of tax.

4.8 Are there any local taxes not dealt with in answers to other questions?

Hotel Residency Tax

The hotel residency tax is payable by all persons residing in a hotel, both Albanian and foreigners and amounts to 5% of the hotel bill. It is calculated and withheld by the hotel administration. The hotel administration must remit the total amount of hotel residency taxes to the respective municipality by the 5th of the month for the previous month.

Tax on New Constructions

This tax is levied on the value of a new investment at a rate from 2% to 4% in Tirana and from 1% to 3% in other municipalities. The local municipality determines the actual rate. Exceptionally, for infrastructure projects such as construction of national roads, ports, airports, tunnels, dams, construction of infrastructure in energy, the infrastructure tax is 0.1% of the investment value (which includes the value of equipment and machineries for such project), but not less than the cost of rehabilitation of the damaged infrastructure.

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5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains from the sale of a company's fixed business assets are taxed as part of the company's ordinary business income.

Losses may be carried forward for 3 years. If during the tax year more than 25% of direct or indirect ownership of the share capital or voting rights of the company is transferred, losses may not be carried forward. No carry-back is allowed.

Because capital gains are taxed as part of the company's ordinary business income, the rules on ordinary losses apply also to capital losses.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The rate of the tax imposed upon capital gains is no different from the rate imposed upon business profits.

5.3 Is there a participation exemption?

There are no participation exemptions.

5.4 Is there any special relief for reinvestment?

There is no special relief for reinvestment provided under the Albanian tax legislation.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed upon the formation of a subsidiary in Albania.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are not any significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch are determined in the same way as the taxable profits of a local company in Albania.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

An Albanian branch of a foreign entity is subject to corporate income tax at the same rates applicable to resident companies.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

In principle, the establishment of an Albanian branch by a foreign enterprise creates a permanent establishment of that enterprise in Albania and therefore it enjoys the benefits of tax treaty provisions (if applicable).

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax is imposed as the result of a remittance of profits by the branch in Albania.

7 Anti-avoidance

7.1 How does Albania address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is no general anti-avoidance provision in the Albanian tax legislation.

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Since 1999 Mrs. Uruçi focused her practice on tax and customs laws in all industries and sectors in Albania. With her double major studies background in Law and Economics, Alketa has acquired solid understanding and experience in tax legislation and its impact and interaction with other legal framework such as labor and employment, commercial companies law, real estate and construction.
Her practice areas encompass corporate tax, VAT, national taxes, local taxes, personal income tax, excise tax and customs duties. Alketa advices and manages tax assignments in all industries and sectors such as aviation, banking and financial institutions, cement, consumer goods, construction and real estate, telecommunications, etc.
Alketa is active as tax litigator in all levels of Albanian courts, where she represents the clients during judiciary claims against the tax assessments and tax authorities.

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Ms. Jonida Skendaj has acquired a vast experience in tax legislation, commercial law and she has gathered excellent knowledge in competition and antitrust legislation. She assisted a number of legal and tax due diligence assignments as well as tax assistance concerning major tax issues of international companies investing in industrial sector, such as energy, telecommunication, construction etc.
Ms. Jonida Skendaj graduated from University of Paris X - Nanterre, Faculty of Law in Business Law in 2002 and has obtained a master degree from the same University in Business Law, in 2003.

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Argentina

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Argentina?

Compared with the tax treaty network of more developed countries, Latin America's network is rather limited. Argentina, party to only 17 tax treaties, provides a representative example. At present, Argentina has treaties in force with Australia, Bolivia, Brazil, Belgium, Canada, Chile, Denmark, Germany, Finland, France, Italy, the Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom.

1.2 Do they generally follow the OECD or another model?

Most treaties currently in force are structured along the lines of the OECD Model Convention (OECD MC). Exceptions are the tax treaties entered into with Bolivia and Chile, which are patterned after the model tax treaty approved by Decision 40 of the Andean Group, and the treaty with Brazil, which, although following the formal structure of the OECD MC, has certain unique provisions

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Under the Argentine legal system, the power to conclude tax treaties lays on the Executive Branch; however, treaties need to be ratified by Congress. Thus, they become laws only upon congressional approval. The congressional ratification must be notified to the other contracting country and the treaty enters into effect as from the date provided therein.

Consistent with the provision contained in Section 25 of the Vienna Convention, Argentine law authorises the Executive Branch to decide the provisional application of signed treaties before the actual effective date. So far, however, the Executive Branch has made use of this prerogative in only two cases (the existing treaty with Switzerland and the amendment protocol to the Chilean treaty dated April 23, 2003, later approved by Congress).

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Besides the general beneficial ownership rule included in certain treaties, Argentine tax treaties do not specifically address treaty-shopping. They are similarly silent on the use of domestic anti-avoidance rules. The only conditions for treaty benefits to apply are those stated in a domestic resolution holding that persons benefiting from the withholding tax reduction in Argentina under the provisions of a tax treaty must submit an affidavit to the local withholding agent to prove entitlement. The affidavit must include the name and tax address of the effective beneficiary, the origin of the income and a declaration that it has no permanent establishment in Argentina. Additionally, the beneficiary must furnish an affidavit issued by the home country tax authorities confirming its status as resident for purposes of the relevant treaty. This regulation was enacted to attain a minimum degree of control over the use of treaty benefits.

Nonetheless, certain limitation of benefits clauses exist under some treaties. For instance, the treaty signed with Spain contains an ownership test to condition specific benefits (i.e., tax sparing). Thus, Spanish residents deriving royalties from the transfer of technology or technical assistance to Argentina are deemed subject to a 15% Argentine withholding (when, in fact, such withholding under the treaty is 10%), as long as the Argentine payor of the royalties neither holds directly or indirectly an equity interest in a third country's company exceeding 50%, nor is controlled directly or indirectly by a corporate shareholder residing in a third country.

The treaties in force with the U.K. and Sweden provide a broad limitation of benefits provision in connection with interest and royalty payments. Thus, if the parties to the loan or licence agreements intend to capitalise on treaty benefits, the source based tax reduction shall not apply. Furthermore, Article 9 of the treaties in force with Canada, Finland, Sweden, Denmark, The Netherlands, Norway, and Switzerland states that correlative adjustments otherwise available for the application of transfer pricing rules are not allowed in the cases of fraud, negligence or intentional omission.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

The Argentine Constitution sets forth the principle that international treaties approved by Congress prevail over domestic laws, so that tax treaties enjoy a well-settled legal status in Argentina. Based on this constitutional provision, a subsequent statute (for instance, domestic income tax reforms) may not override the provisions of an existing tax treaty.

The Argentine treaty provisions are silent on applying the "economic reality" principle (Argentine general anti-avoidance rule) or preventing treaty-partner countries from doing so. As a result, Argentine courts and tax authorities would not be limited in applying these domestic rules in a treaty ruled scenario.

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Nonetheless, due to the constitutional status of tax treaties, if a limitation of benefits clause is included, the application of domestic anti-avoidance rules in conflict with that treaty clause would not prevail.

There is a recent precedent from the competent authority on treaty interpretation that is worth highlighting. The case involved an Argentine resident holding stock in an Austrian company. 99% of the assets of the Austrian company were shares in an entity located in the British Virgin Islands (BVI) and owned entirely by the Austrian Company (100% participation). According to the terms of the then in force Argentine-Austrian double tax treaty, the jurisdiction to tax personal assets, income and dividends was exclusively granted to the State in which the company was a resident. Therefore, the Argentine resident's holding in the Austrian Company and dividends received therefrom were not taxable in Argentina by personal assets and income tax, respectively. In addition, Argentine fiscal transparency rules were circumvented by the interposition of the Austrian company.

The Argentine competent authority qualified the situation as an abuse of the Treaty and made reference to the possibility of applying general anti-avoidance rules in that context, in accordance with (i) the opinion of the U.N. Expert Committee on International Tax Cooperation, Subcommittee on Improper Use of Treaties, and (ii) the Commentaries to article 1, OECD model, 2008 text. By applying general anti-avoidance rules in the case, the Argentine competent authority disregarded the interposed company in the treaty country jurisdiction (Austria) and treated the holding of the shares in and income obtained by the BVI company as if the interposed company did not exist.

2 Transaction Taxes

2.1 Are there any documentary taxes in Argentina?

In Argentina, stamp taxes are provincial levies imposed on written contracts and other instruments documenting transactions entered into for consideration, if: (i) executed in the province; or (ii) performed in the province. The taxable event arises from the execution of the document itself, despite eventual circumstances that may modify the transaction in the future. Applicable stamp tax rates vary depending on the taxing jurisdiction and the type of transaction.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

■ Value Added Tax

Value added tax ("VAT") is levied on three different classes of transactions, namely: the sale of tangible personal property within Argentina; the import of tangible personal property and services into Argentina; and the provision of services within Argentina. Taxable services include financial services. The general VAT rate is 21%, although certain sales and services may be subject to a reduced 10.5% rate or exempted altogether. Utilities (e.g., telephone, electricity, water and gas supplies) provided to VAT registered taxpayers are subject to a higher than standard 27% tax rate. Exports of tangible personal property and services are subject to a zero rate system. This means that Argentine exporters are allowed to recover, by way of refund, VAT paid to their suppliers for the inputs utilised to manufacture or perform exported goods or services.

■ Gross Turnover Tax

Gross turnover tax is a provincial tax. Argentine provinces and the Autonomous City of Buenos Aires levy this tax on the gross turnover at companies conducting business activities within their jurisdictions. The applicable tax rates vary depending on the specific jurisdiction and the activities concerned. In addition, certain provinces exempt from this tax-specific economic activities.

If a company engages in business activities in more than one province, it would likely be subject to gross turnover tax in each of them. In that case, it would have to allocate its gross receipts among the relevant provinces based on a formula that considers the amount of revenues and expenses and the places where obtained or incurred respectively. The gross turnover tax is deductible for Argentine federal income tax purposes.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The sale of books and aircraft, the rendering of certain educational, medical and transportation services, among others, are transactions exempted from VAT.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

VAT registered taxpayers are required to pay VAT to their suppliers (input VAT) and to collect VAT from their customers (output VAT). Input VAT is credited against output VAT within the relevant period. Any excess input VAT in a given period may be carried over and credited against future output VAT. This feature makes the VAT a neutral tax on consumption effectively borne only by final consumers. The tax loses its neutral character if a single participant in the production chain is not a VAT registered taxpayer (e.g., it is a non-resident). In this case, the VAT charged to the participant that is not a VAT registered taxpayer may not be treated as a credit either by it or by the subsequent participant. Thus, the VAT paid becomes an additional cost.

Excess output VAT over input VAT constitutes the taxpayer's VAT liability. If the VAT paid to suppliers in a particular period exceeds the VAT collected from customers during that period, the VAT taxpayer holds a credit position, which can be carried over to subsequent periods. However, the credit can only be recovered by offsetting it against future output VAT. No cash refund can be requested for excess VAT credits.

Although, as a general rule, the export of services is exempt from VAT, services rendered by Argentine registered VAT taxpayers to non-residents are subject to VAT if they are utilised by the latter in Argentina. Non-residents cannot request a refund for the VAT charged in these situations, and, hence, the VAT becomes an additional cost.

Services rendered by non-residents to Argentine registered VAT taxpayers are always subject to VAT. A reverse charge system is applied in these cases. Argentine purchasers of services provided by non-residents must pay the corresponding VAT directly to the Argentine tax authorities, and an equivalent input VAT credit is available to the taxpayer the month following that in which the VAT taxable event occurred.

2.5 Are there any other transaction taxes?

■ Financial Transactions Tax

All credits to and debits from bank accounts held at Argentine financial institutions, as well as certain cash payments, are subject to a financial transactions tax, which is assessed at a rate of 0.6%.

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A credit against the income tax and/or the minimum presumed income tax is granted for 0.2% of this financial transactions tax. Argentine financial institutions are required to withhold the tax from both the transferor and the transferee when a transfer of funds is effected. In the case of international wire transfers, this tax applies only to the Argentine transferor or transferee, as the case may be.

2.6 Are there any other indirect taxes of which we should be aware?

Excise duties are levied on particular types of goods and services (e.g., alcoholic beverages, soft drinks, tobacco, automobiles, cellular telephone services, and certain technological products as well as other luxury items). Customs duties are generally payable on exported and imported goods.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends distributed by Argentine companies are non-taxable regardless of the shareholder's residence. However, distributions of untaxed corporate earnings and profits are subject to a 35% withholding tax (i.e., the equalisation tax). This equalisation tax applies whenever accounting profits exceed taxable income at the corporate level.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Foreign-domiciled entities and non-resident individuals without presence in Argentina (i.e., a branch or permanent establishment) are taxed on Argentine source income by way of withholdings at source to be made by the local payor of the income. The statutory withholding rate currently stands at 35%. However, as a general rule, foreign beneficiaries are not taxed on an actual net income basis, but rather on a presumed net income basis, which varies depending on the type of income. Thus, as a general rule, actual expenses or other deductions otherwise allowable in determining net taxable income may not be claimed in the case of foreign beneficiaries.

Unless otherwise provided in a tax treaty, royalty payments are subject to an effective withholding tax rate of 28% (35% of a presumed net income of 80%) in the case of registered trademarks, patents, industrial know-how, and other technology transfers. Payments made in consideration for technical assistance, engineering and consulting services not obtainable in Argentina are subject to a 21% (35% of a presumed net income of 60%) effective withholding rate.

To apply the reduced withholding tax rates of 21% and 28%, the agreements must be registered with the Argentine Trademark and Patent Office which will issue a certificate indicating, among other considerations, that the agreement complies with the Technology Transfer Act and, if applicable, that the technical assistance cannot be obtained in the country. Otherwise, a 31.5% effective tax rate would apply.

To clarify the registration procedure to qualify an agreement for the tax benefits, the Argentine Trademark and Patent Office issued Resolution P-328/2005. According to the resolution, technical assistance, consulting and licensing of know-how, in each case if related to financing, sales and marketing unconnected to a local "productive activity" do not qualify. Agreements to acquire products, the licensing and updating of software, the repair and maintenance of equipment (unless coupled with training of personnel) all similarly fail, as do general services related to the current or ordinary business of the Argentine company.

Resolution P-328 does provide a three-prong test of technical assistance to help determine if the agreement qualifies. First, the technical assistance must benefit the local company's productive activity. Further, the transfer must be made through recommendations, guidelines, procedures, plans, or studies. Finally, the consideration paid for the technical assistance must be proportional to the services performed. Resolution P-328 excludes services related to unspecified or contingent needs, as well as those services compensated through royalties or other revenue-based fees.

The resolution also clarifies the registration procedure. An agreement cannot be registered if its original term is expired. An existing agreement may be registered but only if the parties furnish an accountant's certificate attesting to the existence of payments due or payable in the future. In addition, already-registered agreements may retain their benefits, provided the parties file an affidavit certifying the update of the technology received and identifying the additional technology to be furnished during the renewed term.

Licence agreements that provide the right to use a software programme registered in Argentina as well as those allowing the sub-licensing of software in Argentina derive Argentine source income.

An effective withholding rate of 12.25% (35% of a presumed net income of 42%) is levied if: (i) the agreement and the software are registered with the National Copyright Bureau (*Dirección Nacional de Derechos de Autor*); (ii) profits derive from the exploitation of software; (iii) income tax is levied on the authors or their successors (*derechohabientes*); and (iv) the software is not developed upon demand.

If the above-mentioned requirements are not satisfied, software royalty payments made to a foreign beneficiary would be subject to the maximum (31.5%) withholding tax rate.

The tax authorities have held that the term "successor" is a synonym of "inheritor". Therefore, under this interpretation, foreign purchasers or licensees are not successors and, hence, not entitled to the reduced withholding tax rate. In addition, the tax authorities limit the special tax treatment only to "authors". As a result, lower withholding rates are denied by the tax authorities under software licence agreements when payments are made to foreign legal persons other than the author.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Non-resident lenders are subject to Argentine withholding tax on interest paid by an Argentine resident. The general withholding tax rate on interest is 35% (e.g., this rate applies to interest on inter-company loans). However, the 35% withholding tax rate applies on a presumed net basis of 43% (resulting in a reduced effective rate of 15.05% on gross payments) if payments are made: (i) by Argentine financial institutions; or (ii) to non-resident suppliers of capital assets, non-resident financial institutions, and certain non-resident investors in privately-placed corporate bonds.

Interest paid to a non-resident financial institution will benefit from the reduced presumed net basis to the extent that the recipient meets the following requirements: (a) it is overseen by a Central Bank or

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an equivalent agency; (b) it is resident in a jurisdiction that is not a tax haven for Argentine tax purposes, or, if so, the jurisdiction has entered into an information exchange treaty with Argentina; and (c) it is not exempt from providing information to its tax authorities due to bank secrecy or other types of privacy laws.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Thin capitalisation rules apply to interest payable to "foreign related lenders" (as defined by the statute), when the Argentine borrower's debt-to-equity ratio exceeds 2:1. Should that be the case, the full interest expense accrued on the debt exceeding that ratio would be disallowed as a deduction and recharacterised as a dividend distribution. For the thin capitalisation rules to apply, interest must be subject to withholding tax at an effective rate of 15.05% under domestic law (35% tax rate on a 43% presumed net basis, *see* question 3.2 above). A foreign lender is considered "related" if any of the following conditions are met: (i) it directly or indirectly manages or controls (or is managed or controlled by) the Argentine borrower; or (ii) it has the decision-making power to influence or define the activity or activities of the Argentine borrower, or *vice versa*, as a result of the level of equity participation, intercompany debt financing, or functional equivalent.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

See question 3.4 above.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

There are no statutory rules providing the application of thin capitalisation rules to debt advanced by a third party but guaranteed by a parent company. However, under specific circumstances, Argentine courts and tax authorities could likely apply the economic reality principle (general anti-avoidance provision) to recharacterise the transaction as if it were entered into between the local subsidiary and the foreign parent company. Facts generally determinative of these cases might include: the absence of credit risk by the third party lender and its sole compensation by a fee or commission for acting as intermediary; the lack of borrowing capacity of the subsidiary; absence of a standard credit risk analysis of the borrower; first demand guarantees, etc.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Besides thin capitalisation and transfer pricing rules, there are no specific restrictions on tax relief for interest payments to non-residents.

3.8 Does Argentina have transfer pricing rules?

Argentine transfer pricing rules are generally based on the arm's-length principle, which was first incorporated into Argentine law in 1943 (in particular to deal with export and import of goods between related parties). In 1998 Argentina enacted detailed rules including a number of methods to determine whether this standard is met in particular situations. Methods expressly contemplated include the comparable uncontrolled price method, the resale price method, the cost-plus method, the profit-split method, the residual profit-split method, and the transactional net margin method. These methods are defined, in general terms, consistently with the OECD Guidelines on Transfer Pricing to Multinational Enterprises and Tax Administrations.

As transactions between related parties are concerned, if and when they do not meet the arm's-length standard, an adjustment to the transaction's price, or to the income, loss or expenses allocated to the Argentine party should be made according to the most appropriate of the transfer pricing methods referred to in the preceding paragraph. Transfer pricing rules also apply to transactions entered into between an Argentine branch and its foreign head office (or another entity related to the foreign head office), and *vice versa*.

Furthermore, transactions entered into by an Argentine company, trust, or permanent establishment with related or unrelated entities incorporated or located in low- or no-tax jurisdictions (i.e., tax havens) are not deemed to comply *per se* with the arm's-length standard. Consequently, Argentine taxpayers are required to demonstrate the arm's-length character of this type of transaction based on the most appropriate of the aforesaid transfer pricing methods.

In addition, since 2003 a new method though arguably contrary to the arm's-length principle has been employed to assess Argentine source income deriving from exports of commodities sold to foreign related intermediaries that fulfil a three-part test. The method applies as long as the foreign intermediary: (i) does not have real presence in its residence country with a permanent establishment where the business is managed; (ii) its principal activity consists of either the production of passive income or the trading of goods from or to Argentina or with other members of the same economic group; or (iii) its international trade transactions with members of the same economic group are higher than 30% of the total amount of operations carried out during the year. In those cases, the statute deems the "best method" to assess the Argentine source income from exports to be the market price prevailing as of the date in which the goods are shipped, regardless of the price effectively agreed upon at the time of execution. Nonetheless, if the agreed-on price is higher than the price prevailing as of the date of shipping, the higher price will determine the value of the transaction.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax on corporate profits is 35%.

4.2 When is that tax generally payable?

Corporate taxpayers are required to make ten estimated advance income tax payments during the fiscal year. Filing of the annual income tax return and payment of the income tax owed in excess of advanced payments (and withholding at source, if applicable) is due approximately five months after the end of the entity's fiscal period.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Corporations are taxed on their taxable income. Taxable income is assessed by deducting from gross income ordinary business expenses and other allowable deductions. Gross income for

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corporate tax purposes involves all income from whatever source derived regardless of its character -whether passive (investment) or active (business income)-, unless expressly excluded or exempt.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

See question 4.3 above.

4.5 Are there any tax grouping rules? Do these allow for relief in Argentina for losses of overseas subsidiaries?

Tax consolidation or other group relief is not permitted in Argentina.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate upon distributed, as opposed to retained profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Argentina levies a minimum presumed income tax ("MPIT") on Argentine corporations (e.g. an Argentine subsidiary of a foreign corporation) and non-residents that maintain a permanent establishment in Argentina (e.g. a branch). The MPIT is levied on the taxpayer's total assets (with certain exceptions) at a rate of 1%, to the extent that the value of total assets within Argentina (inventories included) exceeds AR$200,000 (approximately US$50,000). If assets do not exceed this threshold amount, no MPIT is payable.

The corporate income tax paid by the Argentine taxpayer may be credited against its MPIT liability. If the taxpayer's MPIT liability is greater than its corporate income tax liability, it is required to pay the excess MPIT. This tax may be carried over and credited against its income tax liabilities arising in future years for a maximum 10-year period.

Notwithstanding the above, in re Hermitage, the Supreme Court of Justice has recently challenged the application of this tax under certain circumstances.

In addition, foreign entities and individuals owning stock in an Argentine corporation are subject to a personal assets tax at a rate of 0.5% on the proportional net-worth value (*valor patrimonial proporcional*) of their participation. The tax is assessed and collected by the Argentine issuing corporation.

4.8 Are there any local taxes not dealt with in answers to other questions?

A tax on real property (real property tax) is also imposed by each of the provinces. Applicable real property tax rates vary depending on the taxing jurisdiction.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

There is no special rule for capital gains in Argentina. Gains from the sale or exchange of real estate and other capital assets (whether short or long-term) by corporate taxpayers are taxed at the ordinary income tax rate (35%).

Notwithstanding the above, capital gains from the sale of stock in Argentine corporations are generally exempt from tax in Argentina (unless realised by an Argentine corporate taxpayer).

Corporate taxpayers are not allowed to offset operating income with losses arising from the disposition of certain securities or derivative instruments. Such losses may only be applied against income from the same type of transactions. Thus, losses arising from the disposition of shares, quotas or other corporate participations, including units of common investment funds, may only be offset against income from the disposition of the same type of assets obtained in the same year or in the subsequent five years. Likewise, losses arising from derivative instruments or contracts (except hedging transactions) may only be offset against income originated by this type of instrument/contract, within the same year or in the subsequent five years.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

See question 5.1 above.

5.3 Is there a participation exemption?

Although Argentina does not have a participation exemption regime, dividends from Argentine companies are generally non-taxable in Argentina (*see* question 3.1 above). The exemption applies to local and foreign shareholders regardless of their equity participation in the distributing entity. In addition, foreign entities and individuals are not taxed on capital gains realised from the sale of stock in Argentine corporations (*see* question 5.1 above). The exemption is not available to corporate resident taxpayers.

5.4 Is there any special relief for reinvestment?

There is not. However, the potential application of the equalisation tax rules (*see* question 3.1 above) upon a profit distribution may act, indirectly, as an incentive for reinvestment. In addition, Argentine income tax law provides for a roll-over regime applicable to capital assets used in the business.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The subsidiary's deed of incorporation or articles of incorporation may be subject to stamp tax depending on the taxing jurisdiction where the subsidiary is incorporated (exemptions may apply). In those cases, the tax is assessed taking into account the corporate capital. No other taxes are imposed upon the formation of a subsidiary.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no other significant taxes or fees incurred by locally formed subsidiaries. Both local branches and subsidiaries pay income tax on a worldwide income basis at the same 35% corporate income tax rate.

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However, certain differences should be considered. Start-up losses of an Argentine subsidiary may be offset against subsequent profits over a five-year period rather than against the foreign parent's income. In the case of local branches, start-up losses may be offset against not only the head office's other profits but also other members of the group's profits to the extent this procedure is consistent with the head office's home legislation.

Upon disposition of the investment, as a general rule, foreign shareholders will not be taxed on the capital gains deriving from the sale of their participation in an Argentine stock corporation. (*See* question 5.1.) Conversely, a foreign head office having a branch in Argentina may only dispose of its investment by selling the assets of the branch. Income deriving from the transaction would be taxed at the ordinary 35% corporate income tax rate.

6.3 How would the taxable profits of a local branch be determined?

Taxable income of local branches is determined on the basis of separate accounting and following the same rules concerning taxable income, exclusions, and allowable deductions as those applied to domestic taxable entities. However, if the local branch's accounting records are inadequate or do not accurately reflect net income of the branch, the tax authorities may treat the branch and the foreign head office (including its other branches or subsidiaries, if any) as a single economic unit, and determine taxable income of the local branch as a portion of the unit's aggregate income, at its own discretion.

There is no "force of attraction" rule under Argentine income tax law. Therefore, income attributable to the foreign head office for works, services or other activities carried out directly by the foreign head office without intervention by the local branch would not be taxable at the latter's level. Such income is subject to the withholding tax at source provided for in the case of non-residents generally.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Local branches of non-resident companies are only subject to the ordinary 35% corporate income tax rate on their worldwide income.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Local branches of foreign entities are deemed Argentine residents under the Argentine income tax law. Therefore, they should be entitled to the benefits of the tax treaties signed by Argentina.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

As explained above in question 6.3, local branches are subject to the ordinary 35% corporate income tax on their worldwide income. To the extent accounting profits do not exceed taxable profits at the branch's level, no additional tax would apply on the remittance of funds to the head office. (Otherwise, a 35% would apply on the excess [*see* question 3.1 above].)

7 Anti-avoidance

7.1 How does Argentina address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Argentine general anti-avoidance rules are contained in sections 1 and 2 of the Tax Procedural Law (Law 11,683, as amended, TPL). Although in a different context, both sections describe the so-called *economic reality principle*, a term more familiar among Argentine scholars and tax practitioners than *substance over form* or similar terms frequently used in Anglo-Saxon tax circles. Section 1, TPL, mandates the application of the economic reality principle to the construction of tax law. Section 2, TPL, provides for the application of the principle to the characterisation of the acts and transactions of taxpayers, *i.e.* to the assessment of facts.

Section 1, TPL, sets forth the principle that tax provisions must be construed in accordance with their purpose and economic meaning, adding that whenever it is not possible to ascertain the meaning or the scope of application of a tax rule based on its wording or intent, the interpretation may be made resorting to private law rules, concepts, and principles.

Section 2, TPL, in turn, directs consideration of the acts, situations, and economic relations actually performed, pursued or created by taxpayers to determine the true nature of the taxable event. Under this rule, when a taxpayer's chosen legal form does not coincide with a structure offered or authorised by law to properly shape actual economic objectives, the chosen form may be discarded. In its stead, the law requires that the actual economic situation be considered within the structures provided by private law and the most natural form applied consistent with the taxpayer's actual intention.

In addition, specific anti-avoidance rules are found in a number of income tax law sections and are aimed at specific situations that, for different reasons, the legislator has considered inadequately covered by *economic reality principle*. In their particular areas of application, specific anti-avoidance rules usually describe in detail the targeted transactions and the tax consequences derived therefrom. Specific anti-avoidance rules may either take the form of mechanical rules that apply to all transactions meeting the statutory definition, or rules whose application depends on a finding of the taxpayer's intent for entering into the transaction. In the latter case, the law often presumes a specific intent, unless the taxpayer proves the contrary.

Argentina does not have disclosure rules imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted or otherwise.

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Negri & Teijeiro is a full-service law firm with over 50 legal professionals. N&T offers its clients high-quality advice and service commensurate with international standards. The firm's culture is largely defined by professionals trained abroad and used to working with international clients. The firm provides comprehensive legal services focused on business activities in Argentina. Its senior attorneys have particular expertise in international banking and finance, debtor-creditor proceedings, labour and administrative law and business litigation. The Tax Department combines local savvy with expertise in the areas of tax planning, general tax advice and tax litigation.

Tax planning services emphasise advising clients on federal and local Argentine taxes and developing efficient structures for business activity in Argentina. The group has vast experience in advising on cross-border investments, transfer pricing and qualifying businesses for special sector regimes (e.g., software, mining, agricultural, infrastructure projects). The tax litigation practice involves representing businesses and individuals in disputed federal, provincial and municipal claims for the payment and collection of taxes as well as the reimbursement of taxes paid in excess at every level of government. Partnered with white-collar criminal defense counsel, the tax department has also successfully defended taxpayers against federal and provincial tax fraud claims.

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Australia

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Australia?

Australia has comprehensive income tax treaties with 41 countries, including the US, UK, most Western European countries, most East and South-East Asian countries and New Zealand. Australia has also concluded or is concluding a number of Tax Information Exchange Agreements with a number of countries including some low tax jurisdictions.

1.2 Do they generally follow the OECD or another model?

Australia's tax treaties generally follow the OECD model. However, the US treaty follows the US model and some differences exist in some other treaties. In particular, some treaties allocate rights to tax land rich entities in the same way as rights to tax real property.

The US, UK and Japanese treaties (and other recently concluded and renegotiated treaties) provide withholding concessions and exemptions for interest paid to unrelated financial institutions and dividends paid to holding companies and significant corporate shareholders. For details see questions 3.1 and 3.3.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Treaties must be incorporated into Australia's domestic law before they take effect. Each time a treaty is concluded, the International Tax Agreements Act 1953 (**Agreements Act**) is amended to give force of law to the treaty with the treaty incorporated as a schedule to that Act.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Australia's tax treaties traditionally did not incorporate anti-treaty shopping rules. However, limitation of benefits articles are included in some of Australia's more recently negotiated treaties, including its treaties with the US and Japan. Other new treaties contain specific provisions within the dividend, interest, and royalty articles.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Yes, occasionally. The Agreements Act gives treaties the force of Australian law. To the extent a treaty provision conflicts with domestic legislation, the treaty provision takes precedence. However, specific override provisions can also be found in the Agreements Act. These include the preservation of Australia's general anti-avoidance rule.

2 Transaction Taxes

2.1 Are there any documentary taxes in Australia?

Yes. Stamp duty is a documentary tax.

Stamp duty is levied by the various Australian States (and Territories). Although largely aligned, the duty regimes differ between the States (and Territories).

Stamp duty is levied on transfers of interests in land, the creation of beneficial interests in land, transfers of shares and units in land rich entities, motor vehicle transfers and insurance contracts at rates up to 7%. One state (New South Wales) applies lesser rates of duty to mortgage documents and two States (New South Wales and South Australia) impose stamp duty on transfers of shares in private companies at 0.6%. A nominal amount of duty also applies to some documents such as trust deeds.

While stamp duty was historically a documentary tax, avoidance-type rules can also apply duty to transactions effected without documents.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. Since 1 July 2000, goods and services tax (**GST**) has been imposed on supplies that are connected with Australia, and on goods imported into Australia. The GST rate is 10%. GST is similar in scope and operation to the Value Added Tax systems of European Union Member States.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Supplies that are classified as "GST-free" do not attract GST. These supplies include education, health-related services, most basic types

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of food, exports (of goods and services), and certain supplies of businesses.

Other supplies that do not attract GST are known as "input taxed" supplies. These include financial supplies, residential rent and the sale of some residential premises.

The distinction is important because while neither class of supply is subject to GST, input tax credits cannot be claimed for acquisitions that relate to input-taxed supplies.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

An entity is broadly entitled to claim input tax credits for things acquired in the course of its business, except to the extent that the acquisition relates to input-taxed supplies (for example, financial supplies such as money lending or other dealings with debt or equity interests). Input tax credits are offset against the taxpayer's GST liabilities so that only a net GST amount is payable. Apportionment for "mixed use" acquisitions is required.

2.5 Are there any other transaction taxes?

Various States impose minor licensing fees.

2.6 Are there any other indirect taxes of which we should be aware?

Yes. Australia also imposes the following indirect taxes.

Excise duty

Excise duty is levied on some goods manufactured in Australia, including alcohol, tobacco and petroleum.

Land tax

Land tax is imposed by each State and the Australian Capital Territory on the value of commercial real estate. Agricultural land is excluded. Broadly, the liability for land tax rests with the land owner and the rate differs depending on the jurisdiction.

Customs duty

Goods imported into Australia may be subject to customs duty.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends are subject to 30% dividend withholding tax, unless the rate is reduced under an applicable treaty (generally to 15%). However, Australia operates under an "imputation system" whereby dividends paid by an Australian resident company out of post tax profits may carry a franking credit (essentially a tax credit) for the tax already paid by the company. "Fully franked" dividends are exempt from dividend withholding tax.

Under the US, UK, Japanese, Finnish, New Zealand and Norwegian treaties (generally Australia's recently concluded or renegotiated treaties), dividend withholding tax is reduced to nil where a beneficially entitled company holds at least 80% of the voting power in the company paying the dividends, and a 5% rate applies where the recipient is a company and holds at least 10% of the voting power. The second concession also applies under the French and South African treaties (which are also recently renegotiated treaties).

Unfranked dividends will not be subject to dividend withholding tax where they are paid out of "conduit foreign income". Conduit foreign income is essentially foreign income of the Australian company that is not subject to Australian tax (for example, non-portfolio dividends) and is paid on to a foreign resident as a dividend rather than accumulated in Australia.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties are subject to 30% royalty withholding tax. If a treaty applies, royalty withholding tax is usually reduced to 10%. Royalty withholding tax is reduced to 5% under the US, UK, New Zealand, Finnish, South African, Japanese and French treaties.

The term "royalty" is broadly defined in Australia's domestic legislation and includes fees paid for the use or supply of commercial property and rights. The term royalty is also defined in Australia's treaties and can differ from Australia's domestic legislation. In those cases the treaty definition prevails.

More recently negotiated treaties exclude natural resource payments and equipment royalties from royalty withholding tax. However, royalty withholding tax applies to rental payments to non-residents under arrangements in which cross-border leases are structured as hire-purchase arrangements.

Royalties that are effectively connected with an Australian branch of a non-resident are treated as business profits and taxed on an assessment basis (that is, they are not subject to withholding tax).

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Interest is generally subject to 10% interest withholding tax. This rate may be reduced under an applicable treaty.

Exceptions apply to interest paid on Eurobonds and other debt instruments offered publicly. Under Australia's recently concluded and renegotiated treaties (e.g. the US, UK, French, Japanese, Finnish, New Zealand, Norwegian and South African treaties), interest paid to an unrelated financial institution is exempt from withholding tax.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Australia's thin capitalisation rules apply to foreign controlled Australian groups (inward investors) and Australian groups that invest overseas (outward investors). The rules restrict interest deductions when the amount of debt used to finance the Australian operations exceeds specified limits (please see question 3.5 below).

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

A safe harbour is provided under *de minimis* exemptions and three maximum allowable debt tests.

***De mimimis* exemptions**

Exemption from the thin capitalisation rules applies to:

- taxpayers with interest deductions of less that $250,000; and
- outward investors whose Australian assets make up 90% or more of total assets by value.

Maximum allowable debt tests

Thin capitalisation rules will not apply to deny any portion of an

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entity's interest deductions provided that debt is within the maximum allowable under one of the following three tests:

- For inward and outward investors, the "safe harbour test" prescribes a maximum debt to equity ratio of 3:1.
- For inward and outward investors, the "arm's length debt test" prescribes a maximum level of debt that is referable to the level of debt that could reasonably be borrowed from commercial lenders, but judged according to strict statutory criteria.
- For outward investors only, the "worldwide gearing test" allows gearing of Australian operations up to 120% of the overall worldwide gearing applied by the group it controls.

Significantly greater debt levels to those set out above are afforded to financial institutions, including a 20:1 safe harbour.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

The thin capitalisation rules apply to all debt interests, including debt advanced by related and unrelated parties, whether an Australian or foreign resident, and in the case of debt advanced by an unrelated party, whether or not supported by a related party.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Any interest withholding tax due on interest payments by a local company to a non-resident must be remitted to the Tax Office before the local company is entitled to a tax deduction for interest payments.

The Tax Office maintains at present, somewhat controversially, that Australia's transfer pricing rules (see question 3.8 below) require Australian operations to have an arm's length capital structure and can therefore restrict interest deductions beyond the restrictions imposed by the thin capitalisation rules.

3.8 Does Australia have transfer pricing rules?

Australia has transfer pricing rules that are modelled on the OECD Transfer Pricing Guidelines. The rules are contained in Australia's domestic legislation and its tax treaties. The rules apply to "non arm's length" cross-border transactions. Guidance on what is considered "arm's length" is provided by the Tax Office via a number of public rulings.

The rules give the Tax Office the discretion to adjust non arm's length pricing of transactions to increase taxable income in Australia. Conversely, treaties can require Australia to reduce taxable income.

The preferred methods applied in Australia to determine appropriate arm's length pricing of cross-border transactions are:

- Comparable Uncontrolled Price method.
- Resale Price method.
- Cost Plus method.
- Profit Split method.
- Transactional Net Margin method.

To confirm that international prices are arm's length, entities can apply for an advanced pricing agreement with the Tax Office.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of company tax is 30%.

4.2 When is that tax generally payable?

Companies are generally required to pay tax under a "Pay As You Go" (**PAYG**) collection system. This requires large companies (and most other large taxpaying entities) to pay quarterly instalments of estimated tax, calculated by reference to the amount of income derived during that quarter. The instalments are due on the 21st day of the month after the end of each quarter. Any difference in tax payable from the estimate is due, in the case of a company, 5 months after the year's end.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Australian taxpayers are taxed on their worldwide "taxable income", typically for a year ending 30 June.

Taxable income comprises "assessable income" less allowable tax deductions. The amount of assessable income and tax deductions often varies from the amount of income and expenses recognised for accounting purposes. Tax adjustments often therefore produce differences between a company's taxable income and its reported profits.

Australia also has complex rules to attribute certain underlying income earned by foreign entities to Australian owners. Generally, active business income earned by a controlled foreign company is not attributed to the Australian controller, and profit distributed to the Australian controller as a dividend is exempt from tax. Foreign active business income derived directly is also generally exempt.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Taxable income often differs from commercial accounting profit because of:

- different tax depreciation rates for plant and equipment;
- differences in the timing of recognition of income and deductions for tax purposes compared to revenue and expenses for accounting purposes;
- tax concessions which allow greater than 100% depreciation for certain research and development expenditure;
- special tax incentives available from time to time, for example an additional capital expenditure deduction ("investment allowance") to encourage investment during the "global financial crisis";
- recognition of some taxable capital gains not recognised for accounting purposes;
- capitalisation of some expenses for tax purposes;
- in the case of consolidated groups, different calculations of the tax cost of assets; and
- elimination from taxable income of impairment, fair value and mark-to-market type adjustments made for commercial accounting purposes.

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4.5 Are there any tax grouping rules? Do these allow for relief in Australia for losses of overseas subsidiaries?

Special grouping rules apply in respect of income tax and GST.

Income tax consolidated group

An Australian resident head company may irrevocably elect to form an income tax consolidated group. A consolidated group consists of a head company and all its wholly owned Australian subsidiary companies and eligible trusts and partnerships. The consolidated group is taxed as a single entity and intragroup transactions are ignored. The head company is primarily liable for the group income tax and subsidiaries may be jointly and severally liable if it fails to pay. Broadly, the tax consolidation regime allows group restructuring, pooling of losses and tax free movement of assets within the group without tax consequences. The tax costs of a subsidiary member's assets are set at the time of joining the group and the tax cost of shares in the subsidiary are set on leaving the group. Non-income tax matters are outside the scope of the consolidation regime.

Losses made by overseas subsidiaries cannot be brought onshore. This is the case irrespective of income tax consolidation.

Top tier Australian companies in a wholly owned multi-national corporate group that has multiple entry points into Australia may irrevocably elect to form a Multiple Entry Consolidated (**MEC**) group for income tax purposes.

GST Group

As a separate election, groups with 90% common ownership may be registered as a GST group. A GST group must nominate a representative member who is responsible for the GST liabilities of the whole group. Subsequent supplies and acquisitions made within the group are ignored for GST purposes. Non-GST matters are outside the scope of the GST group regime.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Australian tax is generally imposed on company profits regardless of distributions. However, there is an exception for "conduit foreign income", which is exempt from Australian tax if distributed as a dividend to a foreign entity.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Fringe benefits tax

Fringe benefits tax (**FBT**) is a tax on employers on the value of non-cash "fringe benefits", provided to their employees. Fringe benefits typically include the provision of motor vehicles, expense payments and low interest loans.

The FBT rate is 46.5% of the "grossed-up" value of benefits (that is, grossed-up so that the tax payable is equivalent to the tax that would be payable on an equivalent amount of salary).

Petroleum resource rent tax

Petroleum resource rent tax is imposed on income from the recovery of petroleum products from offshore petroleum projects. Various other natural resource royalties are also applied.

Luxury car tax

Luxury car tax is levied at 33% of the excess over $57,466 (indexed) of the retail value of a new car sold in or imported into Australia.

Wine equalisation tax

Wine equalisation tax (**WET**) is levied at 29% of the wholesale value of wine for consumption in Australia.

4.8 Are there any local taxes not dealt with in answers to other questions?

Payroll tax

Payroll tax is a tax imposed by each State and Territory on wages, salaries and other employee benefits up to a rate of 6.85% (depending on the State or Territory).

Gaming licences

Each State has a regime for the imposition of gaming licence fees in one form or another.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

A comprehensive set of statutory rules within the income tax legislation include capital gains (after netting off capital losses) in assessable income.

These rules also contain capital gains tax exemptions and concessions, including the ability to index cost basis until 19 September 1999 and, alternatively, reductions of taxable gains made by individuals and complying superannuation funds on assets held for at least 12 months.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No. The rate of tax imposed on capital gains made by a company is the same 30% tax rate imposed on income. Companies are not eligible for the gain reductions ("CGT discounts") available to individuals and complying superannuation funds.

5.3 Is there a participation exemption?

Different exemptions from capital gains tax apply to non-resident and resident investors.

Non-resident investors

From 12 December 2006, non-residents are broadly only subject to capital gains tax on assets that are "taxable Australian property" as defined. These assets include direct and indirect interests in Australian real property and the business assets of Australian branches. A non-resident investor is not subject to capital gains tax on a sale of shares in an Australian company unless its holding exceeds 10% and the Australian company's value is mostly attributable to Australian real property.

Resident investors

Australian resident companies are *prima facie* subject to Australian tax on their worldwide income. However, a capital gain or loss made by a resident company on shares in a foreign company may be reduced (in some cases to nil) under a specific "participation exemption". The resident company must have held a 10% or greater direct voting interest in the foreign company for a continuous period of 12 months in the last 2 years. In that case, the capital gain or loss is reduced by the value of the foreign company's active business assets as a percentage of the value of its total assets.

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5.4 Is there any special relief for reinvestment?

Relief for reinvestment is not available in Australia *per se*. However, the CGT provisions contain some "replacement asset" rollovers which allow deferral of tax on capital gains. They are generally targeted at restructures and takeovers. A commonly used rollover ("scrip-for-scrip" rollover) is available for scrip exchanges where the bidder acquires at least 80% of the shares in the target company. A limited rollover is available where the ownership of a capital asset ends due to compulsory acquisition by the government.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There is not any tax imposed on the formation of a subsidiary. A nominal administrative charge is levied by the Australian corporate regulator (**ASIC**) on incorporation of a company and also applies to the registration of a branch of a foreign company.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Australia's tax rules generally do not differentiate between conducting Australian operations through a subsidiary or a branch. Both forms of operation are subject to the same 30% corporate tax rate.

However, an Australian resident subsidiary with offshore investments would *prima facie* pay Australian corporate tax on its worldwide income (subject to the conduit foreign income rules mentioned in question 3.1 above), whereas a branch of a non-resident company would be taxed only on its Australian sourced income.

Subsidiary company profits on which tax has been paid in Australia are able to be repatriated as dividends free of Australian dividend withholding tax.

6.3 How would the taxable profits of a local branch be determined?

A foreign company with an Australian branch is taxed on its Australian sourced income that is attributable to that branch. Arm's length transfer pricing rules apply to transactions between a branch and its offshore head office or other foreign branches.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Australia does not impose branch profits tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Generally yes, but Australia's tax treaties broadly allow full taxing rights to the source country where a treaty resident company carries on business through a permanent establishment in Australia. The treaties do invariably require arm's length principles to be applied in determining the taxable income of the branch. In these respects Australia's treaties broadly follow OECD treaty principles. However, the branch of a non-resident generally would not be able to take advantage of Australia's treaties with a third country.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

There is not any withholding tax or other tax imposed on the remittance of profits by a branch.

7 Anti-avoidance

7.1 How does Australia address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Australia has a general anti-avoidance rule contained in Part IVA of the tax legislation. It supplements other more specific anti-avoidance rules dealing with, for example, franking credit streaming and dividend stripping.

The provisions of Part IVA are extremely broad and extend to schemes entered into with the sole or dominant purpose of obtaining a tax benefit. A tax benefit is essentially a reduction of assessable income, an increase in allowable tax deductions (including tax deferral beyond what would be reasonably expected) or access to a tax credit. The application of Part IVA is dependant on the Commissioner's discretion, which is generally reserved for schemes that the Commissioner considers artificial or contrived.

Part IVA prevails over other provisions of the Australian tax legislation and Australia's tax treaties. Where it is applied the tax benefits are denied and administrative penalties are generally imposed.

Taxpayers may seek a Tax Office ruling for assurance about the tax treatment of a potentially contentious transaction.

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- dividend and capital return strategies;
- capital gains tax and other reorganisation issues associated with mergers and acquisitions and corporate restructures;
- the taxation of public and private trusts and alternative structures such as stapled vehicles, partnerships and unincorporated joint ventures;
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We are a team of highly experienced taxation specialists focused on developing deep relationships with clients to fully understand their business needs. Our philosophy is for directors to be actively involved in advising clients to ensure the highest standards of technical expertise and provide the experience necessary for creative yet highly practical solutions. In recognition of the success of our approach, we were awarded Australian Tax Firm of the Year for 2007 by International Tax Review. Our first tier performance has been consistently recognised in league tables, tax guides, and industry-related awards.

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Chapter 5

Austria

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Austria?

Currently, there are 88 tax treaties in force in Austria.

1.2 Do they generally follow the OECD or another model?

Generally, they follow the OECD model, although some of the older treaties significantly deviate from the OECD model. Important examples of treaties which do not follow the OECD model in essential points are those with Brazil, France and Japan.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Treaties become effective upon their ratification by the two governments or representative houses of the two parties to the treaty. Formal incorporation into Austrian legislation is not required.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Generally, Austrian tax treaties do not incorporate anti-treaty shopping rules. The most notable exemption from this principle is the tax treaty with the United States, which has a strict "limitation of benefits" article.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In principle, tax treaties are considered to be international law and as such should be protected from being overridden by national Austrian tax law. Nevertheless, in practice the Austrian tax authorities often deny treaty benefits to entities resident within treaty jurisdictions if these entities have a low degree of substance. Technically, the denial of treaty benefits in such situations is achieved by applying the general anti-abuse rule of Section 22 of the General Austrian Tax Code (*Bundesabgabenordnung* – BAO).

2 Transaction Taxes

2.1 Are there any documentary taxes in your jurisdiction?

The most significant documentary tax is provided for in the rather formalistic and old-fashioned Austrian Stamp Duty Act ("*Gebührengesetz* – GebG"). According to section 33 of the Austrian Stamp Duty Act, stamp duties are levied on certain types of transactions if these transactions are documented in writing. Generally, all parties entering into the agreement which triggers stamp duty are jointly and severally liable for these stamp duties.

In practice, the most important transactions which are subject to stamp duty under the Stamp Duty Act in the context of international business transactions are:

Loan or Credit Agreements

Loan and credit agreements are subject to a stamp duty amounting to 0.8% of the loan principal if a written agreement is made on the loan (except in cases of shareholder loans, when the stamp duty is incurred even if there is no written agreement). Important exemptions from this stamp duty apply to intra-bank loans.

Lease and Rental Agreements

Lease and rental agreements are subject to stamp duty if a written rental or lease agreement is made. The stamp duty amounts to 1% of the annual sum of the rental payments multiplied by the duration of the contract (1% of 18 annual payments at the maximum). If there is no definite lease period, the stamp duty amounts to 1% of three times the annual value of the contract.

Agreements on the Assignment of Rights and Receivables

The assignment of rights and receivables is generally subject to stamp duty if a written agreement is made. The stamp duty amounts to 0.8% of the purchase price or of the fair value of the assigned receivables. Exemptions apply for assignments of receivables to special purpose securitisation vehicles.

Technique for avoiding stamp duties

Generally, Austrian stamp duty law is very formalistic and follows a rather old-fashioned "form over substance" approach. The law provides that in general all stamp duties arise upon either of the two following alternatives:

i) the agreement subject to stamp duty is concluded in writing on Austrian territory, or the written agreement (or a certified copy of it) is brought into Austrian territory at any later stage; or

ii) the contract is entered into abroad (and not brought to Austria), but one of the parties to the contract is an Austrian resident and the legal obligations / transactions (payments) resulting from this contract are to be fulfilled in Austria.

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On the basis of this legal environment, Austrian stamp duty in the context of international business transactions (with one party not being Austrian resident) can therefore mostly (with the important exemption of shareholders' loans) be avoided using offshore signing schemes. If both parties to the agreement are Austrian residents, the stamp duty can only be avoided if no written document is signed by both parties.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Austria has a VAT system which follows the 6th EC VAT Directive. The generally applicable VAT rate is 20%. Lower rates apply to a few selected goods and services of public interest in the food, health and cultural sectors.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

In principle, the supply of goods and services in any transaction is subject to VAT.

In the context of international business transactions, in practice, the most relevant VAT exemptions are the following:

Share Deals

The transfer of shares in a corporation is always exempt from VAT. Please note that in contrast to the treatment of shares in corporations, the transfer of partnership interests is treated for VAT purposes as an asset deal, i.e. VAT applies to the supply of all goods owned by the transferred partnership.

Financing

As in most other countries, the supply of financing services by banks and finance institutions is exempt from Austrian VAT. As a consequence of this exemption banks are not entitled to claim input VAT refunds in Austria.

Real Estate Transactions

In the case of the transfer of real estate property, the seller has an optional right to treat the sale as being subject to or exempt from VAT. Generally, in business transactions the option to subject the sale to VAT is elected in order to not retroactively lose input VAT refunds claimed by the seller prior to the sale. If the sale is subject to VAT, the buyer can claim an immediate VAT refund if he is an entrepreneur for VAT purposes.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

There are certain business sectors, most notably the banking sector, the services of which are exempt from VAT and which are accordingly not entitled to recover VAT under the input VAT system. Other examples besides the banking and finance sectors are holding companies (with no other activities except holding participations) or medical services.

2.5 Are there any other transaction taxes?

The transfer of Austrian real estate property in an asset deal or the transfer of all of the shares in an Austrian corporation which owns real estate property triggers a real estate transfer tax of 3.5%. The real estate transfer tax in the case of a share deal may be avoided if not 100%, but only 99% of the shares in the company holding the real estate are transferred.

2.6 Are there any other indirect taxes of which we should be aware?

In the context of business transactions, the capital duty (1% levied on equity contributions to corporate entities) is of high practical relevance.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Under Austrian national tax law, dividends are subject to a 25% dividend withholding tax. This withholding tax is reduced by most tax treaties. In addition, no withholding tax will be imposed at source on intra-group dividends to EU-resident parent corporations, in compliance with the EC Parent Subsidiary Directive, if the following requirements are met:

- the parent company directly and continuously holds at least 10% (in some countries 25% is required under the principle of reciprocity) in the distributing Austrian company for a period of one year;
- the Austrian company is in the legal form of an AG or a GmbH, i.e. a corporation;
- the parent company is a corporation as listed in Art. 2 of Directive 90/435/EC;
- the parent corporation provides a residency certificate issued by the foreign tax authorities which is issued within one year before or after the dividend is paid; and
- the parent company provides confirmation to its subsidiary that it has active business income, employees and its own office premises.

If any of these requirements are not met, withholding tax has to be withheld and the foreign parent can apply for a refund. During the course of this refund procedure, the Austrian tax authorities will verify whether the foreign parent is entitled to the withholding tax reduction or whether the structure is abusive. Pure holding companies, as foreign shareholders, will only be able to rely on the withholding tax reduction at source if it is clear that the structure was not set up purely for tax-avoidance reasons.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid by an Austrian corporation to a non-resident are subject to a 20% withholding tax. However, under most of the tax treaties in force, this withholding tax is reduced to a rate of between 0% and 15%.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Austria does not levy any withholding tax on interest paid to a foreign or domestic corporate party. Treaty relief is not required. However, if debt is reclassified as hidden equity and, in consequence, interest payments are regarded as hidden dividends, the withholding tax rates for dividends may apply to interest payments.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Austria does not have statutory thin capitalisation rules or safe

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harbour debt/equity ratios. However, depending on the economic situation of a company, the tax authorities may reclassify parts or all of a company's debt into equity on a case-by-case basis. From a practical point of view it is thus definitely advisable to adhere to industry standards.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There is no statutory safe harbour. However, generally speaking, a debt/equity ratio of 70:30 per cent should usually be acceptable to the Austrian tax authorities. The debt/equity ratio is always measured on a consolidated basis. In the case of a leveraged acquisition, this usually means that the debt incurred by the acquisition vehicle has to be consolidated with the already-existing debt of the target.

Besides thin capitalisation, in order to avoid a reclassification of debt into hidden equity for tax purposes, the Supreme Administrative Court and the Ministry of Finance stress the importance of relatively formal issues, such as written loan agreements with arm's length terms regarding interest payments and repayment of loan principals.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes, these informal thin capitalisation rules also extend to debt guaranteed by a related party.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

In general, expenses are not deductible if they are directly related to tax exempt income. Exemptions from this principle may apply.

3.8 Does Austria have transfer pricing rules?

Austria does not have statutory transfer pricing rules. Nevertheless, transactions between related parties have to comply with the arm's length principle. In enforcing the arm's length principle, the Austrian tax authorities generally use the OECD transfer pricing guidelines as a reference.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Austria has a flat corporate tax rate of 25%.

4.2 When is that tax generally payable?

The tax is in general payable within one month after receipt of the tax assessment, which is usually issued a few weeks after the filing of the tax return. A corporation generally has to file its corporate income tax return within three months after the end of the fiscal year. If the corporation is represented by a certified tax adviser, the filing date may be routinely extended by up to another year. Apart from the final tax payment, the corporation is subject to quarterly prepayments of corporate income tax on the basis of preliminary estimates issued by the tax authorities.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In principle, the tax base for corporate income tax is the corporation's annual profit on the basis of the statutory commercial accounts. However, significant deviations and adjustments from the commercial accounts are required, according to the Austrian tax accounting rules.

The most significant of theses adjustments are:

- the treatment of provisions (in the case of most provisions, deductibility for tax purposes is limited to 80% of the provision);
- the treatment of depreciation periods (for tax purposes, only straight line depreciation is accepted; goodwill has a standard tax depreciation period of 15 years); and
- the treatment of national or international dividend income (national dividend income is always tax-exempt on a corporate level; international dividend income is exempt if the requirements of the international participation exemptions are met).

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Differences between the profits shown in the commercial accounts and the tax accounts are based on tax accounting rules as provided in the General Income Tax Act (*Einkommensteuergesetz* – EStG) and the Corporate Income Tax Act (*Körperschaftssteuergesetz* – KStG). Examples of important differences between statutory commercial accounting and tax accounting are the treatment of provisions, the treatment of depreciation periods and the treatment of dividend income or capital gains.

4.5 Are there any tax grouping rules? Do these allow for relief in Austria for losses of overseas subsidiaries?

In 2005, Austria introduced a new modern group taxation regime. The new group taxation regime allows the integration of non-Austrian corporations into an Austrian tax group, which allows the cross-border of losses within the group.

The requirements for an Austrian tax group are the following:

- the group parent must be either an Austrian corporation or an Austrian registered branch of an EU resident corporation. Several companies may jointly act as a group parent, provided that at least one company holds at least 40% and the other companies hold at least 15% in the prospective group member;
- **Austrian or foreign companies** which are in a legal form comparable to an Austrian corporation may participate as group members. **Foreign companies** can only be a member of the group if they are directly held by the Austrian group parent or if they are a member of an Austrian group;
- to qualify as a tax group, the group parent has to hold a direct or indirect participation of more than 50% in the share capital as well as a majority of the voting rights of the Austrian or the foreign subsidiary ("financial integration"). The requirement of financial integration must be met during the entire business year of the participating subsidiary;
- the group parent and the group members must file a written application for group taxation with the revenue office. The application is binding for at least three years; and
- group taxation is optional. The option can be exercised separately by each company that is a potential group member.

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Under the new rules, all taxable profits and losses of the Austrian group members are attributed to the group parent, whereas in the case of foreign group members, only losses and no profits will be attributed to the group parent. If – in the years to follow – the foreign group member in its jurisdiction obtains a credit for the loss which is carried forward, the loss previously used in Austria must be recaptured at the level of the Austrian group parent in order to avoid the double use of losses. Should the foreign member cease to be a member of the tax group for any reason but insolvency, losses previously used in the Austrian tax group are to be recaptured as well.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, there is no such differentiation in corporate tax law. The model exists, however, in the field of small-sized one-person businesses and small-sized partnerships with a profit of less than EUR 100,000.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Real estate property located in Austria is subject to property tax. The tax base for property tax is the historically-assessed standard value of the respective property, which is generally substantially below its actual fair value. The property tax is levied at a basic federal rate multiplied by a municipal coefficient. The basic federal rate is 0.2% of the historically assessed standard value; the municipal coefficients range up to 500%. There are at present political tendencies, supported by a recent decision of the Constitutional Supreme Court, in favour of raising the historically-assessed values to fair market value.

4.8 Are there any local taxes not dealt with in answers to other questions?

No, all taxes on corporate (as opposed to individual) taxpayers are levied at a federal level.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

There is a special set of rules regarding capital gains and losses incurred with international participations in non-Austrian corporations exceeding a minimum shareholding of 10%.

Capital gains or capital losses realised upon both the sale of such participations as well as depreciations of the participation are in principle not tax-effective. In the past (i.e. up to 2004), such capital gains were tax-exempt, whereas capital losses were deductible. Due to EU pressure, both capital gains and capital losses are now tax-neutral (i.e. gains are exempt and losses are not deductible).

Only losses realised upon the liquidation or insolvency of a foreign subsidiary are still tax-deductible to the extent that they exceed tax free dividends received in the five years before the liquidation or insolvency.

As an alternative to the "tax-neutral statues" of international participations, an option model is available, as follows:

Any corporate holder of a foreign participation can opt out of the tax neutrality of foreign participations. If such opt-out is chosen, capital losses and write-downs are fully tax deductible (however, they have to be depreciated over a fixed period of seven years), and on the other hand capital gains will be fully taxable. Dividends, however, are not covered by this option and remain tax-exempt under the participation exemption.

It is possible to choose one of the two aforementioned options for each international participation. However, once the choice is made it cannot be revoked.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No, the corporate tax rate imposed on capital gains is not different from the regular corporate tax rate of 25%.

5.3 Is there a participation exemption?

As already indicated, there is an international participation exemption which applies to dividends and capital gains received from foreign subsidiaries, as opposed to the national participation exemption which only applies to dividends.

According to the Austrian international participation exemption, dividends received by an Austrian holding company from a subsidiary, or capital gains incurred by an Austrian company upon the sale of a foreign subsidiary, are not subject to income tax in Austria if the following requirements are met:

- the Austrian company must hold at least 10% of its foreign subsidiary (in the case of EU jurisdiction the 10% threshold for dividend payments is not required any more);
- the foreign subsidiary must be comparable to an Austrian AG or GmbH (i.e. it must be a corporation); and
- the participation in the foreign company must be held at least for one year (the holding period).

The international participation exemption is subject to a set of specific "anti-abuse of law" rules. Under these anti-abuse rules, the Austrian participation exemption does not apply if:

i) The subsidiary is located in a low-tax jurisdiction.

A jurisdiction is deemed to be a low-tax jurisdiction if the effectively applicable tax rate under Austrian tax accounting rules amounts to less than 15%.

ii) The subsidiary generates primarily passive income.

A foreign subsidiary is considered to earn mainly passive income if the passive part of its operations constitutes more than 50% of its total activity (calculated on the basis of assets, employees and profits). The passive part is defined as activities in connection with interest income, income from licences or leasing, or the sale of participations, etc.

5.4 Is there any special relief for reinvestment?

For corporations there is no such relief. A relief for reinvestment exists only for individuals and private foundations.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The formation of a subsidiary triggers a capital duty of 1% on the basis of the contributed equity (nominal capital plus share premium).

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6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

The transfer of equity to the Austrian branch of a non-Austrian parent company in principle also triggers the 1% capital duty. However, this capital duty does not apply if the parent company is resident in an EU Member State.

6.3 How would the taxable profits of a local branch be determined?

In principle, Austrian branches are not treated differently from Austrian resident subsidiaries. They are subject to Austrian tax accounting rules even though the statutory accounting is prepared at the level of the foreign parent company. The debt-equity ratio of a branch is measured on a stand-alone basis, i.e. the strong or weak equity position of the parent company is not relevant to the Austrian tax position.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Austria does not have the concept of a branch profits tax (such as for instance the United States). Branches are subject to Austrian corporate income tax on the basis of the assumption that the branch constitutes a permanent establishment in Austria of its non-Austrian parent. Thus the non-Austrian parent company becomes subject to Austrian corporate income tax on all profits that can be allocated to the Austrian permanent establishment.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

In principle, a branch is transparent for tax treaty purposes and is thus not entitled to treaty benefits, such as reductions of withholding tax on dividends, interest or royalties. From a tax treaty perspective, a branch generally is to be treated as a permanent establishment, whose income is either exempt or credited in the jurisdiction of the parent company depending on the relief method article of the respective tax treaty.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No, there is no withholding tax levied on the remittance of profits from a branch to its parent.

7 Anti-avoidance

7.1 How does Austria address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The Austrian General Fiscal Code (*Bundesabgabenordnung* - BAO) contains a general anti-abuse provision. The provision – Art 22 – incorporates the substance-over-form principle into Austrian tax law and generally allows the tax authorities to disregard transactions or structures which have been chosen solely for the purpose of avoiding or reducing.

Apart from this general provision several more specific anti-abuse provisions can be found in a variety of Austrian tax laws. Examples are the principle of "actual place of management" in the field of corporate taxation, anti-abuse rules in the participation exemption, which take away the benefit of the participation exemption from dividends received from passive tax haven companies, or CFC legislation for offshore investment funds etc.

There are no specific disclosure rules for avoidance schemes. Avoidance schemes are usually challenged by the tax inspectors in the course of tax audits.

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Belgium

Eubelius

Philippe Hinnekens

1 General: Treaties

1.1 How many income tax treaties are currently in force in Belgium?

Currently, Belgium is party to almost 100 bilateral income tax treaties that have entered into effect. Treaties have been concluded with most European countries as well as the majority of the developed countries worldwide, including those in the Asia-Pacific Region. Belgium was the first State to conclude a bilateral tax treaty with Hong Kong. This offers an interesting route for structuring investments from Chinese investors in Europe and the other way around. A new treaty with the US was signed in November 2006, and entered into effect on 28 December 2007.

1.2 Do they generally follow the OECD or another model?

The bilateral income tax treaties to which Belgium is a party generally follow the OECD Model Convention, although nearly all treaties contain some deviations from the Model Convention. Some deviations relate to the specific characteristics of the Belgian income tax system (e.g. article 16 relating to Directors' fees in most recent treaties) or to the specific needs or concerns of the other treaty state (e.g. limitation on benefits and exchange of information and administrative assistance provisions in the new US treaty). In June 2007 the Belgian tax authorities published a Draft Model Convention which should be the basis for the (re)negotiation of the future bilateral tax treaties to be concluded by Belgium.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. A bilateral tax treaty, signed on behalf of the Belgian State, needs to be formally approved by the Parliament before entering into force on the date specified in the treaty. Such approval is incorporated in a formal statute.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Traditionally, the bilateral tax treaties concluded by Belgium do not include anti-treaty shopping provisions, except for the reference to "beneficial ownership" which is required to invoke the treaty benefits in respect of dividends, interest income and royalties, that has been systematically included in the treaties concluded after 1977 (i.e. the treaties based on the 1977 OECD Model Convention).

Some treaties include a limitation on benefits provision (e.g. with Switzerland and with the US) or expressly exclude certain entities from the personal scope of application of the treaty (e.g. the Luxembourg 1929 holding company).

The treaties concluded with Luxembourg and Germany, and more recently the treaty concluded with Hong Kong, state expressly that the treaty does not prevent the application of domestic anti-abuse provisions in both treaty states.

Finally, a general anti-treaty shopping provision has been included in article 27 of the Belgian Draft Model Convention.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In general, neither domestic law which exists when the relevant treaty enters into effect, nor any subsequent domestic legislation, can overrule a bilateral tax treaty. This general principle was confirmed by the Belgian Supreme Court in 1971 in its ruling on the "*Franco Suisse Le Ski*" case. Furthermore, a more recent attempt by the Belgian legislator to still levy income tax on pension capital amounts paid to beneficiaries who emigrated from Belgium prior to their retirement (article 364 *bis* of the Belgian Income Tax Code (BITC)), has also been rejected by the Belgium Supreme Court in a treaty context, on the basis of the general "*pacta sunt servanda*" principle.

An exception to this principle are the rules included in the Belgian Constitutional Code that, in theory, in the opinion of the Belgian Constitutional Court, can overrule treaty law. In practice, however, this Court has never condemned an international treaty entered into by Belgium, based on a constitutional infringement.

2 Transaction Taxes

2.1 Are there any documentary taxes in Belgium?

Documentary taxes are due on certain formal documents and duplicates thereof, such as notarial deeds or a bailiff's summons. Legislation in this matter changed in December 2006, which has replaced stamp duties per page with lump sum duties per deed or document, and has facilitated payment thereof through "modern" payment facilities, such as wire transfer. The lump sum duties per document range from €0.15 per document (bank transcripts) to €95 (certain notarial deeds).

Registration duties apply to certain types of transactions, provided

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that they are subject to the formality of registration (whether or not compulsory):

(i) Real estate transfer tax

Transfer of real property in Belgium is subject to a 12.5% registration tax. In the Flemish region, that transfer tax rate is reduced to 10%. In the event of a resale of the real property within 2 years, part of this transfer tax (up to 60%) can be recovered by the taxpayer.

Provided that certain conditions are respected, a professional real estate trader can benefit from a reduced rate of transfer tax, which varies between 4% and 8% depending on the Region in which the real estate is located.

The real estate transfer tax can, subject to certain conditions set forth by the Belgian Ruling Committee, be reduced to a mere 0.69% through a "split sale" structure, which implies the vesting of a long lease right (0.2% registration tax; see below), followed by the sale of the freehold to another (related) person (10%-12.5% transfer tax on a reduced base).

The transfer of buildings that are considered to be "new" (until 31 December of the second year following the year in which the building is used for the first time) and that are subject to VAT, will be exempt from transfer tax.

(ii) Rental and leasehold contracts

Rental and leasehold contracts in respect of real estate in Belgium, as well as the transfer thereof, are subject to a 0.20% registration duty on the total sum of rental payments and charges to be borne by the lessee during the (remaining) term of the contract.

(iii) Other registration duties

The grant or transfer of a mortgage on real estate in Belgium will in principle trigger a 1% registration tax due on the amount guaranteed by the mortgage. Reduced registration tax may be applicable for registration of certain types of security documents.

As from 1 January 2006, contributions in cash or in kind to the capital of a Belgian company are no longer subject to a capital duty. The contribution by an individual of residential real property in Belgium, however, will trigger real property transfer tax.

Transactions that are exempt from proportional registration duties are still subject to a fixed duty of €25 upon fulfilling the registration formality.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Belgium has adopted a VAT system in conformity with the relevant EU Directives. Currently 3 rates apply:

- 6% on necessities and services of a social nature (e.g. food and water), pharmaceutical products and, subject to certain conditions, work related to real estate;
- 12% on fuel and the supply of social housing (if not exempt) and works related thereto. As of January 1 2010, the 12% rate also applies to catering and restaurant services with the exception of beverages; and
- 21% (general rate): on all other goods and services.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Generally, VAT is due in Belgium on: (i) the delivery of goods or services supplied by a VAT-registered person that take place in Belgium for VAT purposes; (ii) the import of goods into Belgium; and (iii) acquisitions of goods from another EU Member State (intra-Community acquisitions) that take place in Belgium for VAT purposes.

However exemptions apply for:

- some social services (among others: medicine, elderly homes, education);
- supply and leasing of real estate (with the exception of a supply of a "new" building (see *supra*);
- insurance, banking and other financial services;
- management of a collective investment fund, or a pension fund that has been set up or converted in a specific legal form;
- legal services (lawyers, notaries, bailiffs); and
- a transfer of a universality of goods or a business unit (in the context of corporate reorganisations), subject to certain conditions.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input VAT is only recoverable by a VAT taxpayer. Deduction of input VAT from output VAT due, or refund of excess input VAT, is limited to supplies of goods or services that are acquired by the VAT taxpayer for the performance of services and/or supply of goods that are subject to VAT. No such deduction or refund is allowed for goods or services that are used for other (exempt) activities. If a VAT taxpayer engages in VAT and non-VAT activities, the amount of deductible or refundable input VAT is determined proportionally to the turnover that arises from the VAT activities compared to the overall turnover. Alternatively, the VAT taxpayer may apply (and the VAT authorities may also oblige him to do so) for permission to deduct input VAT based on the actual use that is made of the relevant goods and services. In that case, goods and services that are not attributable to a specific activity (e.g. overhead costs), must be attributed based on an allocation key that reflects reality as closely as possible.

In April 2007 a VAT consolidation system has entered into effect in Belgium. Subject to the fulfillment of certain conditions and formalities, a group of Belgian enterprises may decide to form a so-called "VAT-unit". Transactions between members of such unit generally are outside the scope of the VAT system. Any restrictions on the deduction of input VAT is measured at the level of the VAT-unit as a whole.

2.5 Are there any other transaction taxes?

Stock market transactions are subject to a transaction tax of 0.07%, 0.17%, 0.50% or 1.1% (depending on the type of securities and the type of transaction), due by both buyer and seller, with a maximum of €500, and in some cases €750, per transaction and per party. Some market participants, such as non-residents (under specific conditions) and some institutional investors, are exempt from this tax. Further to a decision of the European Court of Justice in 2004, subscription to newly-issued securities is not subject to this stock market tax.

Physical delivery of securities, as a result of: (i) their acquisition (for consideration); (ii) conversion of registered securities into bearer securities; or (iii) withdrawal of securities that have been deposited with a financial institution, is subject to a tax of 0.6% on their value. No maximum applies. However, the Belgian legislature has issued legislation providing for the abolition of bearer securities in Belgium. Such securities may no longer be issued as of 1 January 2008 and all existing bearer securities must be converted into registered or dematerialised securities by 2014.

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2.6 Are there any other indirect taxes of which we should be aware?

An indirect tax is levied on premiums related to insurance contracts, including most collective life and pension insurance agreements that cover a risk located in Belgium. The rates vary from 1.1% to 9.25%. Numerous exemptions exist, among others for reinsurance, labour accident insurance, and individual or collective pension savings accounts.

Customs duties are generally payable on goods imported from outside the EU. Excise duties are levied on specific types of goods (e.g. alcohol and tobacco) upon their distribution in Belgium.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

According to domestic tax law, dividend distributions are generally subject to a 25% withholding tax in Belgium. This tax rate is reduced to 15% for dividend distributions on certain qualifying shares (so-called "VVPR"-shares) issued after 1993, and to 10% for liquidation and share buy-back bonus distributions.

Full withholding tax exemption can be obtained for:

- dividends paid by a Belgian resident company to a non-resident legal entity which does not exercise a business or professional activity and is exempt from income tax in its state of residence (e.g. a foreign pension fund);
- dividends paid by a Belgian resident company to a parent company resident in another EU Member State, that holds a stock participation of at least 10% in the capital of the former for not less than 12 months; and
- dividends paid by a Belgian resident company to a parent company resident in a jurisdiction with which Belgium has concluded a bilateral tax treaty, subject to the same conditions as for parent companies resident in the EU (see *supra*), provided that this treaty (or another separate treaty) provides for the exchange of information for purposes of applying domestic tax law between the treaty states.

Generally, most bilateral tax treaties concluded by Belgium provide for a reduction of the Belgian dividend withholding tax rate to 15% and even 10% or 5% in the case of a substantial participation in the capital of the Belgian company (often 25%), held by a company resident in the other contracting state. Most recent treaties (e.g. the treaty with Hong Kong and with the US) and the Belgian Draft Model Convention provide for a 0% rate for dividends on such substantial participation.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

According to domestic tax law, Belgian source royalty payments are subject to a withholding tax of 15%. However, in many bilateral tax treaties to which Belgium is a party, royalty payments must be exempt from income tax in the source state. In some treaties, however, this is limited to specific types of royalty payments.

In execution of the EU Interest and Royalty Directive, royalty payments by a Belgian resident company to a related company in another EU Member State are exempt from withholding tax, provided that, during the period to which the royalty income relates, the underlying assets or intellectual property for which the royalties are paid are not connected to a permanent establishment of the beneficial owner of the royalty income located outside the EU territory. Companies are considered to be "related companies", provided that *either*:

(i) one of these companies directly or indirectly holds a participation of at least 25% in the capital of the other company, during an uninterrupted period of at least 1 year; *or*

(ii) a participation of at least 25% in the capital of both companies is directly or indirectly held by an EU resident company during an uninterrupted period of at least 1 year.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

According to domestic tax law, Belgian source interest payments are generally subject to a 15% withholding tax. Some bilateral tax treaties to which Belgium is a party (e.g. treaties with Germany, Luxembourg and the Netherlands) provide for an exemption from interest withholding tax in the source state. Other treaties limit the withholding tax to be levied in Belgium to 10%. Domestic tax law also provides for a withholding tax exemption for certain interest payments to non-residents, such as:

- interest payments on receivables (other than bonds) that are paid by Belgian companies or professionals (including permanent establishments of non-resident companies or physical persons) to non-resident credit institutions located in a Member State of the European Economic Area, or in a country with which Belgium has concluded a bilateral tax treaty;
- interest payments on receivables (other than bonds) that are paid to non-residents that do not use the receivables for professional activities in Belgium, by Belgian financial enterprises, including certain listed holding companies and intra-group financing companies, subject to certain conditions;
- interest payments on registered bonds that are paid to non-residents that do not hold the bonds for professional activities in Belgium, subject to certain conditions;
- interest payments to the Belgian permanent establishment of foreign banks; and
- interest payments between two non-residents through the intermediation of a group finance or cash pooling centre located in Belgium (under certain conditions).

Moreover, in execution of the Interest and Royalty Directive, interest payments by a Belgian resident company to a related company in another EU Member State are exempt from withholding tax, provided that, during the period to which the interest income relates, the underlying receivable is not held through a permanent establishment of the beneficial owner of the interest income located outside the EU territory. We refer to question 3.2 above for the definition of "related companies".

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Belgian tax law includes 2 specific rules aimed at avoiding thin capitalisation:

- **the "7:1" rule:** according to this rule, interest payments, other than those on bonds or similar publicly-issued debt securities, to beneficiaries that are not subject to income tax or benefit from a substantially more favourable tax regime in respect of such interest income compared to the normal tax treatment in Belgium, are not tax-deductible to the extent that they relate to that part of the loans granted by such beneficiaries which exceeds seven times the paid in capital and (non-exempt) reserves of the Belgian borrowing company; and

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- **the "1:1" rule:** this rule applies to interest payments on loans, excluding bonds or similar publicly-issued debt securities, granted by shareholders/physical persons or directors of the company, to the extent that the total amount of these loans exceed the company's paid-in capital and (non-exempt) reserves. In that case, the excess interest is recharacterised as a (non-deductible) dividend distribution, (generally) subject to a 25% withholding tax.

Both thin capitalisation rules are also applicable to cross-border interest payments, in which case their compatibility with both the "arm's length" article in the relevant bilateral tax treaty and EU law needs further attention. More specifically with respect to the application of the 1:1 rule on interest on loans granted by foreign companies acting as the director of the Belgian borrowing company, the ECJ has ruled that it is contrary to the European freedom of establishment (*Lammers & Van Cleef*, case C-105/07, d.d. 17 January 2008).

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Naturally, the above risk of denial of the deductibility of interest payments can be avoided by respecting the 7:1 or 1:1 debt/equity ratio, respectively. In addition, the 1:1 rule can be easily avoided in a cross-border intra-group financing context by not making the lender a member of the board of directors of the Belgian company.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

The 7:1 rule is applicable to interest payments to both related and unrelated parties. The 1:1 rule is only applicable to interest payments to:

(i) an individual shareholder, his spouse and minor children, provided that the shareholder or spouse, respectively, have the legal benefit of the latter's income;

(ii) an individual director, his spouse and minor children, under the same provision as (i) above; or

(iii) a foreign corporate director (the 1:1 rule explicitly excludes a resident corporate director from its field of application). However this difference in treatment has been condemned by the ECJ (*cf.* question 3.4 above).

Whether or not the loans are guaranteed by a parent company is not relevant for the application of the above thin capitalisation rules.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Interest payments that are made directly or indirectly to a non-resident or to a foreign establishment of a Belgian resident, which, according to the tax legislation of the state in which it is established, is not subject to income tax or benefits from a tax treatment which is significantly more favourable than the Belgian income tax regime applicable to such interest income, are in principle not tax-deductible, unless the taxpayer can prove that the interest expenses relate to a genuine financing transaction and that its terms and conditions do not deviate from "at arm's length" conditions.

Moreover, interest payments in general only qualify as tax-deductible professional expenses to the extent that the interest rate does not exceed the normal market interest rate in that specific situation and that they are made in order to realise or maintain taxable income.

3.8 Does Belgium have transfer pricing rules?

Yes. Belgian tax law allows upward corrections of taxable income in Belgium when a transaction with a foreign person deviates from "arm's length" conditions. Such corrections generally apply to transactions between related parties, but can also apply to transactions with non-related foreign parties that are not subject to any income tax in their jurisdiction of residence or to an income tax regime that is substantially more beneficial than the normal income tax regime in Belgium.

Furthermore, income arising from gratuitous or benevolent advantages received by a Belgian resident enterprise from a transaction that did not meet the "arm's length" criterion cannot be offset by the tax losses and other specific tax deductions available to that enterprise.

The "arm's length" concept (with reference to the relevant OECD guidelines in this respect), was formally introduced into Belgian tax law in 2004. At the same time, the Belgian legislature has also established a procedure for corresponding downward adjustments of taxable income in Belgium pursuant to article 9 §2 of the OECD Model Convention.

It is also possible to obtain an advance formal ruling in respect of the "arm's length" nature of a certain transaction from the Belgian Ruling Commission.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of corporate tax is 33.99% (33% + 3% surcharge). Reduced rates apply to companies with annual taxable profits which do not exceed €322,500 (subject to certain additional conditions). The effective tax rate is generally further reduced to 25-26% by the application of the notional interest deduction; i.e. an annual tax deduction of a (deemed) cost of equity (see *infra*). The recently introduced deduction for patent income may further reduce the effective tax rate for qualifying companies.

4.2 When is that tax generally payable?

Corporate tax is due on an annual basis and must be paid in advance through quarterly installments that are offset against the final tax charge due. The absence of sufficient tax prepayments will give rise to an increase of the final tax charge.

The final tax charge is payable within 2 months after the tax assessment has been sent to the taxpayer. Income tax is generally assessed before 30 June of the year following the assessment year. In other words, a company that closes its accounting year on 31 December of year N will have to pay its final corporate tax before the end of August of year N+2, without taking possible extended tax return and/or assessment periods into consideration.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Corporate income tax is generally based on worldwide income reported in the company's annual statutory financial statements in accordance with Belgian GAAP principles, and includes all profits and losses. This initial taxable base is then adjusted by specific tax law corrections, such as restrictions on deductible expenses and the exemption of certain capital gains (see *infra*).

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4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The profit or loss recorded in the commercial accounts is subject to certain technical tax adjustments. Differences between the final result for accounting and income tax purposes are mainly due to:

- non-deductibility of certain expenses, such as corporate income tax or withholding taxes, a certain percentage of car-related expenses, fines or capital losses and reductions in value of shares;
- certain restrictive conditions for the deductibility of depreciations of receivables;
- tax exemption of realised capital gains on shares (see *infra*);
- tax deduction of 95% of qualifying dividend income (see *infra*); and
- deduction of a notional interest amount, calculated as a percentage of the preceding year's equity (after certain adjustments). This percentage is based on the preceding year's average yield of a long-term (10-year) government bond, amounting to 4.473% in the assessment year 2010, but has been capped to 3.8% for the assessment years 2011 and 2012.

4.5 Are there any tax grouping rules? Do these allow for relief in Belgium for losses of overseas subsidiaries?

No tax consolidation or other form of group relief is applied in Belgium. Only profits of foreign permanent establishments of a Belgian resident company (provided that the PE is not located in a treaty country) or losses of such foreign establishments (whether or not they are in a country that has concluded a tax treaty with Belgium), are taken into consideration to determine the Belgian corporate income tax base.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

As a general rule, distributed profits are taxed at the same corporate tax rate as retained earnings. However, in some cases, profits are temporarily exempt from corporate income tax, provided that they are recorded on an unavailable equity account on the balance sheet; e.g. for revaluation gains on fixed assets.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

A real estate tax is annually due on property located in Belgium. It is calculated on a deemed rental income attributed to such property when it is used for the first time (which is generally considerably lower than its fair rental value). The tax is assessed separately, and it cannot be offset against final corporate income tax. The real estate tax rate amounts to 2.5% in the Flemish region and 1.25% in the Walloon and Brussels regions, but due to provincial and municipal surcharges, the effective rate is a multiple thereof.

4.8 Are there any local taxes not dealt with in answers to other questions?

The Belgian regions, provinces, municipalities and "agglomerations" have power to levy taxes on a wide-range of matters. The Flemish and the Walloon region have used this power to introduce a tax on unoccupied business premises. Most municipalities impose a variety of (non-substantial) business taxes, but there is some federal pressure to reduce the number of such local business taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Generally, capital gains are taxed at the same corporate income tax rate as ordinary business income, whilst capital losses are also fully deductible from ordinary business income. However, capital gains realised on shares are tax exempt provided that certain "subject to tax" requirements are fulfilled at the level of the subsidiary. No minimum threshold or minimum holding period requirement applies for this exemption. Capital losses on shares are not deductible, unless they are realised upon the subsidiary's liquidation, limited to the actual capital amount represented by these shares. There is no restriction to the deductibility of interest expenses for borrowings related to such share investments.

Capital gains realised on certain intangible and tangible fixed assets can benefit from a tax deferral, provided that the sales proceeds are fully reinvested in qualifying (depreciable) assets. Reinvestment should in general take place within 3 years, unless the proceeds are reinvested in a building, a ship or an airplane, in which case the reinvestment period is 5 years. If all conditions are fulfilled, the capital gains tax will become due in accordance with the tax depreciations on the qualifying reinvestments.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No, the rate imposed for capital gains is the same as that imposed for business profits.

5.3 Is there a participation exemption?

As far as capital gains exemption in respect of share investments is concerned, we refer to question 5.1.

Moreover, Belgian resident companies are entitled to deduct 95% of the gross amount of dividends received from their corporate income tax base. The remaining 5% is subject to tax, but ordinary expenses, losses or interest payments can be deducted from this taxable margin, even if such expenses, losses or interest payments directly relate to the share investment from which the dividend income has arisen. As a consequence, tax-efficient leveraged acquisitions through a Belgian company are possible. So-called "excess" dividend received deduction, i.e. the amount of the deduction that cannot be effectively used to offset taxable income (e.g. because of an operating loss), cannot be carried forward to the following taxable periods, by virtue of Belgian tax law. However, recently the ECJ has decided that this legal restriction violates the EU Parent-Subsidiary Directive, so that the excess dividend received deduction relating to dividend income from EU subsidiaries can effectively be carried forward (*Cobelfret v. Belgium*, C-138/07, d.d. 12 February 2009).

Following this decision, as of January 1, 2010 the Belgian Income Tax Code expressly stipulates that the excess dividend received deduction, relating to dividend income from EU subsidiaries, can be carried forward.

The question remains whether this jurisprudence also applies to dividend income from non-EU subsidiaries based on the freedom of capital movements, which, subject to certain restrictions, also

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applies in relation to non-EU states. The ECJ refrained from taking a clear decision on this issue in the *KBC Bank NV v. Belgium* case (C-439/07), and also the Belgian legislator did not provide for a clear answer. The Belgian tax administration issued a circular containing a number of guidelines to be taken into account to determine whether an excess dividend received deduction relating to dividend income from a non-EU subsidiary can be carried forward.

Certain participation requirements must be respected by the Belgian company in order to benefit from this dividend received deduction. Its investment should: (i) at least correspond to a 10% share in the capital of the dividend generating company, or have an acquisition value of at least €2.5 million; (ii) be held in full ownership for at least 1 year, which must not necessarily have been completed at the time of dividend distribution; and (iii) be recorded as a financial fixed asset in its annual accounts.

In addition, the dividends received must meet detailed "subject to tax" requirements, which ensure that subsidiaries (with no tier limitation) are subject to a normal corporate tax regime.

Both the dividend-received deduction and capital gains exemption on share investments (see *supra*), together with the extension of the dividend withholding tax exemption to all foreign parent companies that are resident of a treaty state, result in a very attractive regime for holding companies established in Belgium, which could serve as an important incentive to structure investments through Belgium.

5.4 Is there any special relief for reinvestment?

There is no specific relief for reinvestment, apart from the reinvestment relief with respect to capital gains on certain intangible and tangible fixed assets, as mentioned in question 5.1 above.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

Generally, no taxes are imposed upon the formation of a subsidiary (apart from a fixed registration duty of €25 and limited stamp duties).

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no other such significant taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

The profits of a Belgian branch, provided that the branch can be considered as a "permanent establishment", as defined in the relevant bilateral tax treaty, are determined by treating it as a separate enterprise for tax purposes. Most times, separate accounting records and separate financial statements are drawn up in respect of the Belgian branch, although this is not always obligatory. In absence of separate accounting records and separate financial statements, taxable income is generally fixed on a lump sum basis (e.g. €22,000 per employee in the chemical industry), with a floor of €19,000.

Income realised through transactions with third parties is attributed to the Belgian branch, provided that it has intervened in realising such income. Accordingly, expenses are deemed to be borne by the branch, provided that they have been made for the benefit of the branch's business operations. The same goes for income or expenses derived from assets or liabilities that are allocated to these operations. However, this fiction of "independence" of the branch for tax purposes is mitigated in respect of transactions between the branch and the non-resident company to which it relates. More specifically, interest, royalty or rental payments by the branch to the non-resident parent company are not accepted as deductible expenses by the Belgian tax authorities, unless (for interest payments) it is a branch of a non-resident bank. For the rest, the Belgian branch's taxable base is determined following the same corporate income tax principles, being entitled to the same tax deductions (including the notional interest deduction on the "equity" of the branch) and exemptions as apply to resident Belgian companies.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no "branch profits tax" or other form of withholding tax in Belgium on the branch profits that are repatriated by the non-resident company. The non-resident company doing business in Belgium through a branch will be subject to non-resident income tax, which implies in practice that it will end up paying Belgian corporate income tax on the income realised through such branch.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Generally, only resident companies can invoke the provisions of a bilateral tax treaty to which Belgium is a party.

The foreign company which have a branch in Belgium can also invoke the treaty that its country of residence has concluded with Belgium in order to protect the branch from discriminatory tax measures. In a decision d.d. 26 November 2006, the Brussels Court of First Instance granted the benefit of a tax-sparing credit, provided for in the bilateral tax treaty between Belgium and India, to a Belgian branch of an Indian company with respect to its Indian source interest income, on the basis of the PE non-discrimination provision in that treaty.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Repatriation of profits is not a dividend, and therefore is not subject to Belgian dividend withholding tax, nor any other tax.

7 Anti-avoidance

7.1 How does Belgium address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

With respect to income tax and registration tax, the Belgian legislator has introduced in 1993 a general anti-abuse provision, which allows the tax authorities to recharacterise a series of legal actions into another (single) legal action, if the taxpayer has set up such series in order to avoid tax. The taxpayer may rebut this recharacterisation by demonstrating the legitimate economic or

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financial needs for the chosen legal characterisation of the transaction. The Belgian Supreme Court has however mitigated its effectiveness by requiring that the new characterisation by the tax authorities covers all (relevant) legal consequences arising from the transaction.

For VAT purposes, a general anti-abuse provision has entered into effect in August 2006 and is based on recent case law of the ECJ in this respect. Abuse is defined as a series of transactions which aim at and give rise to a tax advantage which is contrary to the objectives of the VAT system. It is penalised by a rejection of input VAT deduction.

There is no legal obligation to disclose anti-avoidance schemes in advance of the company's tax return being submitted, but companies can still choose to do so in order to obtain an advance ruling from the Belgian Ruling Committee.

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He specialises in international taxation and the tax aspects involved in corporate restructuring, M&A and transaction financing.

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Canada

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Canada?

As of October 2010, Canada has 87 bilateral income tax treaties ("DTAs") in force, five new DTAs and two protocols to DTAs that have been signed but are not yet in force, and 14 DTAs that are under negotiation/renegotiation. Canada has also signed nine tax information exchange agreements ("TIEAs") that are not yet in force, and is currently negotiating 14 more TIEAs.

1.2 Do they generally follow the OECD or another model?

Canada's DTAs are generally based on the OECD Model Tax Convention, although particular provisions of some DTAs may incorporate wording from the UN Model Tax Convention or be effectively hybrids of the two models. The Canada-US DTA also incorporates provisions from the US Model Tax Convention.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. Canadian DTAs must be ratified by both Canada and the other contracting State and then enacted into Canadian federal law by an Act of Parliament before they can take effect.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The Canada-US DTA is the only Canadian DTA that incorporates a limitation of benefits provision in Article XXIX-A.

Canadian DTAs generally do not contain explicit anti-treaty shopping rules. However, some tax treaties, such as the Canada-Barbados DTA and the Canada-Ireland DTA, exclude or limit treaty benefits in respect of certain tax-advantaged persons/entities.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In principle, Canada adopts the position that the provisions of a DTA may be overridden by a change in domestic law occurring after the enactment of the DTA.

The *Income Tax Conventions Interpretation Act* ("ITCIA") may affect the interpretation of a DTA where Canada is the source country and the DTA provides that source country interpretations will apply where terms are not defined in the DTA. In such case, a change to the ITCIA or to a definition in the Canadian domestic tax legislation ("ITA"), or a change based on a Canadian court decision could result in a modification of the ITCIA's interpretive rules. Although these rules will not override DTA provisions, they may change the way they are applied by Canada from the date of the change.

Canada's general anti-avoidance rule ("GAAR") (see question 7.1) embodies Canada's approach to tax avoidance both in the domestic and treaty context. A change in the application of the GAAR could alter the application of a DTA subsequent to its enactment, though such a change may not be described technically as a domestic override of a DTA. In 2004, the GAAR was amended (effective retroactively to its 1988 enactment) to clarify the existing tax administration view that it could apply to a misuse or abuse of DTAs.

This view has not been favourably received by the Canadian courts, which have yet to apply the GAAR as the main ground for denying treaty benefits to a taxpayer. In *MIL (Investments) S.A. v. The Queen*, the Canadian courts refused to find an inherent anti-abuse rule in the Canada-Luxembourg DTA, based on the provisions of the Vienna Convention or on the general purpose of DTAs to prevent tax avoidance. As the treaty did not explicitly preserve the application of domestic anti-abuse rules, the courts held that the GAAR did not apply. Similarly, in *Garron Trust v. The Queen*, which is currently under appeal, the trial judge was unconvinced that there was an implicit anti-abuse principle in the Canada-Barbados DTA that would permit the application of the GAAR in the treaty context.

The Canada-US DTA has recently been amended to explicitly preserve the right of Canada and the US to apply domestic anti-avoidance rules to counter-treaty abuses. The Technical Explanation to the DTA states not only that the principle is inherent in the DTA, but that the explicit statement in the DTA is not intended to suggest that the anti-abuse principle is not also inherent in other Canadian or US DTAs.

2 Transaction Taxes

2.1 Are there any documentary taxes in Canada?

Generally there are no documentary taxes in Canada. Quebec imposes notary fees, which are payable in respect of certain transactions involving real property, mortgages and hypothecs.

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Some Canadian provinces and municipalities impose land transfer taxes, which are technically not documentary taxes. They apply to transfers of real property. The tax is generally payable by a purchaser on the registration of the transfer and calculated at graduated rates based on the fair market value of the property transferred.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Canada imposes a goods and services tax/harmonised sales tax ("GST/HST") on the consumption of goods and services in Canada. GST/HST is a form of value-added taxation.

HST is levied in the provinces of British Columbia, Ontario, New Brunswick, Newfoundland and Labrador and Nova Scotia, which have chosen to harmonise their retail sales taxes with the federal GST. GST applies in those provinces that have not so harmonised. Non-harmonised provinces (except Alberta) levy a sales tax in addition to the GST (see question 2.5).

The rate of federal GST is 5%. In provinces that have harmonised their taxes, the HST tax rate varies from 12% to 15%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

While most sales of goods and services are subject to GST/HST, some are exempt or zero-rated (i.e., taxable, but at a rate of 0%). Notable exclusions are basic groceries, prescription drugs, certain healthcare and educational services, financial services, certain goods and services supplied by charities and certain exports.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

While GST/HST is collected by all businesses at each stage in the production or marketing of goods and services, the burden of the tax is borne by the ultimate consumer. Businesses collect tax on their sales and claim input tax credits for any tax paid on their purchases.

While most sales of goods and services are subject to GST/HST, no GST/HST is payable by a purchaser of an exempt supply. The supplier of an exempt supply is therefore not entitled to claim input tax credits in respect of GST/HST paid by it on its purchases to the extent they relate to the making of exempt supplies. No GST/HST is payable by a purchaser of zero-rated supplies, but the supplier is nevertheless entitled to claim input tax credits in respect of GST/HST paid on purchases used to provide zero-rated goods or services.

2.5 Are there any other transaction taxes?

The provinces of Saskatchewan, Manitoba and Prince Edward Island impose retail sales taxes. These taxes are levied directly on the purchaser, consumer or lessee of taxable goods and services based on the sale or lease price of the goods or services supplied in those provinces. Tax rates range from 5% to 10%.

In Quebec, a provincial sales tax is levied, which is generally similar to, and applies to the same goods and services as, the GST/HST.

Most provinces also impose a tax on forestry and mineral operations and a royalty on petroleum and natural gas production. Additional taxes and levies are imposed on other commodities, such as alcoholic beverages, tobacco products, fuel and other specific items at the federal and/or provincial levels.

2.6 Are there any other indirect taxes of which we should be aware?

No, there are not.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Amounts paid or credited (or deemed paid or credited) by a Canadian resident company ("Canco") as, *in lieu* of, or in satisfaction of, dividends to a non-resident, are subject to a 25% rate of domestic Canadian non-resident withholding tax ("NRWT"), subject to potential reduction under an applicable DTA. Many of Canada's DTAs reduce the 25% domestic rate to 15%. Certain DTAs may reduce the rate to 5% where the beneficial owner of the dividends is a corporation entitled to treaty benefits and owns a substantial interest (generally, at least 10% of the voting shares of the Canadian corporation paying the dividends). No Canadian DTA exempts dividends entirely from Canadian NRWT.

Taxable Canadian corporations are generally allowed to return capital to a non-resident shareholder free of Canadian NRWT. The corporation's paid-up capital ("PUC") for tax purposes and the shareholder's tax cost of its shares are reduced by the amount returned. Any amount returned to the shareholder in excess of PUC may be deemed to be a dividend subject to Canadian NRWT at the 25% domestic rate (subject to potential reduction under an applicable DTA).

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid or credited by a Canco to a non-resident are generally subject to Canadian NRWT at the 25% domestic rate, unless exempted under the ITA or an applicable DTA or reduced (in many cases, to 10%) under an applicable DTA.

Domestic exemptions from NRWT on royalties include payments in respect of the production or reproduction of computer software, and payments made under a *bona fide* cost-sharing arrangement meeting specified requirements. Many of Canada's DTAs reduce the NRWT rate to 10% or 15% and may also exempt from NRWT a payment for the use of, or the right to use, a patent, information concerning industrial, commercial or scientific experience, or computer software.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Amounts paid or credited (or deemed paid or credited) by a Canco as, *in lieu* of, or in satisfaction of, interest to a non-resident are exempt from Canadian NRWT unless the interest is either: (i) not "fully exempt interest" and paid to a person with whom the payer does not deal at arm's length; or (ii) "participating debt interest". The domestic exemption for interest paid to arm's length lenders extends to payments such as stand-by, commitment and guarantee fees, as long as the amounts are not participating debt interest.

"Fully exempt interest" is generally interest on debt issued by government or quasi-government entities and certain tax-exempt organisations, non-deductible interest on mortgages in respect of real property situated outside of Canada, and interest on qualifying securities-lending arrangements. "Participating debt interest" is

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interest that is paid or payable on an obligation, all or any portion of which is contingent or dependent on the use of or production from property in Canada or is computed by reference to: (i) revenue, profit, cash flow, commodity price or any other similar criterion; or (ii) dividends paid or payable to shareholders of any class of shares of the capital stock of any corporation (whether or not related to the borrower).

Non-exempt interest may be eligible for an exemption or rate reduction (in many cases, to 10%) under an applicable DTA between Canada and the non-resident recipient's country of residence. The Canada-US DTA exempts from Canadian NRWT related party interest payments (except participating interest), provided that the US recipient is resident in the US, the beneficial owner of the interest and entitled to treaty benefits under the limitation on benefits provision and the interest rate does not exceed an arm's length rate.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Canada's thin capitalisation rules limit interest deductibility on debt owing to a non-arm's length non-resident (a shareholder that either alone or together with non-arm's length persons holds 25% or more of the votes and value of the stock of Canco, or a non-resident related to such a shareholder). The thin capitalisation rules currently apply only to Cancos in respect of amounts owing to specified non-residents and do not apply in the domestic context, or to trusts, Canadian branches of non-resident corporations or partnerships (though they may apply to corporate partners in certain circumstances).

Where the debt-to-equity ratio of a taxable Canco calculated under the thin capitalisation rules is greater than 2:1 for a taxation year, the rules deny the deduction of interest paid on the debt exceeding the ratio in computing the corporation's income for the taxation year. Interest on debt exceeding the ratio retains its character as interest for purposes of Canadian NRWT and Canada's DTAs.

Canada has been reviewing its system of international taxation and may propose changes to those rules in the future.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There is no "safe harbour" rule for the thin capitalisation regime.

Generally, a Canadian corporation may deduct simple interest provided that the corporation's debt-to-equity ratio under the thin capitalisation rules is no more than 2:1 for a taxation year and the following four requirements are satisfied under Canada's general interest deductibility rules:

- the interest must be compensation for the use of money and be calculated with reference to a principal sum, and it must accrue daily;
- there must be a legal obligation pursuant to which the interest is paid in the year or payable in respect of the year;
- the borrowed funds or the obligation on which the interest is payable must be used for one of several specified eligible uses, such as funds borrowed, or an amount payable for property acquired, for the purpose of earning income from a business or property (other than exempt income or income from an insurance policy); and
- the amount of the interest must be reasonable (generally, an arm's length interest rate).

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Canada's thin capitalisation rules do not extend to debt advanced by a third party but guaranteed by a parent company.

The thin capitalisation regime does contain an anti-avoidance rule that applies to back-to-back loans and may deem a loan to have been made to the ultimate corporate borrower unless certain administrative conditions are met. Where the conditions are not met, the loan is deemed made by the top lender directly to the ultimate borrower and the thin capitalisation rules can result in the disallowance of interest deductions.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

See question 3.8 below.

A premium paid by a borrower as a pre-payment of interest, as an interest rate buy-down (other than on an extension, substitution or conversion of a debt) or to induce an early redemption of a debt generally will be deemed to be interest paid or payable by the borrower and received or receivable by the lender. Further, where interest owing to a non-arm's length creditor is deducted by a Canco in advance of actual payment, the ITA will require that deductions be clawed back or arrangements made to notionally treat the interest as paid to the creditor within a prescribed period.

3.8 Does Canada have transfer pricing rules?

Canada's transfer pricing rules incorporate the arm's length principle set out in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Non-arm's length parties are required to conduct their transactions under terms and conditions that would have prevailed if the parties had been dealing with each other at arm's length. Where either the terms or conditions made or imposed in respect of a transaction between a taxpayer (or partnership) and a non-arm's length non-resident differs from those that would have been concluded between persons dealing at arm's length, or the transaction itself would not have been entered into between persons dealing at arm's length and can reasonably be considered not to have been entered into primarily for *bona fide* business purposes other than to obtain a tax benefit, the Canadian tax authorities ("CRA") can adjust the quantum of any transaction amount in respect of the taxpayer or, in the latter case, recharacterise the transaction.

In *General Electric Capital Canada Inc. v. The Queen* (currently under appeal), although the tax court found that the guarantee fees paid by GE Canada to its US parent satisfied Canada's transfer pricing rules, it considered factors rooted in the parent-subsidiary relationship in applying the arm's length standard.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The general federal corporate tax rate for 2010 is 18%. The rate is scheduled for reduction to 16.5% for 2011, and to 15% for 2012 and subsequent years.

Provincial/territorial corporate income tax is levied on a

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corporation's taxable income attributable to a permanent establishment in a Canadian province/territory, and is generally calculated as a percentage of the federal corporate tax payable. Provincial/territorial income tax rates on general corporate income vary by province, ranging from 10% to 16%.

Canada is working toward a mainstream combined federal/provincial corporate income tax rate of 25%, which will be effective as of 2012.

4.2 When is that tax generally payable?

Corporations generally must pay monthly tax instalments during the tax year, and must pay any final balance of tax owing for the year within two or three months (depending on the type of corporation) after the end of the year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The ITA provides detailed inclusion, deduction and timing rules governing the calculation of income. Generally, Canadian resident taxpayers are taxable on their worldwide income. A Canco's income for a taxation year from its businesses is its profits from those businesses for the year determined in accordance with well-accepted business principles (which may differ from accounting principles). Expenses are deductible in computing net income of a business to the extent they are made or incurred for the purpose of gaining or producing income from the business or property. Certain more general expenses are also deductible in computing taxable income. Expenses that are otherwise deductible under the ITA may be disallowed to the extent that they are not reasonable. Specific rules may also limit or deny a particular expense depending on whether it is characterised as on income or capital account and, in the latter case, whether it is incurred in the course of a business (in which case a portion of the expense may be amortised as eligible capital).

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

As the rules governing the calculation of income (and taxable income) for tax purposes and for accounting purposes are not necessarily the same, differences may result, such as with respect to the timing and recognition of income, the valuation, write-up and write-down of assets, and the depreciation of capital assets. Differences are normally identified in a reconciliation that forms part of the corporate tax return.

4.5 Are there any tax grouping rules? Do these allow for relief in Canada for losses of overseas subsidiaries?

The ITA does not permit the consolidation of income tax returns of separate taxpayers. As a result, certain debt push-down strategies and other planning techniques are normally used by corporate groups to ensure that overall tax is minimised among related corporations.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Generally no, as dividends are paid out of a Canco's after-tax profits. However, private Cancos are subject to a $6^{2/3}$% refundable tax on passive investment income (including dividends and capital gains), to discourage the use of such corporations as deferred vehicles for their shareholders. The tax is refunded as the corporation pays sufficient dividends to its shareholders.

The ITA contains certain integration mechanisms intended to avoid double taxing corporate income. A taxable Canco is generally entitled to a full intercorporate dividend deduction in respect of taxable dividends received from another taxable Canco, although it may be subject to a refundable tax. Individual Canadian shareholders (including trusts that are not registered charities) use a gross-up and credit mechanism for eligible dividends received from Cancos.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Owners of real property generally must pay annual property taxes to the municipality in which the property is located.

Employers generally must withhold and remit to the CRA payroll taxes in respect of their employees, and may be liable to pay a provincial health tax in respect of employees employed in the province.

Capital tax on corporations other than financial institutions has been eliminated in Canada and most provinces. Capital tax is still imposed in the provinces of Manitoba, Nova Scotia and Quebec on a corporation's taxable capital employed in the province, but it will be eliminated in Manitoba and Quebec on January 1, 2011, and in Nova Scotia on July 1, 2012.

4.8 Are there any local taxes not dealt with in answers to other questions?

No, there are not.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

The ITA provides specific rules for the taxation of capital gains and losses on the disposition of capital property. The determination of whether a property constitutes capital property for income tax purposes is based on common law principles developed in relevant Canadian tax jurisprudence.

A Canadian resident corporation generally will realise a capital gain on the disposition of capital property to the extent that the proceeds of disposition exceed the adjusted cost base and any reasonable costs of disposition of the property. Only one-half of the capital gain must be included in computing the corporation's income for the year of disposition.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

A Canadian resident corporation's net taxable capital gains (generally 50% of total capital gains minus 50% of total capital losses) for a taxation year are subject to income tax at normal corporate tax rates (see question 4.1).

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5.3 Is there a participation exemption?

Dividends may be paid between taxable Cancos free of mainstream corporate income tax (see question 4.6). Cancos are also able to receive dividends from certain foreign subsidiary corporations derived from active business profits earned in specified jurisdictions free of mainstream corporate income tax. However, the ITA does not exempt Cancos from tax on capital gains realised on the disposition of property (whether Canadian or foreign), but does permit deferral of tax in certain circumstances where shares are disposed of in a share-for-share exchange, capital reorganisation or amalgamation.

5.4 Is there any special relief for reinvestment?

Under special rules in the ITA, a taxpayer may defer recognising a capital gain and recaptured depreciation on the disposition of a former business property (other than corporate shares), where the taxpayer acquires a replacement property meeting certain requirements within a specified period of time following the disposition.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No Canadian taxes are generally imposed on the formation of a Canadian subsidiary.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

A Canco is taxable on its worldwide income in a taxation year from any source, while a non-resident corporation operating through a Canadian branch is generally liable for Canadian income tax for a tax year only on its taxable income earned in Canada from carrying on a business in Canada or disposing of taxable Canadian property in the year (subject to tax relief under an applicable DTA). Dividends paid or credited by a Canco to a non-resident shareholder are subject to Canadian NRWT. Branch profit taxes will be levied by Canada where a non-resident operates through a branch (see question 6.4).

A non-resident corporation whose business is carried on principally in Canada or who performs specified activities in Canada will be deemed to be a resident of Canada for Canadian NRWT purposes in respect of certain amounts paid or credited to another non-resident, to the extent that the amounts are deductible in computing the corporation's taxable income earned in Canada. In such case, the amounts paid or credited by the non-resident corporation will be subject to Canadian NRWT at the 25% domestic rate (subject to tax relief under an applicable DTA).

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a Canadian branch of a non-resident corporation would be determined for Canadian income tax purposes in the same way as the taxable profits of a Canadian resident corporation. However, the Canadian branch may deduct only expenses related to the Canadian business operation. There are also limitations on the parent branch charges that may be recognised for Canadian tax purposes.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Canada imposes a 25% branch tax on a non-resident corporation carrying on business in Canada. The branch tax is a substitute for Canadian NRWT on dividends paid by a Canadian subsidiary to its non-resident parent corporation. The branch tax base is determined in accordance with detailed rules, and is generally the non-resident's Canadian-source after-tax business profits less an allowance for investment in Canadian property.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Canada's DTAs generally reduce the branch tax rate to the treaty rate applicable for dividends (5% to 15%), and may provide a limited exemption from the tax. For example, under the Canada-US DTA, the rate is reduced to 5% and the first C$500,000 of after-tax profits is exempted from the branch tax. To benefit from a DTA, the non-resident must be entitled to treaty benefits in its own right.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

A remittance of profits by the Canadian branch of a non-resident corporation would not be subject to Canadian NRWT.

7 Anti-avoidance

7.1 How does Canada address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Canada's GAAR applies to an "avoidance transaction", unless it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the ITA (including an applicable DTA), or an abuse of the ITA as a whole. An "avoidance transaction" is a transaction that would result, or is part of a series of transactions which would result, in a tax benefit (a reduction, avoidance or deferral of tax), unless the transaction has been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit. If the GAAR applies, the CRA may re-determine the tax consequences to a taxpayer as is reasonable in the circumstances in order to deny a tax benefit from the avoidance transaction. In addition to the GAAR, the ITA is replete with specific anti-avoidance rules.

Transactions must be disclosed to the CRA if they are "tax shelters" for Canadian tax purposes. Generally, a tax shelter is a transaction or arrangement that is promoted to provide an investor with deductions within the first four years of the investment that equal or exceed the amount of the investor's cost of the investment minus certain benefits such as a revenue guarantee. If a transaction is a tax shelter, the promoter must apply to the CRA for a tax-shelter identification number and provide detailed information before selling investments in the tax shelter. The promoter is also required to provide certain information to the investor(s) in the tax shelter, including the tax shelter's identification number. If the registration is not obtained, the taxpayer will be deprived of the tax benefit of the arrangement.

Canada has also proposed a regime of mandatory disclosure for certain tax avoidance transactions entered into after 2010, as well as

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transactions that are part of a series that commenced before 20 1 1 but is completed after 2010. A "reportable transaction" under the regime would be an avoidance transaction as described above, that is entered into by a taxpayer and satisfies at least two of the following three hallmarks:

- An advisor or promoter in respect of the transaction is entitled to fees that are either: (i) based on the amount of, or contingent upon obtaining, a tax benefit; or (ii) attributable to the number of persons who participate in the transaction or have been given tax advice by the advisor or promoter.
- An advisor or promoter in respect of the transaction has "confidential protection" about the transaction or series, i.e., a prohibition against the disclosure of the details or structure of the transaction to any person.
- The taxpayer has "contractual protection" in respect of the transaction, i.e., any form of assurance (other than standard professional liability insurance) or other protection which protects against a failure of the transaction or series to achieve any tax benefit or pays for or reimburses any expense, fee, tax, interest, penalty or similar amount that may be incurred in the course of a dispute in respect of a tax benefit from the transaction or series.

The requirement to report is jointly imposed on taxpayers who benefit from the transaction, person acting for (or for the benefit of) such taxpayers, promoters, legal advisors and other service providers involved in the transaction, subject to certain carve-outs. If a reportable transaction has not been disclosed by June 30 of the calendar year following the year in which the transaction occurred, the CRA may deny the tax benefit resulting from the transaction. However, to the extent that the benefit sought would otherwise be permitted under the GAAR, a taxpayer may still obtain the tax benefit if the taxpayer provides the required information to the CRA and pays a penalty. Penalties to which the taxpayer is subject are generally based on total fees paid to service providers in respect of the transaction or series of transactions.

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China

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1 General: Treaties

1.1 How many income tax treaties are currently in force in China?

As of October 10, 2010, Mainland China has signed 90 tax treaties with 90 countries and 2 arrangements with 2 Special Administrative Regions.

1.2 Do they generally follow the OECD or another model?

They generally follow the OECD model and UN model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

No, treaties do not have to be incorporated into domestic law before they take effect.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

No, they do not generally incorporate anti-treaty shopping rules.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No, the treaties are not overridden by any rules of domestic law.

2 Transaction Taxes

2.1 Are there any documentary taxes in China?

Stamp Duty ("SD") is a documentary tax levied on specific categories of documents executed in China at different rates. SD is payable by all the contracting parties based on the contract value.

The categories of dutiable documents are outlined as below:

1) contracts or documents in the nature of a contract with regard to: purchases and sales (SD rate is 0.03%); the undertaking of processing (0.05%); engineering project reconnaissance and designing (0.05%); contracting for construction and installation projects (0.03%); property leasing (0.1%); commodity transport (0.05%); warehousing or custody (0.1%); loan (0.005%); property insurance (0.1%); and technology contracts (0.03%);
2) documents transferring the title of property (0.05%);
3) accounting books (0.05% for capital book and RMB5 per book for others);
4) certificates or licences (RMB5 per certificate/licence); and
5) other documents which the Ministry of Finance determines to be dutiable.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

China has enacted Value Added Tax ("VAT") rules since the early 1980s and in 2008 China revised the VAT rule. The new VAT rule has been effective since January 1, 2009. In China, VAT is a turnover tax levied on all businesses engaged in the sale of goods, provision of processing, repair or replacement services within China, or importation of goods.

The applicable VAT rate varies according to different type of taxpayers and different goods.

- The basic VAT rate is 17%.
- A reduced VAT rate of 13% is applicable for the sales and importation of some specific goods (e.g. crop, water, gas, books, newspapers, magazines, etc.).
- The 3% collection rates are applicable for all goods sold by small scale VAT taxpayers engaged in manufacturing and trading. The 6%, 4% or 3% rate are applicable to some specific goods sold by general VAT taxpayers. Under such mechanism, VAT is calculated on sales income while no input credit is available.
- Export is generally zero-rated, but there is not a full zero-rated system. China adopts different VAT refund rates for different types of products.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

In China, BT is another type of turnover tax. BT and VAT are mutually exclusive. BT applies to the provision of services (excluding the VATable services, i.e. processing services, repair and maintenance services), the transfer of intangible assets and the sale of real estate properties in China.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input VAT is only recoverable by a general VAT taxpayer.

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Furthermore, under the following circumstances, input VAT is not recoverable even for general VAT taxpayers and should be transferred out as a cost or expense of the enterprise:

- Purchase of goods or taxable services which are used for non-taxable items.
- Purchase of goods or taxable services which are used for tax-exempt items.
- Purchase of goods or taxable services which are used for collective welfare or personal consumption.
- Purchase of goods which suffer abnormal losses.
- Purchase of goods or taxable services consumed in the production of work-in-progress or finished products which suffer abnormal losses.
- Purchase of motorcycle, car and yacht for self-use.
- Purchase of goods or taxable services without receiving valid VAT invoices.

In case of exportation, input VAT may be totally or partially non-recoverable, provided that the exported goods are not entitled to a VAT refund or the VAT refund rate of the goods is lower than its applicable VAT rate.

In addition, in order to credit the input VAT against output VAT, the input VAT invoices should be valid and verified within a determined period (normally 180 days, effective January 1, 2009); otherwise the relevant input VAT will be non-recoverable.

2.5 Are there any other transaction taxes?

CT is levied on 14 categories of goods, including tobacco, alcoholic drinks, cosmetics, jewellery, fireworks, gasoline, tires, motorcycles, automobiles, golf balls and instruments, luxury watches, yachts, disposable wooden chopsticks and solid wood floor boards. CT is normally levied at the manufacturing stage and import stage but for some goods it is levied at the sales stage.

2.6 Are there any other indirect taxes of which we should be aware?

All goods permitted to be imported into or exported out of China shall be subject to Customs import or export duties according to the PRC Customs Import and Export Tariff.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Under the new corporate tax law of China and its implementation rules, the WHT rate for dividends paid by a locally-resident company to a non-resident is 10%. Some treaties allow lower rates at 5% or 7%, etc.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Under the new Corporate Income Tax Law of China and its implementation rules effective January 1, 2008, China-sourced royalties obtained by a foreign enterprise shall be subject to 5% BT and 10% WHT based on the royalty payments. BT may be exempt for the licensing of technologies. The BT and WHT should be withheld from the amount of each payment by the Chinese payer (as the withholding agent).

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Under the new Corporate Income Tax Law of China and its implementation rules effective as of January 1, 2008, China-sourced interest income obtained by a foreign enterprise shall be subject to 10% WHT with the Chinese payer as the withholding agent.

According to the new BT rules effective from January 1, 2009, the interest shall be subject to 5% BT.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The new Corporate Income Tax Law introduced the "thin capitalisation" rule into China income tax regime. The new law stipulates that if the debt investment from affiliated parties exceeds the statutory requirement, the interest expense for the exceeded debt investment will be non-deductible for corporate income tax purposes.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There is no such "safe harbour" available under current China tax rules and regulations.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes, the "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No there are no restrictions.

3.8 Does China have transfer pricing rules?

Yes. China established detailed transfer pricing rules in 1998. And in 2009, China released new transfer pricing rules. According to the transfer pricing rules, related party transactions should be carried out at arm's length; otherwise the tax authorities are empowered to make adjustments on the taxable income by a reasonable method and to impose relevant taxes accordingly.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax on corporate profits is 25%.

4.2 When is that tax generally payable?

Enterprises shall file quarterly tax returns for the corporate income tax and make quarterly estimation payments. The quarterly returns and estimation payments are due within 15 days after the end of each quarter, i.e., 15 January, 15 April, 15 July, and 15 October. An

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annual tax return, together with financial statements of the enterprise audited by a local accounting firm, must be filed within five months after the end of the tax year. The tax already paid in advance by quarterly instalments could be set off against the annual tax payment. Meanwhile, any overpayment should be refunded.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base follows the accounting profit subject to book-to-tax adjustments.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The differences between book profit and tax profit can be classified into two types: permanent differences; and timing differences. The main permanent differences include over-deducted expenses and non-deductible expenses for tax purposes, interest income from treasury bonds, deemed income for tax purposes, etc. The main timing differences include provisions, accrual expenses, pre-operation expenses, depreciation expenses and amortisation expenses, etc.

4.5 Are there any tax grouping rules? Do these allow for relief in China for losses of overseas subsidiaries?

No. There is no tax grouping rules in China for Foreign Investment Companies.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Under the new income tax law, profit distributed to a foreign enterprise is subject to 10% withholding tax. Profit distributed between resident enterprises shall be exempt from income tax.

Retained profit is not subject to PRC tax.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

The other major national taxes include Real Estate Tax, Land Appreciation Tax, Deed Tax, Resource Tax and Motor Vehicle Acquisition Tax.

Real Estate Tax ("RET")

RET is payable by Foreign Investment Enterprises that own properties in the designated cities or areas. RET is levied annually at the rate of 1.2% on the original value of the property. Generally local authorities will grant a 10% to 30% discount of the taxable amount. For leased property, RET is levied annually at the rate of 12% on rental income.

Land Appreciation Tax ("LAT")

LAT is levied on gains realised from real property transactions at progressive rates from 30% to 60%, "based on the land value appreciation amount", which is the excess of the consideration received from the transfer of real property over the total deductible amount.

Deed Tax ("DT")

DT is levied on the purchase or sale, gift or exchange of ownership of land-use rights or real properties. The transferee/assignee is the taxpayer. Tax rates range from 3% to 5%.

Resource Tax ("RT")

RT may be levied on natural resources, generally on a tonnage or volume basis, at rates specified by the Ministry of Finance in consultation with relevant ministries of the State Council. The resources taxed include crude oil, natural gas, coal, other raw non-metallic minerals, raw ferrous metals, nonferrous metallic minerals, and salt (including solid and liquid salt).

Motor Vehicle Acquisition Tax ("MVAT")

MVAT is imposed on purchasing and importing of the following types of transport vehicles:

- Cars.
- Motorcycles.
- Trams.
- Electric buses.
- Carts.
- Certain types of trucks.

Manufacture of the above vehicles for own use or receipt of the above in the form of a gift or lottery, etc., would also be subject to MVAT. The MVAT rate is fixed at 10% of the taxable consideration.

4.8 Are there any local taxes not dealt with in answers to other questions?

Vehicle and Vessel Tax ("VVT")

VVT is levied on Vehicle and Vessel. Certain categories of vehicles and vessels (e.g. non-powered vehicles and vessels) are exempt from VVT as listed in the governing regulations. The tax on vessels is based primarily on tonnage. The provincial authorities are required to draw up a schedule based on the tax amounts applicable to different types of vehicles and on their tonnage capacity and usage.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

For Foreign Investment Enterprise ("FIEs"), capital gains and losses are taxed the same as business profits. There is no special set of rules for taxation on capital gains and losses.

Foreign shareholders (corporate and individual) are taxed on capital gains from the sale of their investment in China FIEs at a 10% withholding tax rate, with further tax treaty relief available.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Not applicable.

5.3 Is there a participation exemption?

The reinvestment refund incentive is abandoned under the new corporate income tax rules in 2008.

5.4 Is there any special relief for reinvestment?

No. The reinvestment refund incentive for FIEs was revoked upon the effect of the new Corporate Income Tax Law of China.

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6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There is no tax imposed upon the formation of a subsidiary. The capital contribution is subject to stamp duty at the rate of 0.05%.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No. There are no other significant taxes or fees incurred by a local subsidiary.

In practice, it is currently not possible for foreign enterprises to establish branches. Approvals to establish branches have only been granted to several specific industries, e.g. financial institutions, shipping and oil and gas companies. Most of the foreign direct investment takes the form of subsidiaries.

However, it is common for foreign enterprises to establish representative offices in China. A rep office is an extension to its head-office and its business scope is limited to liaison activities which are of a non-profit making nature.

6.3 How would the taxable profits of a local branch be determined?

The taxable profit of a local branch of a foreign enterprise is determined by the same method as that of a foreign invested enterprise, i.e. actual basis method. However, as mentioned above, a branch is not a common investment vehicle by Foreign Investors.

Effective as of January 1, 2010, the taxable profit of a representative office may be determined by one of the following methods:

- Actual basis method.
- Deemed income/profit method.
- Cost-plus method.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No. There is no branch profit tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No. A branch would not benefit from tax treaty provisions.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Currently there is no withholding tax or other tax imposed as the result of a remittance of profits by the branch.

7 Anti-avoidance

7.1 How does China address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The new EIT Law devotes an entire chapter entitled "Special Tax Adjustment" to anti-avoidance. In the chapter, a general Anti-Avoidance Rule is defined as follows: "competent tax authorities may adjust taxable income where business transactions are arranged without reasonable business purpose".

There is no disclosure requirement to disclose avoidance schemes in advance of the company's tax return being submitted. But the company is required to enclose a statement of the annual business transactions between the company and its affiliates when the annual EIT return is submitted.

When the tax authority conducts an affiliated business investigation, the company and its affiliates shall provide the relevant information of the affiliated transaction like pricing, expense pricing method, and profit margin etc.

The new transfer pricing documentation rule has been effective since 1 January 2008.

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Hendersen Consulting was mainly founded by former Arthur Andersen professionals in August 2004. Starting with 3 people, we currently have more than 50 professionals in Shanghai and Beijing. We are mainly serving multinational companies on M&A, finance, tax and customs related areas in China. Over the past 6 years, our firm has achieved fast growth through acquisition of new clients as well as provision of new service offering with high value-added to their investment in China. Currently, most of our clients are fortune 500 multinational companies, investment banks and funds, such as GE, GM, Boeing, BP, Virgin, Agilent, Bayer, BMW, Danaher, Ferrari, SNDA, Starwood, ThyssenKrupp, Tyco, JP Morgan, Merrill Lynch, etc.

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Colombia

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Colombia?

There are treaties with the Andean Community (Bolivia, Ecuador and Peru), Spain and Chile.

The treaty to avoid double taxation with Switzerland will become effective most likely as of January 2011. Treaties with México, South Korea, Portugal and Canada are still under the process of being incorporated into domestic law.

There is an agenda that is to be followed by the Colombian Government in the implementation of income tax treaties. Currently treaties with the USA, Germany, the Czech Republic, Holland, Belgium, India, Japan, and France are being negotiated.

There are treaties in force with Argentina, Brazil, Chile, France, Germany, Italy, Venezuela and the USA about income derived from transportation activities.

1.2 Do they generally follow the OECD or another model?

The Andean Community and the transportation treaties do not follow the OECD model. Treaties with Chile, Switzerland, Canada, and México do.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes, treaties must be presented as a bill to Congress, and must be approved as law and by the Constitutional Court before being enforceable. Nevertheless, treaties dealing with commercial issues may be applied provisionally while the incorporation to domestic law takes place.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, treaties do incorporate rules regarding anti-treaty shopping.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No, treaties are not overridden by rules of domestic law.

2 Transaction Taxes

2.1 Are there any documentary taxes in Colombia?

Colombian tax law provides for stamp tax. Nonetheless, as of 2010 the stamp tax rate is 0%.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Colombian tax law provides for value added tax (VAT), which is triggered in the sale of goods (excluding real estate and fixed assets), the rendering of services and the importation of tangible assets. The general rate for VAT is 16%. There are special VAT rates as follows:

- 1.6% for cleaning services, authorised surveillance and temporary employment services.
- 16% for gambling.
- 10% for certain goods such as coffee, wheat, corn, sugarcane, among others, and for services such as rental of immovable property for commercial purposes, prepaid medical plans, lodging services and storage of agricultural products.
- 11% for flour from wheat or other cereals.
- 20% for jeeps under duty classification 87.03 with an FOB value of less than US$30,000, for leisure and sport boats produced or assembled in the country, and for services such as mobile/cellular phone services.
- 25% for other vehicles under duty classification 87.03 with an FOB value of less than US$30,000, for motorcycles of more than 185c.c.
- 35% for vehicles including jeeps of the duty classification 87.03 and pickups whose FOB value or equivalent FOB value is equivalent to or exceeds US$30,000, private planes and leisure or sport boats imported and classified under duty 89.03.
- 11% for beer of local production.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

VAT is not applicable when the goods/services have been expressly excluded (not taxed) or exempted (0% rate).

Some of the relevant exclusions that can be noted are most groceries, fruit, electric energy, medicines, rubbers, papers, pencils, computers not exceeding US$1,112, medical services, certain

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transportation services, interests, public utility services (except for telephone service), housing rentals, education services, tickets (cultural events, sporting events, movies), and certain services related to agricultural activities.

Some of the relevant VAT-exempt goods or services are: goods that are exported or sold within the country to international commercialisation companies to the extent the goods are effectively exported; notebooks, books and magazines of cultural and scientific nature, newspapers and other periodical obligations; export of services provided that certain conditions are complied; and tourism services provided to foreigners.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

As a general rule VAT paid in the acquisition of goods and services required for the development of the taxed activities is recoverable by a tax payer (an individual or companies who are registered as responsible for VAT (which includes the producers and providers of exempted goods/services)). VAT paid by tax payers can be offset against VAT charged under the payer's taxable operation.

In the case of exporters and producers of exempt goods/services input VAT can be recovered via a tax refund. Producers and providers of excluded goods/services cannot recover any VAT paid which must be treated as a higher cost or expense. VAT paid in the acquisition of fixed assets is generally not recoverable.

If a tax payer has taxable, excluded and exempt goods or services and incurs in expenditures that cannot be directly attributable to either, the VAT on such expenditures shall be apportioned according to the income generated in each activity.

2.5 Are there any other transaction taxes?

Taxes on the purchase of real estate property: when purchasing land or any real estate in Colombia it is necessary that the following taxes are paid:

- Registration Tax: 1% of the total purchase price.
- Registration Right: 0.5% of the total purchase price.
- Notary rights: 0.27% plus VAT at a 16% rate.
- Withholding tax on purchase of real estate property: 1% over the real estate value. This withholding is creditable against the income tax due from the seller.

Taxes over financial disbursements: in Colombia any disbursement or disposal of funds from a checking or savings account is subject to a 0.4% tax. There are some exemptions to this rule such as: (i) any transfer of money made from one account to another of the same account holder; and (ii) an account holder can register a savings account in order to obtain a tax benefit by means of which the first US$4.718 (approximately) disbursement a month is free of tax.

2.6 Are there any other indirect taxes of which we should be aware?

Custom duties are generally paid on imported goods, at rates that vary according to the classification of the imported product.

Additionally, there is a Registration Tax over documents that must be registered before the Chamber of Commerce (i.e. incorporation of companies, pledges over commercial establishments, mergers, liquidation of companies) at a 0.7% rate.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

There is no double taxation between the company distributing dividends and its shareholders, regardless of whether it is a local or non-resident company. Consequently, if the local company has been taxed on the profits being distributed as dividends, no withholding is imposed.

If such profits have not been taxed at the distributing company level, the respective dividends will be subject to a 33% withholding tax.

Under double taxation treaties, these dividends would be subject to rates from 0% to 15%.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

There is a 33% withholding on royalties paid by a local company to a non-resident. In the case of payments derived from royalties for the exploitation of software the applicable rate is 26.40%.

Under double taxation treaties, these royalties would be subject to a rate of 10%.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Generally foreign loans obtained by local companies that develop activities considered of interest for the social and economic development of the country (as per a broad definition for this purpose) are deemed as possessed abroad Colombia and as such any interests paid are not considered as domestic source income and are not subject to withholdings. Otherwise, interest is subject to a 33% withholding tax. Please note that due to exchange control regulations local companies can only enter into foreign loans with foreign financial institutions. Under double taxation treaties, the interests would be subject to rates from 5% to 15%.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There are no thin capitalisation rules in Colombia.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Not applicable to this jurisdiction.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Not applicable to this jurisdiction.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Not applicable to this jurisdiction.

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3.8 Does Colombia have transfer pricing rules?

Yes, transfer pricing rules have been in effect since taxable year 2004 and are applied exclusively to transactions with related parties domiciled abroad.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Currently, the headline rate of tax on corporate profits is 33%.

4.2 When is that tax generally payable?

For companies other than large taxpayers, corporation tax is usually due and the first quota is payable during the month of April of the year following that which is being filed. The specific dates when the returns are to be filed depend on the two last digits of the taxpayers ID and are set by means of a Resolution of the Colombian Tax Authorities (DIAN). The second quota is to be paid in the month of June of that same year. First and second quotas are paid in equal parts.

Large Taxpayers are defined as such through a Resolution of the Colombian Tax Authorities (DIAN). Large taxpayers must pay the first quota on February of the year following that which is being filed. The first quota is equivalent to 20% of the amount payable of the tax return of the previous taxable year. Any balance must be paid to the tax authorities as follows: (i) 35% of the balance at the time the return is filed in May of that same year; (ii) 30% of the balance in June; (iii) 25% of the balance in August; and (iv) the final 10% in October of that same year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The income tax base is the higher between the ordinary taxable income (profits pursuant to commercial accounts subject to adjustments) and the presumptive income (3% of the liquid net worth as of December 31 of the previous taxable year).

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Certain items of expenditure are shown as reducing the profits in the commercial accounts but are not allowed from a tax point of view. For example, expenses incurred abroad which have not been subject to income tax withholding have a limited deductibility.

Penalties paid for tax purposes are not tax deductible. Accounting provisions are not tax deductible. Expenses that have been accounted for in a specific taxable year can be rejected if the expense corresponds to a different taxable year.

On the other hand, there are certain tax benefits that allow for a greater expense than that allowed for tax purposes. Currently, tax laws in Colombia allow for a deductible expense of 30% of the investment value of productive tangible fixed assets used to generate taxable income, which generates a difference between accounting and tax accounts. There is currently a tax bill proposing the elimination of this benefit.

4.5 Are there any tax grouping rules? Do these allow for relief in Colombia for losses of overseas subsidiaries?

No such rules exist in Colombia.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate to retained profits in Colombia.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There is an equity tax that is payable over the company's net equity. The accrual of such tax takes place on January 1, 2011 and the tax rate is equivalent to 2.4% for net equities of US$1.65 million or higher. If the equity is equivalent to or exceeds US$2.76 million the tax rate is increased to 4.8% of the equity. Payments are made in 8 installments in a period of 4 years.

4.8 Are there any local taxes not dealt with in answers to other questions?

In Colombia there are local taxes over gross income of the companies. This tax is called the Industry and Commerce Tax and is payable in each municipality where companies develop and carry out industrial, commercial or services activities. The rates vary in the case of Bogotá (Colombia's Capital) from 0.5% to 1.38%.

There is municipal tax over real estate. These taxes also apply according to each municipality. This tax accrues on January 1 of each year and rates vary according to the real estate. In general terms rates vary in the case of Bogotá from 0.2% to 3.3%.

There is also a municipal tax over vehicles. In the case of Bogota the rates vary from 1.5% to 2.5% over the total list price of the vehicle. This list price is determined by the national government through an official resolution.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes, there is a special set of rules for taxing capital gains and losses. Before the elimination of the inflation adjustment regime (2006), capital gains and losses were included in the determination of the ordinary taxable income.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Except for the capital gains originated in prizes, lotteries, bets and equivalents, which are subject to a 20% rate, the same business profit rate is applicable.

5.3 Is there a participation exemption?

No, there is not.

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5.4 Is there any special relief for reinvestment?

No, there is not.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There is the need to pay notary fees, calculated on the amount of capital destined to the formation of the company at a 0.27% rate plus VAT at 16% and there is a registration tax calculated on the same base at a 0.7% rate.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

In general terms, a locally-formed subsidiary and a branch of a non-resident company are subject to the same taxes and fees. Both are subject to a corporate tax at the same rate but in the case of subsidiaries they are subject to worldwide income tax, as opposed to braches of non-resident companies which are subject only to Colombian source income.

6.3 How would the taxable profits of a local branch be determined?

Taxable profits of the branch are determined in the same way as for local companies as described in question 4.3.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No, there has been no branch profit (remittance) tax since 2007.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

The answer depends on the definitions provided for in each specific treaty, and there are no domestic laws regulating this issue.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No, there is no withholding tax or other tax imposed as the result of a remittance of profits by the branch. Remember that the branch is subject to taxes in Colombia at the same tax rate as any other company established in the country.

7 Anti-avoidance

7.1 How does Colombia address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is no general anti-avoidance rule in Colombia. However, based on the Constitutional principle of substance-over-form, there is some jurisprudence and an official doctrine stating that economic reality will prevail over legal forms if such are abused to reduce taxation. This jurisprudence and official doctrine have been scarcely applied in practice.

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Costa Rica

Arias & Muñoz

Carolina Flores Bedoya

1 General: Treaties

1.1 How many income tax treaties are currently in force in Costa Rica?

No income tax treaties are currently in force in Costa Rica.

1.2 Do they generally follow the OECD or another model?

Not applicable.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Treaties only have to be approved by Costa Rica's Congress before they take effect.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Not applicable.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Treaties are not overridden by any rules of domestic law, except for constitutional provisions.

2 Transaction Taxes

2.1 Are there any documentary taxes in Costa Rica?

Yes. Documentary taxes must be paid for most documents used in courts or public offices and for many private transactions, such as deeds, mortgages, transfer of vehicles and real property. The tax rate is 0.5% of the value of the contract.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes, we have a Sales Tax ("ST"), which is similar to VAT. The rate is 13%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The ST is charged on the sale of merchandise. Services are not subject to sales tax, with very few exceptions. Sale of merchandise includes all transactions resulting in transfer of ownership of moveable goods manufactured or acquired for their ultimate sale. It also includes importation of merchandise. The following products are exempted from sales tax: basic consumption food products; medicines; and agricultural and fishing supplies. The services subject to sales tax are: restaurants; bars; hotels; mechanic workshops; parking; telephone and cable; film developing; storage; laundry; publicity; car wash; custom clearance services; international moving services; insurance premiums, except those for personal risks, labour risks, crops and those for low income housing; press services; and real estate services. The applicable rate is 13% of the sale price.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

ST is always fully recoverable by businesses registered for ST purposes. The tax to be paid is calculated by deducting the fiscal credit from the fiscal debit. The fiscal debit is equivalent to applying the 13% tax rate to all taxable sales made by the business. The fiscal credit is calculated by adding all ST paid by the taxpayer on all purchases and importations.

2.5 Are there any other transaction taxes?

There are transfer and stamp taxes applicable to transfers of real estate and vehicles, which must be registered before the Public Register. The rates applicable are approximately 1.5% for real estate and 2.5% for vehicles.

2.6 Are there any other indirect taxes of which we should be aware?

Excise duties are levied on the transfer of certain goods contained in the law. The applicable rate depends on the type of good. This tax is also applied to imports of merchandise included in said list. Items exported by merchants are exempt. Custom duties are payable on the importation of goods coming from outside Costa Rica.

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3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Yes, there is a 15% withholding tax on dividends paid by a local company to a non-resident.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes, there is a 25% withholding tax on royalties paid by a local company to a non-resident.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes, there is a 15% withholding tax on interest paid by a local company to a non-resident, except when the beneficiary is an entity recognised by the Costa Rican Central Bank as a First Order Bank (only if the loan is invested on farm and industrial activities) or as an Entity Normally Dedicated to International Operations.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There are no "thin capitalisation rules" in Costa Rica. There is only a provision, which establishes that when the amount of interest that the taxpayer intends to deduct is higher than 50% of its liquid income, the taxpayer must file a special form. Liquid income is defined as taxable income less all interest income of the fiscal period, plus the deductions related with deductible financial interest. In all events, the taxpayer must evidence that the interest deducted were required to generate taxable income.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

No, there is no such safe harbour.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

No thin capitalisation rules in such detail exist.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No, there are not.

3.8 Does Costa Rica have transfer pricing rules?

No. Costa Rica does not have transfer pricing rules. Costa Rica's tax law only provides that the local tax authorities may review transactions between related companies and that these transactions must be made under arm's length principles.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax for corporate profits is 30%, calculated over net income.

4.2 When is that tax generally payable?

It is generally payable within two months and fifteen days after closing of the fiscal year, which is on September 30. However, three advanced payments must be made every year on March, June, and September. These advance payments are calculated based on the previous year's income tax return.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In general terms, the tax base is calculated pursuant to commercial accounts with certain adjustments. The tax base is gross taxable income of the company less deductible costs and expenses. Deductions include all necessary expenses to produce taxable income, among them: salaries and bonuses paid to employees; interest; bad debts; depreciation; compensations to directors; and fees for technical services.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Certain deductions allowed under commercial rules are disallowed for tax purposes. For example, bad debts on which the taxpayer has not initiated a formal judicial collection process are not deductible.

4.5 Are there any tax grouping rules? Do these allow for relief in Costa Rica for losses of overseas subsidiaries?

There are no tax-grouping rules. Consolidated accounts and tax returns are not allowed under Costa Rican tax law.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate upon distributed, as opposed to retained, profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There are no other national taxes, but there is a municipal property tax at a 0.25% tax rate on the registered value of all real estate assets. This tax must be paid annually to the corresponding municipality.

4.8 Are there any local taxes not dealt with in answers to other questions?

Yes, there are municipal taxes that must be paid by all commercial establishments. The rate differs between municipalities and is calculated based on the company's income.

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5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes, capital gains are not taxed. Therefore, capital losses may not be deducted.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Not applicable.

5.3 Is there a participation exemption?

There is no participation exemption.

5.4 Is there any special relief for reinvestment?

No, Costa Rica has no relief for reinvestments.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No taxes are imposed upon the formation of a subsidiary. Registration costs are approximately $70.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no other significant taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch are determined just the same way as with a subsidiary. The 30% income tax rate applies on net income (gross income less deductible expenses). There are no special tax regimes for local branches of foreign companies.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

The remittance of branch profits to the head office would be subject to a 15% tax on the gross payment, which must be totally withheld at source by the local entity.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No, because there are no tax treaties in effect in Costa Rica.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

See the answer to question 6.4.

7 Anti-avoidance

7.1 How does Costa Rica address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Costa Rica has criminalised tax evasion by means of a general rule determining when tax avoidance is deemed to have taken place. Such avoidance has to be proven in court by the tax authority.

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Arias & Muñoz is unique in Central America, for it operates as a single firm rather than as an alliance of firms and currently has eight, fully-integrated offices in five countries: Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica. It has become, today, not only a solid, but also an innovative legal firm that continues to spread its influence throughout the region.

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Czech Republic

Salans

Petr Kotáb

1 General: Treaties

1.1 How many income tax treaties are currently in force in the Czech Republic?

At present, there are 77 tax treaties to which the Czech Republic is a party covering all regions worldwide.

1.2 Do they generally follow the OECD or another model?

The tax treaties between the Czech Republic and other countries are generally based on the OECD Model Tax Convention in cases where the other party of the treaty is an industrially-developed country (European countries are typical). In cases of tax treaties with some of the less-developed countries, the UN Model Tax Convention is followed. The tax treaty with the USA stands apart and forms a model of its own.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

International tax treaties need to be agreed to by the Parliament and ratified by the President of the Czech Republic (subsequent to possible examination as to the constitutionality thereof by the Constitutional Court which is done only upon qualified request and which in practice is rarely initiated). The treaties are then published in the Collection of International Treaties and become part of the domestic law. No further incorporation into domestic law is needed.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The general anti-treaty shopping principles contained in the model tax treaties are usually incorporated in the Czech tax treaties; however, the treaties usually do not contain more comprehensive anti-treaty shopping provisions in comparison with those presented in a model treaty. For example, the criterion of place of effective management is commonly applied, in addition to mere registered address, to limit the benefits of a tax treaty available to a foreign corporate taxpayer. On the other hand a "limitation of benefits" clause is not commonly used.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

A tax treaty published in the Collection of International Treaties prevails over any Czech law, irrespective of whether it previously existed or was issued subsequently. In the event that a tax treaty sets forth provisions different than those set forth in the domestic law, the provision of such treaty will be applied. The Ministry of Finance however tends to issue tax instructions for the application of tax treaties which sometimes twist the interpretation of a tax treaty contrary to the common interpretation of the same (e.g., interpretation in respect of the OECD Model Treaty).

2 Transaction Taxes

2.1 Are there any documentary taxes in the Czech Republic?

There are no documentary taxes in the Czech Republic. Based on the nature of the pertinent transaction (real estate transfer, share transfer, etc.) standard court or administrative fees, or notary compensation may be charged that are supposed to cover or contribute to the expenses of the registration made by the pertinent authority and have no taxation nature.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

There is value added tax (VAT) in the Czech Republic and it applies to taxable supplies described in more detail in question 2.3. The Czech VAT system is based on, and generally complies with, the EU VAT rules, particularly the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

Two VAT rates are applied in the Czech Republic:

- the standard VAT rate of 20% is applied to most taxable transactions involving supply of goods and services unless a reduced VAT is set forth; and
- the reduced VAT rate of 10% is applicable to certain supplies of goods and services permitted by the Directive 2006/112/EC (e.g., foodstuffs, medical equipment, pharmaceutical products and books, among others) and to certain supplies related to construction works for residential housing.

As part of the governmental measures addressing the public finance deficit, a rather radical increase of the reduced rate possibly balanced by a small decrease of the standard rate is considered for 2011.

In addition, some taxable supplies that are VAT-exempt still grant

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the supplier the right of VAT deduction on the input, which renders such supplies effectively a 0% rate.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

As a universal indirect tax, VAT applies to a broad array of transactions including delivery of goods, transfer of real estate or provision of service by a person liable to VAT for consideration, acquisition of goods by a person liable to VAT from other EU Member States for consideration, other imports of goods with a place of taxable supply in the Czech Republic, etc.

From among a number of VAT exclusions and exemptions the following examples of supply of goods and services excluded from VAT can be highlighted:

- supply of goods and provision of services effectuated by an exempt person, i.e., a person liable to VAT whose turnover for a period not longer than 12 months does not exceed CZK1 million (i.e., approximately €40,000) who is not registered as a VAT payer;
- the provision of certain services in the public interest (postal services, social assistance, medical goods and services, radio and TV broadcasting, financial activities, insurance activities, etc.) and other listed activities, if the conditions set out by law are complied with (e.g., transfer and lease of land, structures, apartments and non-residential space); and
- exemptions connected to exports of goods and linked transactions and to international transport.

Depending on the type of VAT-exempt supply provided by a taxpayer on its output, such taxpayer may or may not be allowed to deduct VAT charged to it on its input.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

As a general rule, a taxpayer registered for VAT who uses the received taxable supply for the exercise of its economic activity is entitled to a deduction of VAT paid in connection with the received taxable supply.

The deduction is not available when the taxpayer uses the received taxable supply for making supplies that are exempt from VAT without the right of VAT deduction (such as postal services, social assistance, medical goods and services, radio and TV broadcasting, financial activities unless provided to a foreign person, insurance activities, lotteries, transfer and lease of most land and structures, apartments and non-residential space, etc.) or for purposes other than its economic activity (e.g. personal consumption).

2.5 Are there any other transaction taxes?

The following can be considered other transaction taxes in the Czech Republic applicable to transactions involving a legal entity:

- real estate transfer tax, for which the tax rate is set at 3%;
- inheritance tax, for which the tax rate is set progressively and ranges from 3.5% up to 20%; and
- gift tax, for which the tax rate is set progressively and ranges from 7% to 40%.

2.6 Are there any other indirect taxes of which we should be aware?

In addition to VAT, excise taxes and environmental (energetic) taxes represent other types of indirect taxes.

Excise taxes are levied on the following products distributed in the Czech Republic:

- mineral oils;
- spirit (alcohol);
- beer;
- wine and intermediate products; and
- tobacco products.

Environmental (energetic) taxes are levied on supply of the following energetic media to end consumers in the Czech Republic:

- electricity;
- natural and certain other gases; and
- solid fuels.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

In general, a local company paying out dividends (profit distributions) to a Czech non-resident must withhold income tax equal to 15% of the dividend paid.

The above withholding tax rate may be reduced in cases where the dividends are paid out to and beneficially received by a non-resident entitled to a protection under a relevant tax treaty. The treaty-reduced tax rate is usually as low as 10% or 5% or even nil (e.g., under the Czech-Netherlands tax treaty and subject to the terms and conditions as set forth in the treaty).

The income from dividends (profit distributions) paid by a Czech resident to a parent company resident in an EU Member State (including the Czech Republic) or Switzerland, Norway and Iceland is exempt from income tax if the ownership interest of the parent company in the share capital of the Czech company (payer of the dividend) is (or will be) at least 10% for an uninterrupted period of 12 months and certain other conditions based on the relevant EU Parent-Subsidiary Directive (90/435/EEC) are met. In respect of Czech subsidiary companies, the aforesaid rule applies to joint stock companies and limited liability companies.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In general, a local company paying out royalties to a Czech non-resident must withhold income tax of 15% of the royalties paid. The withholding tax rate applicable to financial leases is 5%.

The above-mentioned withholding tax rate may be reduced in cases where the royalties are paid out to and beneficially received by a non-resident entitled to a protection under a relevant tax treaty.

As from January 1, 2011, subject to the conditions set forth by Czech tax law (generally following the rules set forth by the relevant EU Interest and Royalty Directive 2003/49/EC) royalties received by a company which is a tax resident of another EU Member State or Switzerland, Norway and Iceland from a company which is a Czech resident are exempt from Czech income tax and thus also from any withholdings. Similar exemption will apply to payment of royalties to a company which is a tax resident of another EU Member State by a Czech permanent establishment of a company resident in another EU Member State.

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3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In general, a local company paying out interest to a Czech non-resident must withhold income tax of 15% of the interest paid.

The obligation to withhold the tax does not apply to cases where the interest is paid out to and beneficially received by a non-resident entitled to a protection under a relevant tax treaty. The obligation to withhold further does not apply to cases where the interest is paid out to a non-resident's permanent establishment in the Czech Republic. Also, there is an exemption from withholding tax on interest payments that are generally tax-exempt such as on mortgage bonds.

Subject to the conditions set forth by Czech tax law (generally following the rules set forth by the relevant EU Interest and Royalty Directive 2003/49/EC) interest paid to a company which is a tax resident of another EU Member State, or Switzerland, Norway and Iceland, by a company which is a Czech resident is exempt from Czech income tax and thus also from any withholdings. Similar exemption applies to payment of interest to a company which is a tax resident of another EU Member State by a Czech permanent establishment of a company resident in another EU Member State. The aforesaid exemption does not apply to interest from certain loans and credits of hybrid nature (such as those where the creditor is entitled to participate in profits of the debtor as a result of the loan or credit provided to the debtor).

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Although interest paid in excess of the "thin capitalisation" rules may generally be subject to reclassification to profit distribution (dividend) and thus ineligible for certain tax reliefs rendered to interest on loans and credits, such reclassification is disallowed when the recipient of the interest is a corporate resident of the EU or the EEA. Consequently, the tax exemption of interest on loans and credits mentioned in question 3.3 will still apply to EU and EEA residents irrespective of the breach of the "thin capitalisation" rules on the side of the borrower.

In other cases "thin capitalisation" rules apply to debt financings (provision of loans and credits) between related parties (or refinanced by related parties on a back-to-back basis) where the corresponding financial expenses (i.e., in addition to interest also other financial expenses, such as loan arrangement or processing fees, etc.) exceeding the specific debt-to-equity ratio are not tax deductible and, as a result, the interest and other financial expenses are reclassified to dividend (profit distribution). The above debt-to-equity ratio generally equals to 4:1 and in case of banks and insurance companies 6:1.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

A "safe harbour" is usually sought in some bilateral tax treaties binding on the Czech Republic that either do not allow reclassification of interest to dividend, or grant favourable tax treatment to dividends even after reclassification from interest.

As mentioned above, the EU resident or EEA resident status of a corporate lender would suffice to protect the lender from the taxation of interest paid to it in excess of the "thin capitalisation" rules. The adverse impact of such rules on the Czech borrower (the non-deductibility of interest and other financial expenses on loans and credits in excess of the "thin capitalisation" rules) would still remain, though.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Generally, no. A debt advanced by a third party, however, that is conditioned upon the provision to such third party of a directly connected loan or credit by a party related to the borrower (including the borrower's parent) is viewed as debt advanced by a related party and therefore is subject to the thin capitalisation rules as mentioned above in question 3.4.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

As mentioned in question 3.3, tax relief for interest payments by a local company to a non-resident that is a tax resident of another EU Member State or Switzerland, Norway or Iceland is not available in cases of interest from loans and credits that are agreed upon between affiliated persons at non-arm's-length terms or where the creditor is entitled to participate in profits of the debtor as a result of a loan or credit provided to the debtor or to change the right to interest from a loan or credit to the right to participate in profits of the debtor.

Furthermore interest and other financial expenses on loans and credits where such interest or other yield or the maturity of the financial expenses are partly or wholly dependent on the borrower's profits may be reclassified (to recipients other than EU residents and EEA residents) to dividend and thus ineligible for tax relief on interest payments.

3.8 Does Czech Republic have transfer pricing rules?

Yes, under the law in the case where the prices agreed upon between connected persons differ from prices that would be agreed upon between independent persons in ordinary business relations under the same or similar conditions, and unless such variance is justified in a satisfactory manner, the tax authority may adjust the income tax base of the involved taxpayer by the variance so ascertained. Connected persons are deemed to include (in addition to affiliated persons by reason of capital relation or voting rights through ownership of at least 25% of capital or voting shares) persons having created a legal relation mainly for the purpose of reducing a tax base or increasing a tax loss.

Czech law does not provide more detailed guidelines as to how an arm's-length price is to be established. The Czech Ministry of Finance, however, has instructed the local tax authorities to take into account the OECD Transfer Pricing Guidelines as for intra-group transactions exceeding the territory of the Czech Republic. To eliminate uncertainty relating to establishing arm's-length prices, taxpayers may request the relevant local Financial Office to issue an appraisal of the methods employed by a taxpayer when calculating prices to be charged/paid to the connected persons. Such appraisal is binding on all Czech tax authorities and has thus the quality of an advance tax ruling.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax on corporate profits in the Czech Republic is 19%. A reduced tax rate of 5% applies to pension funds,

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investment funds and unit trusts. A reduced rate of 15% applies to certain specified types of income (dividends, profit distributions, liquidation surplus payments, etc.) sourced abroad.

4.2 When is that tax generally payable?

In general, the income tax must be paid not later than within 3 months from the end of the previous tax period (usually, but not always, a calendar year). In certain cases including tax payable by larger companies (the financial statements of which are subject to mandatory audit) and by taxpayers whose tax return is being submitted by a qualified tax advisor and who have notified the tax authority of this in advance, the income tax is payable not later than within 6 months following the end of the tax period.

In addition to the final settlement of tax due, taxpayers are also liable to pay semi-annual tax advances on account of corporate income tax if their most recent known tax has exceeded CZK30,000 (approximately €1,200), or quarterly tax advances if their most recent known tax has exceeded CZK150,000 (approximately €6,000).

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base for income from general business operations is determined on the basis of profits pursuant to commercial accounts (set up in accordance with the national accounting standards and always free of any impact of the IFRS) subject to certain adjustments (see question 4.4).

The tax base is determined differently in certain cases including income subject to withholding tax, profit distributions and other similar income sourced abroad, and taxation of some permanent establishments of non-residents.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The profits or losses ascertained on the basis of the commercial accounts have to be adjusted (increased or reduced by certain items) for the purpose of setting the tax base. The most notable difference stems from the fact that the tax depreciation of fixed assets usually differs from the accounting depreciation of the same.

The items increasing the tax base include for example, the following:

- amounts shown in the accounting which, according to the Income Taxes Act, cannot be included in expenses or can be included therein only in a limited manner (e.g., disallowed expenses such as business entertainment, remuneration of corporate directors, costs relating to revenues excluded from the tax base, certain travel expense reimbursements, certain types of damages, interest that cannot be claimed due to the thin capitalisation rules);
- amounts not included in the accounting for which the tax base is raised (e.g., non-cash income as a result of transfer pricing policy); and
- in certain events the profits must be increased by amounts accounted for as an expense if not actually paid (contractual penalties, social security and medical insurance).

The items reducing the tax base include, for example, the following:

- amounts not included in the accounting for which the tax base may be reduced (e.g., claim of a tax loss from previous years, research and development project expenses);
- revenues exempt from tax (e.g., income from small water power plants) or revenues that are a part of a separate, and not the general, tax base;
- revenues taxed by withholding at a special tax rate; and
- in certain cases, it is possible to lower the profits by amounts accounted for as an expense in a preceding accounting period provided that the payment thereof is made by the company in the current period (e.g., contractual penalties, social security and medical insurance).

4.5 Are there any tax grouping rules? Do these allow for relief in the Czech Republic for losses of overseas subsidiaries?

No, Czech law does not recognise any income tax grouping rules and taxation on a consolidated basis is not applied.

Tax grouping rules have been introduced for the purposes of VAT; the application of the VAT tax grouping is, however, optional.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, taxation at the corporate level does not differentiate between distributed and retained profits and the rate of corporate income tax is not dependent on the fact whether the company allocates the profit from its business activity or not.

4.7 What other national taxes (excluding those dealt with in “Transaction Taxes”, above) are there - e.g. property taxes, etc.?

Other direct taxes applicable to legal entities are:

- real estate tax; and
- road tax.

4.8 Are there any local taxes not dealt with in answers to other questions?

In addition to the aforesaid taxes, there are no taxes imposed at the local level. Local governments can, however, assess quasi-tax payments known as “local fees”. From among a wide array of local fees the following may be particularly relevant to companies as fee-payers:

- fees on admission;
- fees on accommodation capacity;
- fees on operation of winning game slot machines;
- fees on using a public area; and
- fees on an improvement of a construction land parcel by possible connection thereof to a water main or sewage.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Generally, there are no substantial special rules for taxing capital gains and losses.

Subject to the conditions set forth by Czech tax law, capital gains made on the transfer of a qualifying subsidiary are exempt from corporate tax. (See question 5.3.)

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5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

There is no different rate and the standard corporate income tax rate applies unless the relevant capital gain is exempt (see question 5.1).

5.3 Is there a participation exemption?

Yes, similarly as in the case of exemption connected with the dividend payments (see question 3.1), a participation exemption will generally apply in the Czech Republic to income derived by the Czech resident shareholder or a company resident in another EU Member State or Norway or Iceland from the sale of shares (ownership interests) in a Czech subsidiary or other subsidiary resident in the EU or Norway or Iceland, or a country with which the Czech Republic has concluded a double taxation treaty (irrespective of the actual text of such treaty).

The above exemption relating to the sale of shares (ownership interest) requires the participation of the selling shareholder on the subsidiary of at least 10% for an uninterrupted period of 12 months. As for the sale of shares in a foreign non-EU/EEA subsidiary, in addition to the foregoing participation requirement the following pre-requisites must be met: (i) the subsidiary is a resident of a country with which the Czech Republic has concluded a double taxation treaty; (ii) the subsidiary has a legal form similar to a Czech joint stock company, limited liability company or cooperative; and (iii) the subsidiary is subject to corporate tax comparable to the Czech Republic taxation (generally, at a rate of at least 12% and on a similar basis).

5.4 Is there any special relief for reinvestment?

In principle, Czech tax regulations do not link the capital gains exemptions or similar tax relief to reinvesting company's profit, e.g., into the acquisition of the same category of capital asset.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

Formation of a company in the Czech Republic is not subject to any capital or other tax.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

In principle, the taxation of a Czech subsidiary and a Czech branch of a non-resident is subject to identical rules. The only material difference is that in some cases the tax base of a branch (but not a subsidiary) may be determined on the basis of other criteria than profits based on commercial accounts. Such determination is made by the tax authorities only after the formation of the branch and is therefore not of much use for advance tax planning.

In case of a Czech branch of a non-EU resident or non-EEA resident, the deduction from the income paid to it has to be made; such deduction serves as a tax security and is offset against the final Czech tax liability of the branch. Such deduction is not required in case of payments to a Czech subsidiary of a non-EU resident or non-EEA resident.

6.3 How would the taxable profits of a local branch be determined?

In case of a branch, generally only the income gained from its Czech-related activity is subject to income tax. This means that generally the same rules and regulations apply (e.g., the admissibility of tax expenses of the branch, the rate of tax, the list of items increasing and reducing the tax base, admissibility of a tax loss) unless Czech tax law provides otherwise. An important difference resides in the fact that the tax base on a branch can be determined on the basis of other criteria than just profits shown in the branch's corporate accounts (e.g., a commission on sales by the branch, the gross amount of the branch's expenses, the number of the branch's employees, etc.). The level of such-determined tax base, however, cannot be lower than that of Czech resident companies involved in the same business activity.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is neither a special tax set in the Czech Republic for branches nor any special rate under the existing income tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

While many of the benefits under tax treaties apply only to income not generated through a branch (e.g., dividends, interest, royalties or capital gains) there are still considerable advantages provided by tax treaties to branches such as the application of the non-discrimination principle. On the basis of tax treaties, for example, a branch in the Czech Republic may not be imposed a larger tax liability than a Czech company involved in the same type and extent of business; it may deduct from its tax base, in addition to its own expenses, also relevant expenses incurred by the head office outside of the Czech Republic.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Remittance of net profits by the branch of a non-resident company to (the head office of) such non-resident company is treated as intra-company financial transfer and as such is not subject to any withholding tax or other tax. As described under question 6.3, Czech tax law sets forth rules regarding calculation of the tax base of the Czech branch preventing such branch from transferring its profits to its head office without such profits being first duly taxed at the branch.

7 Anti-avoidance

7.1 How does the Czech Republic address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Czech tax law contains very few specific provisions relating to avoidance schemes (e.g., anti-avoidance rules for the utilisation of losses carried forward, for tax-neutral mergers, de-mergers and corporate reorganisation, etc.) and the issue of preventing tax avoidance is regulated mainly on a general level only (e.g., by means of the substance-over-form rule or the transfer pricing

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provisions). Also, sound economic and business reasons other than just tax-saving are expressly required in certain kinds of transactions by law and generally in most if not all transactions by tax practice, in order to give rise to beneficial tax consequences of the same. With the exception of an advance notification of a tax-neutral merger, de-merger or corporate reorganisation, there are no anti-avoidance advance disclosure rules.

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Salans is a full service international law firm with more than 20 offices worldwide. Reflecting the globalisation of business, the firm represents clients from all over the world in a broad range of cross-border transactions and disputes. At the same time, each Salans office provides a full spectrum of in-depth legal services for local law matters. The combination of international capability and domestic expertise enables Salans to provide comprehensive services matching the needs of global and local clients alike. The firm has around 800 lawyers of more than 20 nationalities, qualified to practice law in each of the jurisdictions in which Salans is present. Each Salans office provides wide-ranging expertise in such fields as arbitration, banking and finance, bankruptcy, commercial transactions, competition law, employment law, intellectual property, litigation, M&A, property, securities, taxation, technology and telecommunications.

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Ecuador

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Ecuador?

Ecuador has in effect twelve bilateral income tax treaties with the following countries: Belgium; Brazil; Canada; Chile; Spain; France; Germany; Italy; Mexico; Romania; and Switzerland. An income tax treaty specifically for air transportation matters is in force in Argentina.

In addition, as a Member State of the Andean Community of Nations (CAN), Ecuador complies with CAN DECISION 578, which contains the Regime for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion among Member States.

Lastly, Ecuador has also signed the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties.

1.2 Do they generally follow the OECD or another model?

The majority of bilateral treaties signed by Ecuador follow the OECD model. This is because almost all of the countries with which it has signed this kind of agreement have adopted the OECD rules.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

These treaties only require ratification from the President and take effect in Ecuador once published in the Official Gazette; they do not require approval from the National Assembly.

Furthermore, once approved by the Commission, Andean Community Decisions are subject to a specific procedure defined by CAN rules in order to become effective in each Member State.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Only articles 11 and 12 of the treaties signed with Chile and Mexico incorporate anti-treaty shopping rules, aimed at avoiding any attempt to benefit from the rules of the agreement with regard to interest and royalties. The remaining treaties do not incorporate anti-treaty shopping rules.

Treaty with Chile

Interest Article 11(7). The provisions of this article shall not apply if the purpose or one of the main purposes of any person related to the creation or attribution of a loan with regard to which interest is paid, is to benefit from this article by such creation or attribution.

Royalties Article 12(7). The provisions of this article shall not apply if the purpose or one of the main purposes of any person related to the creation or attribution of the right with regard to which royalties are paid, is to benefit from this article by such creation or attribution.

Treaty with Mexico

Interest Article 11(9). The provisions of this article shall not apply if the loan for which interest is paid was made or assigned mainly for the purpose of obtaining a benefit from this article.

Royalties Article 12(7). The provisions of this article shall not apply if the right or property for which royalties are paid was made or assigned mainly for the purpose of obtaining a benefit from this article.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Pursuant to the Constitution, the rules contained in international treaties and agreements, once published in the Official Gazette, become part of Ecuadorian legislation and prevail over internal laws and other lesser ranking rules and, therefore, cannot be overridden by the rules of domestic law.

2 Transaction Taxes

2.1 Are there any documentary taxes in Ecuador?

No, there are no documentary taxes.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. Ecuador has a sole rate for Value Added Tax (VAT) which is 12%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

As a general rule, VAT applies to all imports and transfers of tangible movable goods produced in the country, as well as to all services rendered locally. The 2010 tax reform included the transfer of intellectual property rights as a taxable transaction.

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The following transfers, however, are not subject to VAT: (i) contributions made in kind to companies; (ii) awards from inheritance or liquidation of partnerships, including the liquidation of community property; (iii) sale of businesses in which assets and liabilities are transferred; (iv) mergers, spin-offs and conversions of companies; (v) donations to entities of the public sector and to legally-organised private charity, cultural, educational, research, health or sports institutions and associations; and (vi) assignment of shares, equity interests and other securities. Only if it is expressly provided under the law will the rendering of specific services, imports or transfers of certain goods within domestic territory be exempt from VAT.

Exempt goods are taxed at 0% and include the following among others: (i) food products deriving from agriculture, aviculture, livestock, apiculture, rabbit breeding, bio-aquatic, or forest source, meats in their natural state, sausages and fish kept in their natural state; (ii) milk in its natural state, pasteurised or homogenised, or locally produced powdered milk, cheese and yogurt, baby formula and children protein foods; (iii) various basic foodstuffs, i.e. bread, sugar, pasta, and animal oil, among others; (iv) various farming inputs; (v) various farming vehicles and equipment; (vi) medicines and drugs for human use; (vii) bond paper and books; (viii) export goods; (ix) selected articles imported by certain officers or for specific purposes established in the law; (x) goods sold to public entities or public enterprises; (xi) energy; and (xii) fluorescent lamps.

Exempt services are taxed at 0% and include the following, among others: (i) transportation of passengers and cargo, whether by river, sea or land, as well as the international air transport of cargo and air transport of cargo to, within and from the Province of Galapagos, including of the shipment of crude oil through pipelines and natural gas through gas pipes; (ii) health services, including pre-paid medical services and medicine production services; (iii) rent or lease services for immovable property used only as housing; (iv) public services of electrical power, potable water, sewage systems, and garbage collection; (v) all educational services; (vi) daycare services for children and homecare services for the elderly; (vii) religious services; (viii) book printing services; (ix) funeral services; (x) administrative services provided by the State and entities of the public sector; (xi) public entertainment services; (xii) financial and stock exchange services; (xiii) export services; (xiv) pre-paid tourism packages; and (xv) toll and like services provided to public entities or enterprises.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

VAT is levied at every stage of production with a tax credit mechanism that prevents a cascade tax effect, hence the input tax paid at the time of importation or purchase of a good or service may be fully compensated with the output tax charged on the sale of goods and/or the provision of services subject entirely to a 12% VAT rate. This treatment includes VAT paid on imported or purchased goods that become part of the taxpayer's fixed assets, including intangible assets.

Therefore, as a rule of general mandatory application, taxpayers are entitled to a tax credit for 100% of the VAT paid on their acquisitions, as long as such acquisitions are employed fully in the production and marketing of taxable goods and services. Subsequently, tax credit is not granted for VAT paid on acquisitions employed in the production and marketing of exempted (zero-rated) goods or services.

For taxpayers supplying both taxable and zero-rated goods or services, VAT paid on acquisitions that cannot be directly attributable to either must be apportioned between supplies. The law provides for the standard method of apportionment fixed on a monthly basis; this is, the ratio of taxable supplies to total supplies expressed as a percentage. Alternatively, the Internal Revenue Service (SRI) may allow these taxpayers to use the full credit if they have bookkeeping systems enabling them to differentiate the VAT paid and attributable to taxable supplies from the VAT paid and attributable to zero-rated supplies.

VAT paid on inputs for exported goods is fully reimbursed. However, as of January 2008, exports derived from petroleum activities or activities related with non-renewable natural resources are not entitled to such VAT refunds.

2.5 Are there any other transaction taxes?

An excise tax called ICE is levied on the importation or distribution of specific goods, among others: cigarettes; beer; carbonated beverages; alcohol; alcoholic beverages; motorised vehicles for ground transportation with a cargo capacity of up to 3.5 tonnes; small aircraft not used for the commercial transport of passengers, cargo or services; and jet-skis, ATV's, yachts and recreational boats.

The ICE rate fluctuates between 5% and 300% depending on the good subject to this tax.

2.6 Are there any other indirect taxes of which we should be aware?

No, there are no indirect taxes to mention.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Only the income earned by companies established or domiciled in Ecuador is subject to Ecuadorian income tax (25%). Dividends and profits paid or credited by local companies to resident companies and to non-resident individuals are tax-exempt. Dividends paid or credited by local companies to resident individuals are not tax-exempt and hence subject to withholding. However, dividends paid or credited by foreign companies to Ecuadorian residents are also tax-exempt as long as they are not remitted from a tax haven country, in which case such payment becomes part of the recipient's taxable income. Dividends paid or credited by a local company to non-resident companies are also tax exempt, except when such non-resident companies are domiciled in a tax haven or a lower tax jurisdiction country, in which case they are subject to tax withholding at a rate of 10%.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties remitted or credited overseas are subject to a 25% WHT at source, except when subject to lower rates under bilateral tax treaties signed by Ecuador.

If the party obligated to make the withholding fails to do so, it will be jointly liable for paying the tax. In this case, the royalties paid or credited overseas will not be deductible as an expense.

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3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

As of January 2008, interest of an Ecuadorian source paid or credited abroad is subject to a 25% WHT under Ecuadorian income tax law and may be deducted as long as the corresponding foreign loan was registered with the Central Bank of Ecuador and rates do not exceed those fixed by such entity. Foreign loans between related parties cannot exceed 300% of the company's equity accounts; otherwise interest derived therefrom will not be deductible. Whoever pays or credits the interest is jointly liable for payment and cannot otherwise deduct it as an expense.

Only interest payable or credited on government to government loans and on loans granted by multilateral entities, such as the World Bank, CAF or BID, are not subject to WHT, as long as the loan is registered with the Central Bank and the interest thereon does not exceed the maximum referential rate set by the Central Bank. If such a loan accrues interest over the maximum referential rate, the 25% WHT will apply on the excess of such rate.

If the foreign loan and its subsequent instalments are not registered with the Central Bank, interest will not be deductible as an expense.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The only restriction applicable to interest payments which refers to "thin capitalisation" rules is the one mentioned in question 3.3.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Ecuadorian tax legislation does not include "safe harbour" provisions in this respect. Please see question 3.3.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes. It applies to all foreign loans granted directly or indirectly between related parties. Please see question 3.3.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

In addition to the registration requirements mentioned in question 3.3, the rate of interest cannot exceed the maximum referential rate fixed by the Central Bank.

3.8 Does Ecuador have transfer pricing rules?

Yes it does.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Ecuador has a flat corporate tax rate of 25%. Nevertheless, only companies reinvesting their earnings to acquire new machinery or equipment to be employed in their production activities or technology in order to increase their productivity may reduce their income tax rate to 15% on reinvested profits as long as their share capital is increased accordingly, and their bylaws are amended and duly registered in the Mercantile Register by December 31 of the following fiscal year.

4.2 When is that tax generally payable?

Corporate tax is generally assessed for the calendar year. Companies may file their tax return from February until April of the following fiscal year. Failure to do so is subject to fines and interest.

Taxpayers, including companies, must state in their returns the advance income tax payment for the current fiscal year. The advance payment is made in two equal instalments in the months of July and September of the year in progress. For an explanation on how to calculate these advance payments, we recommend consulting a local attorney.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base is assessed on the annual global income registered in the books, excluding exempt income (i.e., dividends, occasional capital gains and the like) and subtracting business-related expenses as well as other legal and regulatory applicable deductions. Non-deductible expenses will be added back to the tax base and these and other such adjustments will be reflected in the tax return.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The Internal Tax Regime establishes a list of non-deductible expenses. The important ones are listed below:

- Interest or financial costs arising from foreign loans not registered at the Central Bank of Ecuador, or arising from foreign loans exceeding 300% of equity accounts.
- Lease payments arising from lease contracts between related companies. Payments of this kind remitted to tax haven countries are regarded as transactions between non-arm's length companies.
- Losses arising from the transfer of assets when the transaction is between related companies.
- Depreciation provisions for account receivables exceeding 1% per year and 10% cumulative.

The Law permits tax losses to be carried forward for a period of 5 years without exceeding 25% of the year's taxable income.

4.5 Are there any tax grouping rules? Do these allow for relief in Ecuador for losses of overseas subsidiaries?

Ecuadorian legislation does not permit the consolidation of accounts of companies pertaining to the same business group for tax purposes; accordingly, there is no relief for losses of local or overseas subsidiaries. Each company belonging to the same business group must determine its tax base and applicable income tax on the basis of its own financial statements.

It should be noted that, for purposes of determining employee profit-sharing, referred to in question 4.7.3 below, it is possible to consolidate the profits of companies engaged in businesses related to the same productive process, so that workers of all of these companies may have a share in the consolidated profits.

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4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Profits and dividends are exempt from income tax, except when distributed to resident individuals or foreign companies domiciled in a tax haven or lower tax jurisdiction country, in which case such profits or dividends are subject to 10% WHT, in the terms explained in the answer to question 3.1 above. If the shareholders at their annual meeting approve the reinvestments of profits and meet the applicable requirements, as explained in the answer to question 4.1 above, the company may benefit from a reduction in income tax to 15% levied on the amount of profits reinvested, instead of the normal 25% corporate tax rate.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

4.7.1. Superintendency of Companies contribution: all companies subject to the oversight of the Superintendency of Companies must pay an annual contribution of up to 0.1% over assets, with the Superintendency having the power to set such contribution within this limit. Presently, the Superintendency has set the contribution within a range of 0.065% to 0.085% over tangible assets.

4.7.2. Production chamber dues: companies organised in Ecuador must be affiliated with a production chamber and pay annual or monthly dues, as the case may be, which vary depending on the chamber of affiliation and the capital of the member company.

4.7.3. In accordance with the Labour Code, workers are entitled to participate in 15% of the profits, before taxes, earned by the company for which they work. Although the workers' share is not a tax but rather a labour burden, its effect upon the company's earnings is equal to that of a tax. It should be noted that employee profit-sharing is a deductible expense when determining the tax base subject to income tax.

4.7.4. A Capital Exit Tax is a levy at a rate of 2% on every payment, credit or cash remitted abroad. Under this new law, there are no exemptions either for import payments or foreign loan payments.

4.8 Are there any local taxes not dealt with in answers to other questions?

a) **Tax on total fixed assets:**

Natural or juridical persons who ordinarily engage in commercial, industrial and financial activities for which they must keep books, pursuant to the rules of the Internal Tax Regime Law, are required to pay the municipality where they carry out their activities an annual tax equal to 0.15% of their total assets, for which they may deduct only current liabilities and contingent liabilities. When a company's activities are carried out in two or more counties, the tax is distributed among all of the counties where the company operates.

b) **Property tax:**

- The value of urban property is subject to a percentage tax fluctuating between a minimum of 0.25% and a maximum of 0.5%, which is determined in an ordinance by each municipal council in whose jurisdiction the taxed immovable property is located.
- The value of rural property is subject to a percentage tax fluctuating between a minimum of 0.25% and a maximum of 0.3%, which is set in an ordinance by each municipal council.
- **Municipal patent:** all merchants and industrialists operating in a county as well as those engaging in any economic activity are obligated to obtain an annual patent from the municipality where they carry out their activities. Each municipality issues an ordinance stating the annual tax rate based on the operating capital of the taxpayers within the county. The minimum rate is US$10 and the maximum US$5,000.
- **Transfer tax on immovable property:** the base for calculating this tax is the contract price. If the price is less than the property appraisal stated in the cadastre, the latter will prevail. One percent is applied over the tax base. Taxes in addition to the property taxes created or to be created by special laws are charged together with the main tax unless the law creating them stipulates collection by another agent of the municipal treasury. The amount of the additional tax cannot exceed 50% of the base rate determined in the preceding article, and the sum of additional taxes cannot exceed 100% of the base rate. In the case that it does, only an amount equal to said 1% will be charged and will be distributed among the participants.
- **Increased property value tax:** municipalities are entitled to charge a 10% tax on the gain from the sale of urban immovable property. In addition to other deductions considered for determining the tax base, for each year after the second year counted from the date of purchase, 5% will deducted each year and this tax cannot be charged after 20 years from the purchase.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

No. Although exempt from income tax, income resulting from the occasional sale of immovable property, stock or equity interest is subject to income tax when earnings are the result of transactions pertaining to the normal course of the taxpayer's business or its ordinary activities. Capital gains or eventual losses incurred must be reflected in the company's financial statements and are subject to the general rules regulating the determination of the tax base and applicable income tax.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

This is not applicable in Ecuador. Please see the answer to question 5.1.

5.3 Is there a participation exemption?

The only exemption provided under Ecuadorian Tax Law concerns the occasional gains resulting from the sale of immovable property, stock or equity interest, as explained in question 5.1 above. If not exempt, capital gains will be included in the company's tax base and taxed accordingly at the 25% rate when earnings are not reinvested, as explained in question 4.1.

5.4 Is there any special relief for reinvestment?

No, there is no special relief for reinvestment.

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6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The formation of subsidiaries is not subject to taxes.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no other significant taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

The determination of the tax base of branches of foreign companies is subject to the same rules for determining the taxable earnings of companies organised under Ecuadorian law.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

The branches of foreign companies are subject to the same tax regime as companies organised under Ecuadorian law.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

The bilateral treaties that Ecuador has signed for avoiding double taxation and fiscal evasion regard branches of foreign companies as permanent establishments for all purposes contemplated in the respective treaties.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

The remittance to or credit in an account of the parent company by its Ecuador branch is subject to the same tax treatment discussed in questions 3.1 and 4.1 for the case of companies organised under Ecuadorian law.

7 Anti-avoidance

7.1 How does Ecuador address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The general anti-avoidance rule is included in Chapter II of the Ecuadorian Tax Code under the provisions related to taxable events. This rule is based on the principle of "economy reality", which enables the judge to disregard the legal forms employed by the taxpayer to achieve the taxable event in line with its economic significance. Nonetheless, no special rules on anti-avoidance or disclosure avoidance schemes have been implemented.

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El Salvador

Arias & Muñoz

Luis Barahona

1 General: Treaties

1.1 How many income tax treaties are currently in force in El Salvador?

Recently, El Salvador ratified its first Income Tax Treaty, signed with the Kingdom of Spain, which became effective on January 1, 2009.

1.2 Do they generally follow the OECD or another model?

Yes, it does.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes, according to our Constitution, International Treaties must be ratified by Congress in order for them to become effective in El Salvador.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Not applicable.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

According to our Constitution, ratified International Treaties shall always prevail over domestic laws.

2 Transaction Taxes

2.1 Are there any documentary taxes in El Salvador?

No, presently there are no documentary taxes in our jurisdiction. Tax stamps were abolished in El Salvador in 1992.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes, there is a law denominated "*Ley de Impuesto a la Transferencia de Bienes Muebles y a la Prestacion de Servicios*" (Value Added Tax Law). The rate is 13% over the tax generating transfer, rendering of services or importation. Exportations are not subject to this tax.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Specific exemptions exist within the VAT Law, as follows:

Importations

a. Those made by diplomatic and consular representations of foreign nations and its agents accredited in the country, in accordance to the international treaties subscribed and approved by El Salvador and subject to reciprocity condition.

b. Those made by international institutions and organisations to which El Salvador is part and by its officers, when preceded in accordance to the international treaties subscribed by El Salvador.

c. Goods imported by passengers, crew members, airship and other vehicles, when they fall under traveller's luggage regime and such species are exonerated of customs rights.

d. Goods donated from abroad to certain entities provided by the Income Tax Law.

e. Donations in accordance to treaties granted by El Salvador.

f. Those made by the municipalities, when the imported goods are of a direct benefit to the respective community.

g. Machinery imported by the taxpayers duly registered in the Tax Payers' Registry, destined to be included in their fixed assets, and to be used in the goods and services production.

   In order to be able to **enjoy** this exemption, the taxpayer shall register the specific goods to be imported, in a registry that shall be taken by the Internal Revenue Bureau (*hereinafter referred to as the "Bureau"*) at least 30 days prior to the importation date.

   The Bureau shall establish the necessary requirements, documents and proceedings to register such goods.

   The imported goods' registered price shall be the effective international price to the definitive importation date, which shall be subject to investigation.

h. Buses, shuttle vans and vehicles for lease, dedicated to public transportation. These vehicles may only be transferred after 5 years of the importation date and respective licence legalisation.

Services

The following services shall be exempt of tax payment:

a. Health services provided by public institutions and public utility institutions qualified by the Bureau.

b. Lease, sublease or temporary assignment of use of real estate

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destined for housing.

c. Those rendered in a dependency relation regulated by the labour legislation, and those rendered by the public, municipal and autonomous institution employees.

d. Public and cultural events qualified and authorised by the Bureau.

e. Education services provided by schools, universities, institutes, academies and other similar institutions.

f. Deposit operations, and other forms of money receipt and loans, in relation to interest payment or generation carried out by Banks, or any other Financial institution supervised by the Financial System Superintendence, Cooperative Associations or Savings and Loans Cooperative Companies, Foreign Financial Institutions registered in the Central Bank, Public or Public Utility Foundations and Corporations, dedicated to financial concessions.

g. The issuance and placement of Credit Instruments by the State and autonomous official institutes as well as those carried out by private entities, whose primary offer has been made public through an authorised stock exchange institution, in relation to the payment or generation of interest.

h. Water supply services and sewer services, provided by public institutions.

i. Public land transportation services.

j. Personal insurance premiums as well as reinsurances in general.

k. The contributions made by the employer to the Pension Fund Administrators (AFP's) in regard to the commission (fees) of management employees account.

l. The operations made by the National Lottery Charities.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Yes, the nature and structure of the VAT tax allows the monthly application of credits against debits generated through said tax; this allows its effect to be neutral in regards to its application by merchants.

One of the relevant restrictions issued by the tax legislation is that the VAT tax does not constitute a cost or expense in regards to the goods or services rendered.

2.5 Are there any other transaction taxes?

No, in regards to the transfer of goods or rendering of services, this is the only applicable tax (with a 13% tax rate); however, there is another tax specific to the transfer of Real Estate, which is regulated through the Real Estate Transfer Tax Law, the rate of which stands at 3%, over the excess of US$28,571.43.

2.6 Are there any other indirect taxes of which we should be aware?

Other indirect taxes exist, which are regulated by laws such as: The Tobacco Product Tax Law, Production and Commercialisation of Alcohol and Alcoholic Beverages Regulation Law, Carbonated Unflavoured and Sweetened Beverage Tax Law, etc.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

There is no withholding tax imposed on dividends paid by a resident company to a non-resident as long as the taxes corresponding to said income have been declared and paid by the payer of the dividend. If that is not the case, the non-resident shareholder that perceives them must pay the respective tax through a 20% withholding that the local company is obligated to apply; or 25% if the non-resident is ubicated in a tax haven country.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes, according to Salvadoran Income Tax Law, any person or company who/which makes any payment in concept of royalties to a foreign person or entity shall retain 20% of such payment as withholding tax; or 25% if the non-resident is ubicated in a tax haven country.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes, a certain percentage must be withheld as Income Tax from a non-resident person or company that obtains income as interest or any other type of income from a local company. The applicable rate is 20% over the earned income, in accordance to Article 158 of the Tax Code; or 25% if the non-resident is ubicated in a tax haven country, in accordance to Article 158-A of the Tax Code.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

No such rules exist in our legislation.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The possibility of a safe harbour exists only when the respective income tax is paid by the local company.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

No thin capitalisation rules exist in Salvadoran law.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No, there are not any restrictions on tax relief for interest payments by a local company to a non-resident.

3.8 Does El Salvador have transfer pricing rules?

Yes, the Tax Code establishes transfer pricing rules at Articles 62-A, 199-A, 199-B, 199-C and 199-D, but they are limited in the procedures of the determination and in regards to operations between related subjects.

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4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax on corporate profits is 25%.

4.2 When is that tax generally payable?

The corresponding tax must be paid within the first four months following the finalisation of the fiscal year, which ends on December 31.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The base to calculate such tax is the taxable income, which is determined by deducting the costs and expenses necessary for the production of such income, from the gross income, in a fiscal year.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

No, for these effects, this type of differentiation does not exist in our legislation.

4.5 Are there any tax grouping rules? Do these allow for relief in El Salvador for losses of overseas subsidiaries?

There are no tax grouping rules.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

A different rate is not imposed upon distributed as opposed to retained profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There are no other national taxes, apart from that mentioned above.

4.8 Are there any local taxes not dealt with in answers to other questions?

All municipal taxes, since every one of the 262 different municipal districts have different taxes, rates and conditions. Every single municipal district has its own tax laws, ordinances and municipal services tax rates.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes, our Income Tax Law establishes special rules that must be applied by persons or companies that obtain income through capital gains.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

In accordance to what is dictated in the Income Tax Law, the percentage to be taxed for Capital Gains is 10%, any time the sale/transfer takes place 12 months after having acquired the good.

5.3 Is there a participation exemption?

The Tax Laws do not contemplate any type of participation exemption.

5.4 Is there any special relief for reinvestment?

The Tax Laws do not contemplate any type of special relief for reinvestment.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The application of taxes for a subsidiary or affiliated company in the country has the same fiscal treatment as a domiciled company, with all its rights and duties granted by the tax laws.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no other significant taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

They are determined just as they are determined for the income of local subsidiaries.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

A branch is not subjected to a branch profits tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

This is not applicable since they receive the same treatment as local companies.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Yes, according to Salvadoran Income Tax Law, when the branch makes any remittance of profits, it shall retain 20% of such payment as withholding tax (Article 158 Tax Code); or 25% if the non-resident is ubicated in a tax haven country.

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7 Anti-avoidance

7.1 How does El Salvador address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is not a general anti-avoidance rule; however, every year, the Tax Authority executes inspection plans to avoid the tax evasion.

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He is a specialist in taxes, with more than twelve years of experience. Luis developed his professional career in the Internal Revenue Bureau ("*Dirección General de Impuestos Internos*") of the Ministry of Treasury of the Republic of El Salvador, holding various positions, including Head of the Legal Department of the Internal Revenue Agency and General Director of Internal Revenues until May, 2008.

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Estonia

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Estonia?

Estonia has currently 44 income tax treaties in force (see the list below). The treaties between Estonia and Serbia, and Estonia and South Korea came into force in 2010 and will be effective from 1 January 2011.

Country	Beginning of validity	Riigi Teataja (State Gazette)
Republic of Latvia	01.01.2002 (retroactively)	RT II 2002, 33, 157
Kingdom of Norway	01.01.1994	RT II 1993, 32/33, 108
Kingdom of Denmark	01.01.1994	RT II 1993, 34, 109
Kingdom of Sweden	01.01.1994	RT II 1993, 35, 110
Republic of Lithuania	01.01.2006	RT II 2005, 24, 83
Republic of Finland	01.01.1994	RT II 1993, 37, 113
Federal Republic of Germany	01.01.1994 (retroactively)	RT II 1997, 20, 94
United Kingdom of Great Britain and Northern Ireland	01.01.1995	RT II 1994, 32/33, 139
Republic of Poland	01.01.1995	RT II 1994, 32/33, 140
Kingdom of the Netherlands	01.01.1995 (retroactively) Protocol amending the convention between the Kingdom of the Netherlands and the Republic of Estonia, with protocol 01.1.2005 (retroactively) Protocol amending the convention between the Kingdom of the Netherlands and the Republic of Estonia, with protocol 01.01.2010	RT II 1997, 37, 125 RT II 2006, 6, 10 RT II 2009, 11, 27
Republic of Iceland	01.01.1996	RT II 1994, 30/31, 131
Czech Republic	01.01.1996	RT II 1995, 1, 1
Canada	01.01.1996	RT II 1995, 44, 199
French Republic	01.01.1996 (retroactively)	RT II 1998, 16/17, 31
Ukraine	01.01.1997	RT II 1996, 42, 172
Republic of Belarus	01.01.1999	RT II 1998, 16/17, 30
Republic of Moldova	01.01.1999	RT II 1998, 33/34, 63
Republic of Ireland	01.01.1999	RT II 1998, 33/34, 62
United States of America	01.01.2000	RT II 1998, 40/41, 94
People's Republic of China	01.01.2000	RT II 1998, 52, 119
Republic of Kazakhstan	01.01.2001	RT II 2000, 16, 96
Italian Republic	01.01.2001	RT II 1998, 18/19, 32
Swiss Confederation	01.01.2005	RT II 2004, 18, 79
Republic of Hungary	01.01.2005	RT II 2004, 19, 81
Kingdom of Spain	01.01.2005	RT II 2004, 41, 150
Romania	01.01.2006	RT II 2005, 26, 89
Republic of Turkey	01.01.2006	RT II 2005, 4, 12
Slovak Republic	01.01.2007	RT II 2005, 26 ,88
Republic of Slovenia	01.01.2007	RT II 2006, 13, 36
Hellenic Republic	01.01.2007	RT II 2006, 26, 69
Grand Duchy of Luxembourg	01.01.2008	RT II 2007, 1, 2
Republic of Singapore	01.01.2008	RT II 2007, 19, 55
Republic of Georgia	01.01.2008	RTII 2007, 23, 66
Republic of Azerbaijan	01.01.2009	RT II 2008, 26, 73
Republic of Bulgaria	01.01.2009	RT II 2008, 33, 100
Republic of Macedonia	01.01.2010	RT II 2009, 15, 39
Isle of Man	01.01.2010	RT II 2009, 30, 86
State of Israel	01.01.2010	RT II 2009, 30, 87
Republic of Serbia	01.01.2011	RT II 2009, 31, 93
Republic of Korea	01.01.2011	RT II 2009, 31, 92

1.2 Do they generally follow the OECD or another model?

Yes, they do generally follow the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes, treaties have to be incorporated into domestic law before they take effect.

The Government of the Republic of Estonia signs international agreements and presents to the Parliament of Republic of Estonia, the *Riigikogu*, those treaties that need ratification. The parliament

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ratifies agreements via approving a law. The President of the Republic of Estonia shall proclaim the law passed in the parliament and after that the ratification law is published in the State Gazette.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

No, they do not incorporate anti-treaty shopping rules.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

According to the Constitution of the Republic of Estonia, Estonia shall not enter into international treaties which are in conflict with the Constitution. If laws or other legislation of Estonia are in conflict with international treaties ratified by the Parliament of the Republic of Estonia, the provisions of the international treaty shall apply.

2 Transaction Taxes

2.1 Are there any documentary taxes in Estonia?

Yes, for example, state fees and notary fees.

A state fee is a sum payable in the cases provided by law in an amount established by the State Fees Act for the performance of an act for which a state fee is charged. A notary fee means the fee paid to a notary for the performance of a notarial act and related legal or technical services.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes, there is Value Added Tax (hereinafter VAT) in Estonia. The standard rate of VAT is 20% of the taxable value, the reduced rate is 9% and 0% in some cases.

The rate of VAT on the following goods and services shall be 9% of the taxable value:

- books and work exercise-books used as learning materials;
- medicinal products, contraceptive preparations, sanitary and toiletry products, and medical equipment or medical devices intended for the personal use of disabled persons within the meaning of the Social Welfare Act and specified in the list established by a regulation of the Minister of Social Affairs;
- medicinal products, contraceptive preparations, sanitary and toiletry products, and medical equipment or medical devices intended for the personal use of disabled persons within the meaning of the Social Welfare Act and specified in the list established by a regulation of the Minister of Social Affairs, and the grant of the use of such medical devices to disabled persons; and medicinal products, contraceptive preparations, sanitary and toiletry products, and medical equipment or medical devices intended for the personal use of disabled persons within the meaning of the Social Welfare Act and specified in the list established by a regulation of the Minister of Social Affairs, and the grant of the use of such medical devices to disabled persons;
- periodic publications, excluding publications mainly containing advertisements or personal announcements, or publications of which the content is mainly erotic or pornographic; and
- accommodation services or accommodation services with breakfast, excluding any goods or services accompanying such services.

The rate of VAT on the following goods and services shall be 0% of the taxable value:

- exported goods, excluding cases where the supply of such goods is exempt from tax;
- goods where their transfer and transport to another Member State of the European Community (hereinafter Member State) or transport to another Member State without transfer is deemed to be an intra-Community supply of goods. This provision does not apply in cases where the supply of goods is exempt from tax or the acquirer of the goods, except for new means of transport or excise goods, or where the transferor of own goods to another Member State has no valid number of registration as a taxable person or taxable person with limited liability issued in the other Member State;
- sea-going vessels navigating in international waters, except pleasure crafts used for purposes other than those of business interests, and equipment, spare parts, fuel and other supplies used on such sea-going vessels and goods to be transferred to passengers for consumption on board, except goods sold on board sea-going vessels during intra-Community passenger transport to be taken away;
- aircraft used by an air carrier operating mostly on international routes and equipment, spare parts, fuel and other supplies used on such aircraft and goods to be transferred to passengers for consumption on board, except goods sold on board of such aircraft during intra-Community passenger transport to be taken away;
- goods transferred and transported to another Member State to a diplomatic representative, a consular agent (except an honorary consul), a representative or representation of a special mission or an international organisation recognised by the Ministry of Foreign Affairs, a diplomatic representation or consular post, a special mission or a Community institution;
- goods transferred and transported to another Member State which is a Member State of the North Atlantic Treaty Organisation (hereinafter NATO) and intended either for the use of the armed forces of any other NATO Member State or the civilian staff accompanying them, or for supplying their messes or canteens when such forces take part in the common defence effort;
- non-Community goods (as defined in the Community Customs Code) placed in a free zone or free warehouse, where such goods have not been placed under any customs procedure and have not been consumed or used under conditions other than those prescribed by the customs rules;
- non-Community goods placed in a free zone or free warehouse or other non-Community goods, placed under the customs warehousing procedure, the inward processing procedure applying the suspension system, the transit procedure or the temporary importation procedure with total relief from import duties, and non-Community goods in temporary storage on the condition that the goods have not been unlawfully removed from under customs supervision or consumed or used under conditions other than those prescribed in the customs rules;
- Community goods transferred and transported to a free zone or free warehouse for export purposes and Community goods placed in a free zone or free warehouse which are exported within two months as of transportation to the free zone or free warehouse;
- gold transferred to the Bank of Estonia;
- the goods specified in Annex V to the Council of the European Union Directive 2006/112/EC if the goods are immediately placed in a tax warehouse or have been placed

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in a tax warehouse and the transaction does not involve termination of tax warehousing; and
- excise goods placed in an excise warehouse if the transaction does not involve taking the goods out of the excise warehouse, except transporting the excise goods from one excise warehouse to another.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

No, VAT is not charged on all transactions. VAT shall not be imposed on the supply of the following goods and services of a social nature:
- universal postal services within the meaning of the Postal Act and payment of state pensions, benefits, support and compensation pursuant to the procedure prescribed by the State Pension Insurance Act by means of post; universal postal services within the meaning of the Postal Act and payment of state pensions, benefits, support and compensation pursuant to the procedure prescribed by the State Pension Insurance Act by means of post;
- health services within the meaning of the Health Insurance Act and the supply of human organs, human tissue, human blood, blood product made from human blood, and breast milk, as specified in the list approved by a regulation of the Minister of Social Affairs;
- services provided by dental technicians in their professional activities and dentures transferred by dentists and dental technicians;
- services provided by a non-profit association to its members free of charge or for a membership fee, and services provided by a non-profit association to natural persons relating to the use of sports facilities or sports equipment;
- the social services specified in the Social Welfare Act and financed out of the state or local government budget;
- services relating to shelters for the protection of children and young persons;
- pre-school, basic, vocational, secondary and higher education, including learning materials transferred by the service provider to the recipient of the services, private tuition relating to general education and other training services, except other training services provided for business purposes;
- transportation of sick, injured or disabled persons in vehicles which are specially designed for such purpose and which correspond to the requirements established on the basis of the Traffic Act; and
- services provided by independent associations of persons to their members provided that the following conditions are met: the supply of the recipient of the services is 90% exempt from tax or the activities thereof are not subject to value added tax; the service is directly necessary for the main activity of the member; and the fee paid for the service does not exceed the costs incurred upon the provision of the service.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Yes, VAT is always fully recoverable by all businesses.

2.5 Are there any other transaction taxes?

Other transaction taxes in Estonia are gambling tax, excise duties and heavy goods vehicle tax. Customs duties are charged in certain cases of export and import.

2.6 Are there any other indirect taxes of which we should be aware?

No, transaction taxes are directly related to relevant transactions.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Until 31 December 2008, there was an obligation to withhold income tax on dividends paid to a non-resident legal person if the non-resident was a legal person with a share of less than 15% in the profit-distributing entity or a non-resident located within a low-tax-rate territory.

As before, the resident legal person still has to pay 21/79 of the amount of profits distributed (unless any tax exemption does apply). But as of 1 January 2009, if dividends are paid to a non-resident legal person, then no additional income tax (21%) is withheld on the amount of dividend.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

According to the income tax act, 10% withholding tax applies to royalties paid to non-resident persons. Royalty payments to qualifying companies of the Member States may be exempt if they meet the conditions for the Council of the European Union Directive 2003/49/EC of 3 June 2003. The withholding tax exemption will not apply to any part of the royalty that exceeds the value of similar transactions carried out between unrelated persons.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Income tax is withheld from interest payment subject to income tax paid to a non-resident or to a resident natural person.

Income tax is charged on interest received by a non-resident from the Republic of Estonia, a local government or a resident, or from a non-resident through or on account of its permanent establishment in Estonia, if it significantly exceeds the amount of interest payable on the similar debt obligation, under the market conditions, during the period when the debt obligation and payment of the interest occurred. In that case, income tax is charged on the difference between the interest received and the interest payable according to market conditions on the similar debt obligations.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There are no "thin capitalisation" rules in Estonia.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There is no "safe harbour" principle in the laws.

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3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

See the answer above (question 3.4).

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

See the answers above (questions 3.4-3.6).

3.8 Does Estonia have transfer pricing rules?

Estonia have not had transfer pricing rules since 2007.

If the value of a transaction conducted between a resident legal person and a person associated with the resident legal person differs from the value of similar transactions conducted between non-associated persons, the tax administrator may, upon determining the income tax, use the values of transactions applied by non-associated independent persons under similar conditions. In that case, income tax is charged either on the income which the taxpayer would have derived or the expense which the taxpayer would not have incurred if the value of the transaction conducted with the associated person had been such as applied by non-associated independent persons under similar conditions.

For implementation of transfer pricing rules, a resident company is required to submit additional information on the transactions with associated persons, activity of companies belonging to the same group and structure of the group at the demand of a tax authority.

The methods for determining the value of transactions are established by a regulation of the Minister of Finance.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The system of corporate earnings taxation in force currently in Estonia is a unique system, which shifts the moment of corporate taxation from the moment of earning the profits to the moment of their distribution.

Until 31 December 2008, payments upon proceeds from liquidations, payments upon capital reductions and redemption or return of participation in a company were treated as capital gains of the natural person or non-resident recipient and shareholder. As of 1 January 2009, these payments are generally subject to corporate income tax in the hands of the payer: an Estonian company at the moment of distribution.

The implicit way to distribute profits is to do that through fringe benefits, gifts and donations, as well as expenditures and payments unrelated to business activity.

All of these profit distributions are taxed at a rate of 21/79 (or slightly over 26.6%). This tax rate should not be deceiving. It is still the same rate of 21% as in the provisions for the taxation of salaried work payments. The difference is that 21% is applied to gross payments and 21/79 is applied to net payments.

The resident legal person and the non-resident legal person acting through its permanent establishment registered in Estonia carrying out profit distribution has to pay 21/79 of the amount of profits distributed.

The income tax rate on:

- payments to a non-resident for services provided in Estonia;
- royalties; and
- payments made to a non-resident artiste, sportsman or sportswoman for activities conducted in Estonia,

is 10%, unless a bilateral tax treaty between Estonia and the treaty partner specifies for a lower rate or exemption.

4.2 When is that tax generally payable?

Given the nature of the distribution tax, the relevant taxable period is the calendar month. The tax is payable by the 10th day of the month following the taxation period, i.e. the calendar month when the profits were distributed.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The corporate income tax is levied on:

- corporate profits distributed in the tax period; and
- taxable gifts, donations and representation costs, expenses and payments unrelated to business.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Since profits are not taxable upon generation, the profit shown in commercial accounts have no implications to the corporate income tax.

4.5 Are there any tax grouping rules? Do these allow for relief in Estonia for losses of overseas subsidiaries?

There are no special tax grouping rules in Estonia.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Retained profits are exempt from tax, whilst the rate of corporate income tax is currently 21/79 on the net amount of distributed profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

The tax system in Estonia consists of state taxes provided for in and imposed by Acts concerning taxes and local taxes imposed by a rural municipality or city council in its administrative territory pursuant to law.

The following are other state taxes:

- social tax;
- land tax;
- gambling tax;
- customs duty;
- excise duties (on fuel, packaging, alcohol, tobacco and electricity); and
- heavy goods vehicle tax.

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4.8 Are there any local taxes not dealt with in answers to other questions?

The local taxes that are imposed by a rural municipality or a city council regulation in compliance with the conditions provided by the Local Taxes Act are:

- sales tax;
- boat tax;
- advertisement tax;
- road and street closure tax;
- motor vehicle tax;
- animal tax;
- entertainment tax; and
- parking charge.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains are treated as ordinary income of resident companies, but they are taxed only where there is a profit distribution.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No, the tax imposed on capital gains is the same as that imposed on business profits.

5.3 Is there a participation exemption?

No, there is no participation exemption.

5.4 Is there any special relief for reinvestment?

No, there is no any special relief for reinvestment.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No taxes are imposed upon the formation of a subsidiary, except for state fees and notary fees.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no other such significant taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch are determined in the same way as for local companies, taking into consideration the specifications provided in the Income Tax Act. These are fringe benefits, gifts, donations and costs of entertaining guests, distributed profits, and expenses and payments not related to business made pursuant to commercial accounts.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

A branch shall pay income tax as a resident company, taking into consideration the specifications provided in the Income Tax Act.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

If its residency, prescribed on the basis of an international agreement ratified by the Parliament of the Republic of Estonia, differs from the residency prescribed pursuant to law, or if the agreement prescribes more favourable conditions for taxation of the income of non-residents than those provided by law, the provisions of the international agreement will apply.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax or other tax is imposed as a result of a remittance of profits by the branch.

7 Anti-avoidance

7.1 How does Estonia address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is no general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted.

Tax authorities' rights and obligations to prevent and identify tax avoidance are specified in the Taxation Act.

In order to ensure the performance of functions imposed on tax authorities, the Government of the Republic of Estonia has established the register of taxable persons. In the register of taxable persons, a separate record shall be kept concerning the financial rights and obligations of each taxable person arising from the Taxation Act or an Act concerning a tax, and concerning the performance, the rights and the obligations by each taxable person.

A taxable person is required to notify a tax authority of all facts known to the taxable person which are or may be relevant for taxation purposes. A taxable person shall not prevent a tax authority from performing procedural acts.

The keeping of accounts and accounting for taxation purposes shall be organised in a manner which enables an overview to be obtained within a reasonable period of time of the conduct of transactions and of facts relevant for taxation purposes, including revenue, expenditure, assets and liabilities.

A tax authority may, by way of estimation, establish facts which are the basis for making an assessment of tax payable. Estimation is permitted if the written evidence which is necessary to make an assessment of tax is incomplete, insufficient or unreliable or has been destroyed or is missing and if it is not possible to establish the facts on which the tax liability is based by means of any other evidence. Estimation is also permitted if the expenditure of a taxpayer who is a natural person exceeds his or her declared income and if the taxpayer fails to provide evidence proving that the expenditure has been incurred out of income which was taxed earlier or which is not subject to tax or out of loans taken.

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Estimation shall be based on the information collected on a matter, as well as on the business indicators and expenditure of the taxable person and comparisons with information ascertained in other similar tax matters.

If it is evident from the content of a transaction or act that the transaction or act is performed for the purposes of tax evasion, conditions which correspond to the actual economic content of the transaction or act apply upon taxation.

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AIVAR PILV
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Finland

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Outi Raitasuo

1 General: Treaties

1.1 How many income tax treaties are currently in force in Finland?

Finland has an extensive treaty network with appr. 90 tax treaties (including all kinds of tax treaties) in force or coming into force.

1.2 Do they generally follow the OECD or another model?

Finnish tax treaties generally follow the OECD model. Since the treaties are often tailored to the Finnish or a foreign tax system, there are few exemptions from the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. Finland follows the so-called dualistic method. Therefore tax treaties must be incorporated into Finnish law by an act enacted by the Parliament.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, Finnish tax treaties do not incorporate anti-treaty shopping rules. However, the treaty with the US contains a limitation of benefits clause and the treaties with the UK and Ireland contain a limitation of relief clause. Pursuant to the general opinion in legal literature, domestic anti-avoidance rules can be applied in case of artificial arrangements. Furthermore, some treaties exclude certain entities from the scope of application.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No. Tax treaties prevail over domestic legislation regardless of whether the domestic legislation is introduced prior or subsequent to them. However, please see what is stated on the use of anti-avoidance rules above, under question 1.4.

2 Transaction Taxes

2.1 Are there any documentary taxes in Finland?

Please see what is stated under question 2.5 below, regarding transfer tax.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes, Finland has VAT. In principle, all sales of goods and services are subject to VAT, however, the rate of VAT may vary. As of 1 July 2010 the VAT rates have been increased by one percentage unit, which means that the standard VAT rate is 23%, the rate for e.g. foodstuffs 13%, and the rate for e.g. books and medicine 9%. At the same time the VAT rate for restaurant food was lowered to 13%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

In principle, all sales of goods and services are subject to VAT. However, certain supplies are exempted from VAT as permitted or required by Community Law. The following goods or services are exempted from VAT: i) financial and insurance services; ii) educational services; iii) medical services; iv) the selling and leasing of real property; and v) most corporate transactions such as transfers of business, and the sale and exchange of shares. However, VAT liability may arise if a transaction involves a transfer of assets located in Finland, with the exception of a transfer of a business or the removal of assets from Finland.

Even though the sale of real property itself is VAT-exempt it may, however, trigger an obligation to recover VAT deductions made in respect of certain investments in the property covering a ten-year period prior to the sale.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

When goods and services are supplied for a business subject to VAT, the VAT paid is fully recoverable. If only a part of the business is subject to VAT, only the VAT related to this business is recoverable. Certain goods or services used for entertainment purposes are, however, excluded from the general right of deduction.

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2.5 Are there any other transaction taxes?

Yes, there is a transfer tax which is payable on the transfer of real property located in Finland and the securities of Finnish companies. The rate of the transfer tax is 4% of the transfer price of a real property and 1.6% of the transfer price of securities. However, the transfer tax is not payable on the transfers of publicly-listed securities.

The party liable to pay the tax is the transferee of the real property or securities. If the transferee is neither a resident of Finland, nor a Finnish branch of a foreign credit institution, financial services or fund management firm, the transferor must collect the tax from the transferee, as the tax authorities may collect the tax from the transferor.

2.6 Are there any other indirect taxes of which we should be aware?

There are excise duties levied on alcohol, tobacco products, liquid fuels, electricity, waste, oil waste and oil damage. In addition, e.g. tax on sweets will also be reintroduced. Furthermore, there are custom duties for goods imported from outside the internal EU market.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

In the absence of a tax treaty and provided that the EC Parent-Subsidiary Directive (90/435/EEC) does not apply, dividends paid to a non-resident company are taxed at source. The rate of the withholding tax is 28%. However, dividends paid to recipients residing in the European Economic Area ("EEA") are also exempted from tax in such cases where a similar, Finnish recipient would receive the dividends tax free. This may grant an exemption from withholding tax, e.g. for certain foreign investment funds and charitable entities. This amendment, which came into force in 2009, is based on the practice of the Court of Justice of the European Communities. Thus, any recipients of Finnish dividends within the EEA should consider reclaiming the withheld taxes retroactively.

Dividends paid to a Finnish permanent establishment ("PE") of a non-resident company are not subject to a withholding tax but are taxed as an income of the PE.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid to a non-resident are taxed at source, and thus subject to a withholding tax of 28%, unless tax treaty provisions or the EC Interest and Royalty Directive (2003/49/EC) prevent taxation in Finland. However, the royalties paid to a Finnish PE of a non-resident company are not subject to a withholding tax but are taxed as an income of the PE.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

According to the internal law of Finland, interest paid to a non-resident is usually exempt from taxation in Finland, so no withholding tax is payable on interest payments. However, interest paid to a loan comparable to equity may be subject to a withholding tax.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Finnish tax law does not include a thin capitalisation rule. However, it is possible, in cases involving a clear tax avoidance situation, to apply the general anti-avoidance rule to deny the tax deductibility of interest on excess debt and to treat it as dividend for the purposes of withholding taxes. Due to recently enacted restrictions in deductibility of interest in many European countries, Finland is considering similar restrictions, including possible thin capitalisation rules.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

No, there are not any "safe harbour" provisions. However, in order to avoid problems in the deductibility of interest payments, the (at) arm's-length principle should be applied.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Not applicable.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in answers 3.4-3.6 above?

As mentioned above under question 3.4, Finland is considering introducing restrictions to the deductibility of interest costs. So far, no government bill has been given, but in the spring of 2009 the Ministry of Finance published a report on potential alternatives for restricting interest deductions. The suggestions for restricting interest deductions include, among others, traditional thin capitalisation rules, interest deduction restrictions based on income statements, general anti-avoidance rules and withholding taxation of interest income for non-residents. The report is at the moment circulating at different expert quarters for comments.

3.8 Does Finland have transfer pricing rules?

Yes. The transfer pricing rules apply the arm's-length principle to all transactions between both domestic and international group companies. The rules also lay down a documentation obligation in cross-border situations.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Corporate income in Finland is subject to a flat rate tax of 26%.

4.2 When is that tax generally payable?

Corporate tax is payable annually, approximately eleven months after the end of the financial year, but due to the advance tax system

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it is generally paid as monthly instalments throughout the financial year. The amount paid in the monthly instalments is determined on the basis of an estimate of the taxable income during a respective tax year provided by the taxpayer, or an estimation made by the authorities based on the taxable income of the previous year. If advance taxes are paid, the amount of taxes paid is deducted from the annual final payment.

There is also a possibility to make a supplementary tax payment within four months after the end of the accounting period of the respective tax year, to avoid cumulative interest on the final tax payment.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base for corporate income is generally the statutory commercial accounts of the respective accounting period. However, this is subject to certain adjustments for tax purposes.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Certain expenses are not deductible for tax purposes and there are certain differences between the depreciation of assets for accounting and tax purposes.

There are also some tax free income items such as tax-free capital gains (see answer to question 5.3 below) and dividends. Dividends derived from non-tax treaty countries outside of the European Union and 75% of the dividends from publicly-listed companies when the ownership stake is below 10% are, however, not exempted.

Differences may also take place in connection of the taxation of income of a controlled foreign corporation ("CFC") or income from a partnership (in both cases shareholder's or partner's share of a CFC's or partnership's income is taxable and actual distributions are exempted).

4.5 Are there any tax grouping rules? Do these allow for relief in Finland for losses of overseas subsidiaries?

No, Finland does not have group taxation. However, under the group contribution regime, group contribution between two Finnish resident companies or PEs is deductible, provided that certain preconditions are met. A group contribution is taxable income for the receiving entity and tax-deductible for the paying entity.

By giving a group contribution to a PE with debt, it may be possible to get a "double dip" on interest in some cross-border situations.

Cross-border group contribution is generally not allowed, but there are still pending court cases related to situations where the group contribution has been given to a loss-making subsidiary in another EU country.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, tax is not imposed at a different rate upon distributed profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Finland has a municipal real property tax payable on owning real property including buildings. The amount of real property tax varies between 0.3% and 3% of the value of the real property determined for tax purposes depending on the real property and its use.

4.8 Are there any local taxes not dealt with in answers to other questions?

In addition to the taxes mentioned earlier, there are no other relevant local taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Generally, capital gains and losses are taxed as ordinary business income at the same rate of 26% and the losses can be carried forward for ten years. However, there are a few limitations to the deductibility of losses derived from a passive (non-business) income source and from fixed asset shares. Capital losses attributable to the passive income source can only be deducted from capital gains arising from the same source and the losses can only be carried forward for three subsequent years (from the beginning of 2010 this will be lengthened to five years). Regarding fixed asset shares, please see what is stated under question 5.3 below.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No. Capital gains are considered a part of business income and therefore taxed at a flat rate of 26%.

5.3 Is there a participation exemption?

Yes. A company can make tax-exempt capital gains by disposing of shares, provided that the conditions listed below are met. Correspondingly, losses from the disposal of such shares are non-deductible.

The tax exemption requires that the disposed shares:

i) entitle to an ownership of at least 10% of the share capital in the target company;

ii) have been owned for at least one year;

iii) are determined as fixed assets of the vendor;

iv) are not shares in a housing or a real estate company; and

v) are shares of either a Finnish company or a company subject to the EC Parent-Subsidiary Directive; or that there exists a double-tax treaty between Finland and the resident State of the company disposed of, which must be applied to any dividend paid to the vendor.

Further, the exemption requires that the vendor is not deemed a private equity investor. In some cases the private equity investor status may be beneficial when holding fixed asset shares, since a private equity investor may be able to utilise the goodwill included in the purchase price of the shares.

If these preconditions are not met, capital gains are taxable and losses deductible against capital gains made on the disposal of shares during the five years following the disposal.

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5.4 Is there any special relief for reinvestment?

Yes, there is possibility to make a deduction corresponding to a taxable gain incurred in connection with: (i) insurance compensation received due to the destruction of fixed assets by fire or other damage if new assets are acquired or the old ones repaired within a span of two years; or (ii) capital gain from the sale of business premises if new premises are acquired within two years.

Other reliefs for reinvestment include exempted share exchange and business transfer provisions, where the capital gain incurred from the sale of shares or business assets is, in certain cases, exempted if the shares of the recipient are received as consideration. The tax is deferred until the shares received as consideration are sold in a taxable sale.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed upon the formation of a subsidiary.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no other significant taxes or fees of that kind.

6.3 How would the taxable profits of a local branch be determined?

Generally, all branches are obliged to arrange bookkeeping in accordance with Finnish GAAP. However, there are no specific rules which determine the profits allocable to a Finnish branch. In practice, non-resident companies are taxed on their income derived from Finland and PE's are taxed on all income attributable to the permanent establishment.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax. However, provided that a PE is constituted, branches are subject to the general corporate tax in Finland and taxed on the net profit attributable to the branch (in question).

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No, apart from non-discriminatory rules (in case the branch forms a PE).

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No, there would not be a withholding or other tax imposed in such cases.

7 Anti-avoidance

7.1 How does Finland address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is a general anti-avoidance rule for preventing tax avoidance. According to the anti-avoidance rule, a legal form of a situation, or a measure which does not correspond to the true nature or purpose of the matter, shall be taxed as if the correct form had been used. In order to avoid the application of the anti-avoidance rule, the arrangement in question must have other justifications than tax-related ones (i.e. business reasons).

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France

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1 General: Treaties

1.1 How many income tax treaties are currently in force in France?

France has signed bilateral income tax treaties with around 120 countries or overseas territories. This wide network includes most European, North American, African and Asian countries, and an increasing number of South American countries.

The income tax treaty with Denmark ceased to apply as from January 1, 2009 and has not been renewed. Amendments to bilateral income tax treaties have been signed with Luxembourg, Switzerland and Belgium but are not yet in force.

1.2 Do they generally follow the OECD or another model?

Most of the tax treaties signed by France follow the OECD model, subject to certain specifics and reservations.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties, once they have been ratified by the French Parliament and the President of the French Republic, apply directly without having to be incorporated into French law.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

As set forth in the OECD model, tax treaties frequently contain anti-treaty shopping rules for dividends, royalties and interests, notably by referring to the notion of "beneficial owner". Some provisions are more specific (e.g. the "limitation of benefits" article included in the treaty signed with the U.S. and the one included in the treaty signed with Switzerland whose scope is currently limited to dividends, royalties and interest).

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Once duly ratified, tax treaties override any existing or subsequent domestic law (except the Constitution), provided that the other contracting party applies the treaty.

2 Transaction Taxes

2.1 Are there any documentary taxes in France?

France does not levy any stamp duties on documents evidencing transactions.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Any supply of goods and services made for consideration, within the French territory, by an entity that carries on independently an economic activity (such as industrial or commercial transactions) is generally subject to VAT. The standard rate of VAT is 19.6%, but some products/services, such as food, books, medicine or catering, are subject to lower rates (5.5% or 2.1%).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

French law provides for a number of transactions that are VAT-exempt subject to certain conditions, the main ones being exportations or intra-EU deliveries, certain financial activities, insurance and reinsurance operations or transfers of a totality of assets ("*universalité totale ou partielle de biens*").

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

As a general rule, entities liable to VAT may recover VAT charged on goods and services used in the course of their business for transactions subject to VAT. Entities that are not liable to VAT may not recover VAT. As a general rule, entities that are partially liable to VAT (i.e. entities carrying on activities subject to VAT and activities which are not subject to VAT) may only partly recover VAT (i.e. after application of a VAT *pro-rata*).

2.5 Are there any other transaction taxes?

Transfers of corporate rights and certain types of assets give rise to transaction taxes, which apply to the transfer price - or the fair market value, whichever is higher - at a fixed, progressive or proportional rate.

Regarding the sale of corporate rights, the following rates apply:

- 3%, capped at EUR 5,000, for the transfer of shares issued by a "*société anonyme*", a "*société en commandite par actions*",

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or a "*société par actions simplifiée*", except if they qualify as non-listed real estate companies ("*société à prépondérance immobilière*"). No tax is due upon the sale of listed companies' shares when no deed has been drawn up for the transfer;

- 3% - uncapped - for the transfer of corporate rights issued by corporate entities, the capital of which is not divided into shares. A rebate equal to the number of transferred rights x EUR 23,000/total number of corporate rights issued by the entity is applied to the tax basis (except for real estate companies); and
- 5% - uncapped - for the transfer of shares issued by non-listed real estate companies, irrespective of their form.

Regarding the sale of assets, the following rates generally apply:

- 5.09% for the transfer of real-property assets located in France (however, in some cases, such transfers may be subject to VAT instead); and
- free to 5% for the transfer of a going-concern (3% applied on the part of the price that exceeds EUR 23,000 up to EUR 200,000, and 5% over EUR 200,000).

2.6 Are there any other indirect taxes of which we should be aware?

Some activities or transactions may be subject to specific taxations (e.g. custom duties on goods imported from outside the EU, excise duties on wine, liquor or tobacco).

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid by a French company subject to corporate income tax to a non-resident are in principle subject to a 25% withholding tax (or 18% for EU-resident individuals, subject to certain conditions). Such rates may be reduced or cancelled under tax treaties. However, in case of dividends paid outside of France in a non-cooperative state or territory with respect to the exchange of certain tax information, as such states or territories are listed each year by the French authorities (an "NCST"), the rate of the withholding tax is 50%.

No withholding tax applies on dividends paid by a French subsidiary subject to corporate income tax to its parent company (within the meaning of the EU Directive 90/434), if this parent company is located in the EU and has directly held (or has undertaken to hold) at least 10% of the share capital of the subsidiary for at least two years.

Anti-abuse provisions apply when the beneficiary is ultimately controlled by non-EU resident companies and when the main reason or one of the main reasons for the structure is to take advantage of the withholding tax exemption.

The French withholding tax may be reduced or cancelled in certain specific cases to conform to EU law. The French Tax Authorities have for example admitted that, pursuant to ECJ's "*Denkavit*" decision dated December 14, 2006, dividends distributed by a French subsidiary subject to corporate income tax to its parent company subject to corporate income tax, located in the EU and holding at least 5% in the share capital of the subsidiary for at least two years, may, subject to certain conditions, benefit from a withholding tax exemption. Pursuant to a French case law dated February 13, 2009 (*Sté Stichting Unilever Pensioenfonds Progress*), an exemption is also likely to apply to pension funds located in the EU, with respect to dividends received from French subsidiaries.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid by a French company to a non-resident are generally subject to a 33.33% withholding tax, which may be reduced or cancelled under tax treaties. However, in case the non-resident is located in an NCST, the rate of the withholding tax is 50%. For some royalties, this 50% withholding tax however doesn't apply if the company proves that the main purpose and effect of the transaction are not to transfer income into an NCST.

When the beneficiary is a company located in the EU, no withholding tax applies on the royalties paid by the French company if one company has directly held (or has undertaken to hold) at least 25% of the share capital of the other for at least two years, or if a third company has directly held (or has undertaken to hold) at least 25% of the share capital of the first and the second company for at least two years.

Anti-abuse provisions apply when the beneficiary is ultimately controlled by non-EU resident companies and when the main reason or one of the main reasons for the structure is to take advantage of the withholding tax exemption. Such provisions also apply in the case of excessive royalty payments (for the fraction that is not considered to be at arm's length).

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Interest payments made by a French company to non-residents are generally not subject to withholding tax, unless the payments are made outside of France in an NCST. In that case, interest payments are subject to a 50% withholding tax (except if interest payments are received with respect to certain contracts entered into before March 1, 2010). This 50% withholding tax however doesn't apply if the company proves that the main purpose and effect of the transaction are not to transfer income into a NCST.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

- Interest paid by a French company to any of its direct shareholders is deductible for the fraction that does not exceed a certain interest rate threshold, which is based on the average rate used by banking establishments for two-year maturity loans granted to companies (e.g. 4.81% for the fiscal year 2009), provided that the borrowing company's share capital is fully paid up.
- Moreover, interest paid by a French company on loans and advances granted by any related enterprise (i.e. an enterprise that: (i) directly or indirectly controls the company; (ii) is controlled by the company; or (iii) is controlled by an enterprise that directly or indirectly controls the company) is deductible for the fraction that does not exceed the higher of:
  - the amount of interest computed by application of the average rate used by banking establishments for two-year maturity loans granted to companies; or
  - the amount of interest computed by application of the rate the company may have obtained from independent financial institutions under comparable circumstances.

Interest that does not exceed the above interest rate limitation is disallowed for the fraction that exceeds the highest of:

- the amount of said interest multiplied by the ratio of: (i) 1.5 times the company's net equity; to (ii) the average amount of indebtedness owed to related enterprises over the relevant fiscal year (debt-to-equity ratio);

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- 25% of the company's adjusted earnings before tax and exceptional items; and
- the amount of interest received by the company from related enterprises, unless said fraction is lower than EUR 150,000 for the relevant fiscal year.

Subject to certain conditions, interest disallowed for a given fiscal year pursuant to the second set of limitations will nonetheless be deductible from the company's taxable income of the following fiscal years.

Thin capitalisation rules will not apply to certain financial operations or enterprises (e.g. cash pooling arrangements, credit institutions, etc.).

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

A "safe harbour" provision authorises the tax deduction of interest paid to related enterprises irrespective of the second set of limitations (see question 3.4 above) if the company evidences that its own debt-to-equity ratio does not exceed the debt-to-equity ratio of its group.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Under current law, thin capitalisation rules would generally not apply in this situation.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

In addition to the abovementioned thin capitalisation rules, the tax deduction of interest payments may be challenged by the French Tax Authorities if the debt incurred by the local company does not comply with the normal management of the company, i.e. for instance, if the French Tax Authorities can prove that such indebtedness is excessive with respect to its ability to face the payment of the interest and the reimbursement of the debt over a reasonable period of time.

French Tax Authorities may also try to challenge the deduction by qualifying the loan as an equity instrument instead of a debt instrument.

3.8 Does France have transfer pricing rules?

Under French law, profits indirectly transferred by a French company that controls or is dependent upon a foreign company, through an increase or a decrease of purchase or sale prices or through any other means, such as payment of excessive royalties (i.e. any transaction that is not made at arm's length) have to be added back to the taxable profits of the French company.

French Tax Authorities have to prove both the indirect transfer of profits and the control between the French and the foreign company (if the latter is located in a tax haven - i.e. a jurisdiction where it pays less than one half of the income tax it would have paid if it had been established in France - French Tax Authorities do not need to prove the control).

French and foreign companies have the possibility to negotiate advance pricing agreements with the French Tax Authorities and the relevant foreign authorities.

Large companies and their affiliates are required, when certain criteria are met, to keep and provide on demand to the French Tax Authorities a formal transfer pricing documentation. Additional documentation is required when transactions are carried out with companies located in an NCST.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The standard CIT rate is 33 1/3%, to which a 3.3% surcharge (based on the amount of CIT less a relief of EUR 763,000) is added, resulting in an effective CIT rate of 34.43%.

French law provides for a number of temporary CIT exemptions (e.g. newly created companies, companies established in certain parts of the French territory). Moreover, companies having a turnover which is lower than EUR 7,630,000 and whose fully paid-up share capital is at least 75% held by individuals or by such companies, are subject to CIT at the rate of 15% on their first EUR 38,120 of profits, and are exempt from the 3.3% surcharge.

Special rates apply for long-term capital gains (see question 5.1 below).

4.2 When is that tax generally payable?

CIT is prepaid in four instalments (on March 15th, June 15th, September 15th, and December 15th), which are assessed on the previous financial year taxable results, subject to specific provisions for the first instalment. The balance, if any, is due on the 15th of the fourth month following the end of the fiscal year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

CIT is based on commercial accounts pursuant to French GAAP, subject to specific adjustments for tax purposes.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The main adjustments made on the commercial accounts, so as to compute CIT, are the following:

- excessive depreciation, provisions or expenses that are not deductible for tax purposes, CIT and other non-deductible taxes, interest disallowed under thin capitalisation rules, net long-term capital losses on certain assets, share in the profits of look-through entities for tax purposes and positive results of the marked-to-market valuation of certain specific financial instruments have to be added back; and
- the amount of dividend received by the company (except, as from January 1, 2011, if such dividend is received from a subsidiary established in an NCST), which benefits from the French participation exemption regime, has to be deducted, minus 5% of the amount of the dividend (this lump sum being currently capped to the actual expenses incurred by the company for the contemplated fiscal year). Net long-term capital gains on certain assets, non tax deductible provisions added back to the commercial result of the concerned fiscal year, shares in the losses of look-through entities for tax purposes and distribution received from such entities and the negative result of the marked-to-market valuation of certain specific financial instruments also have to be deducted.

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4.5 Are there any tax grouping rules? Do these allow for relief in France for losses of overseas subsidiaries?

A French company, or a French branch of a foreign company, holding directly or indirectly (either through a French company or, subject to certain conditions, through an EU-resident company or a Norwegian or Icelandic company) at least 95% of the capital and voting rights of other French companies or French branches of foreign companies, may elect to form a tax-consolidated group with said subsidiaries or branches. All the tax-consolidated group's members must be subject to French CIT and have the same financial year; the parent company must not be held at 95% or more by another French company subject to French CIT, either directly or indirectly through companies subject to CIT and held by 95% or more by such other French company.

The group head company is liable to CIT on the group taxable result, which is calculated by adding all members' profits and losses, subject to certain adjustments (such as the neutralisation of certain intra-group transactions).

Except for small and medium-sized enterprises and subject to specific conditions, French tax law does not expressly allow for relief of losses incurred by non French subsidiaries. The possibility to offset losses incurred by subsidiaries located in the EU and held at 95% or more by a French tax consolidated company against French tax consolidated profits, pursuant to ECJ's "Marks & Spencer" decision dated 13 December 2005, still seems debatable in the absence of French case law or administrative guidelines on this matter.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

The CIT rate does not depend on whether or not the profits are distributed or retained; the same rate applies in both situations.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Apart from social security charges, the main taxes applicable to enterprises are:

- Wage tax ("*taxe sur les salaires*") is due by employers that are not subject to VAT on at least 90% of their turnover. It is assessed on the amount of salaries and benefits in kind paid to employees and the applicable rate goes from 4.25% to 13.6%.
- A 3% annual tax on real estate is due by any French and foreign entity, which directly or indirectly owns real estate assets or rights over such assets located in France. The tax is assessed on the fair market value of such assets. Various exemptions apply: tax is not due by entities that have real estate assets representing less than 50% of their French assets, by listed entities and their wholly-owned subsidiaries, by retirement funds or non-profit organisations subject to certain conditions.
- Other national taxes apply such as apprenticeship tax, tax on corporate cars.

4.8 Are there any local taxes not dealt with in answers to other questions?

- Since January 1, 2010, companies engaged in a business in France are no longer subject to the former business tax ("*taxe professionnelle*") but are subject to a new local tax ("*Contribution Economique Territoriale*" or "*CET*"), subject to certain exemptions. Such tax consists of: (i) a land tax generally assessed on the cadastral value of developed or undeveloped property/land ("*Cotisation Foncière des Entreprises*"), at a rate differing from a local authority to another; and (ii) a tax based on the added value of companies whose turnover exceeds EUR 152,500 ("*Cotisation sur la valeur ajoutée des entreprises*"), at a rate of 1.5%. Some allowances apply depending on the companies' turnover. The total amount of the CET is capped to 3% of the added value, upon request of the taxpayer, and cannot be lower than a certain amount of *Cotisation Foncière des Entreprises*, as defined by the local authorities.
- Real property tax on developed property/undeveloped land ("*taxe foncière*") is based on the net cadastral value of said property/land (50% / 80% of the cadastral value). The rate differs from one local authority to another.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains are subject to CIT at the standard rate, except for capital gains mentioned below.

Capital gains on the following fixed assets, when held for at least two years, are exempt, except for a 5% recapture of the net capital gain, resulting in an effective taxation of 1.72%:

- shareholdings recorded as "*titres de participation*" under French GAAP; and
- shares qualifying for the parent-subsidiary tax-regime or shares that have been acquired by way of a takeover bid by the initiator, when those shares are booked in a "*titres de participation*" account or in a special sub-account named "shares eligible to the long-term capital gains regime" of the relevant account.

A specific tax regime applies to capital gains on shareholdings in real estate companies ("*sociétés à prépondérance immobilière*") qualifying as long-term investment "*titres de participation*" for tax purposes:

- a 19% rate applies to shareholdings in listed real estate companies; and
- the standard CIT rate applies to shareholdings in non-listed real estate companies. A 19% rate may however apply when sold to specific real estate companies (e.g. French REITs - "*Sociétés d'investissement immobilier cotées*").

A 15% rate finally applies to:

- shareholdings in certain high risk mutual funds and venture capital firms held for five years or more (however, subject to certain conditions, the capital gain realised upon the disposal of such shareholding could benefit, totally or partially, from the above-mentioned exemption); and
- proceeds deriving from the licensing of rights to use patents, patentable inventions and industrial manufacturing processes and sales of such intellectual property rights, under certain conditions.

Please note that capital gains mentioned above are also generally subject to the 3.3% surcharge (computed as mentioned in question 4.1 above) and that, as from January 1, 2011, the abovementioned reduced rates do not apply to the transfer of shareholdings in companies established in an NCST.

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5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

See above question 5.1.

5.3 Is there a participation exemption?

See above question 5.1.

5.4 Is there any special relief for reinvestment?

No relief for reinvestment is provided under French tax law with respect to capital gains taxation.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

As a general rule, contributions made in exchange for shares are tax-exempt.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no specific taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

A foreign company's French branches are subject to CIT under the same rules as French companies on the profits they made within the French territory, as if they operated independently from the company of which they are a permanent establishment.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Such branches are subject to French CIT. Their after-tax profits are deemed to be distributed to their foreign shareholders, and thus subject to a 25% withholding tax. This withholding tax may be reduced or cancelled under tax treaties. It also does not apply to branches of an EU-resident company that is subject to CIT.

The withholding tax can be revised on the basis of the amount of profits that have been effectively distributed, or if the branch proves that such profits have been distributed to a French resident.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

As a general rule, a branch cannot benefit from tax treaty provisions as it is not, as such, considered as a resident within the meaning of the tax treaty.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

See above question 6.4.

7 Anti-avoidance

7.1 How does France address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Under current law, there is no requirement to disclose avoidance schemes in advance of the company's tax return being submitted.

Under French tax law, tax avoidance schemes may be challenged under abuse of law provisions ("*abus de droit*") (including the cases of fraud), if the scheme is fictitious, or: (i) seeks to benefit from a tax advantage, the grant of which would be contrary to the objectives of the legislator; and (ii) is exclusively tax-driven.

An 80% penalty applies to tax reassessed under the abuse of law procedure, reduced to 40% if the tax payer is neither the main initiator of the scheme nor its main beneficiary.

Moreover, French tax law provides for a range of specific anti-avoidance regimes, such as, for example, regulations limiting transfer pricing (see question 3.7 above) and the CFC regime.

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Germany

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Germany?

Income tax treaties with 90 countries were in force on January 1, 2010. Moreover, negotiations on first-time treaties are carried on with 10 countries in Eastern Europe, South America, Asia and Africa. 27 treaties are going to be amended in the near future.

1.2 Do they generally follow the OECD or another model?

Germany's tax treaties are usually based on the OECD model. Therefore, the official commentary to the OECD model may be used for the interpretation of most provisions in the German treaties. However, some of the treaties, especially those with developing countries, incorporate elements of the UN model treaty. The treaty between Germany and the United States reflects many peculiarities of the United States treaty policy.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

According to German constitutional law, treaties must be incorporated into national law by the federal legislator. This requires the consent of both chambers of the parliament in the form of a federal law. Therefore, the federal law implementing tax treaties must be approved by the *Bundestag and the Bundesrat* and is finally signed by the Federal President (*Bundespräsident*) and promulgated in the Federal Law Bulletin (*Bundesgesetzblatt*).

This legislative procedure has to be distinguished from the process of ratification of the treaty by exchanging documents in which (in case of Germany) the Federal President declares that the requirements for the internal applicability of the treaty have been met. Only upon such ratification does the treaty become binding under international law.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, Germany's tax treaties did not include anti-treaty shopping rules. However, such rules have been adopted, in particular in many of the more recent treaties. Several treaties contain general anti-abuse clauses that may be interpreted in a way to permit the application of domestic anti-abuse rules within the scope of the treaty provisions. If the application of such anti-abuse clauses leads to double taxation, some of the treaties oblige the countries to open the mutual agreement procedure. This type is represented by about 13 treaties, especially the one with Switzerland.

Upon consultation between the parties, several treaties allow the application of the tax credit method instead of the exemption method to avoid a double tax exemption of income or to counter arrangements that lead to an abuse of the treaty (e.g. the treaties with Austria, Denmark, India, Mexico, Norway, Pakistan, Poland, Russia, Singapore, Sweden, Ukraine, USA, Venezuela, and Vietnam). Furthermore, some treaties exclude the application of reduced withholding tax rates for dividends, royalties or interest payments if such treaty benefits are claimed without reasonable economic justification (e.g. Ghana, Korea, Kazakhstan, and Uzbekistan).

A detailed and very complex limitation-on-benefits clause is part of the treaty between Germany and the United States. This clause has become even more rigid as of 2008 after the new protocol amending the U.S./Germany treaty has become effective.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In principle, tax treaties incorporated into German law prevail over statutory law as provided for in the German General Tax Code. However, this conflict rule, like tax treaties after their implementation, has the status of ordinary statutory law and competes against the general "*lex specialis*" and "*lex posterior*" rules. Tax treaties are not superior to ordinary law and, therefore, domestic legislation may override a tax treaty that was concluded previously if it is expressly aimed at abrogating the treaty provision by establishing a deviating rule. Treaty overrides have been used by the German tax legislator for about 20 years, mainly in order to combat tax structures and schemes that it suspected of being abusive. Notwithstanding the effective priority, constitutional admissibility and legality of such a "*lex posterior*" under domestic German law, treaty overriding by the legislator constitutes an infringement of international law, which can only be invoked by the other treaty state.

2 Transaction Taxes

2.1 Are there any documentary taxes in Germany?

Germany does not levy any stamp duties on transactions and has abolished the capital transfer tax.

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2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The German Value Added Tax Act is based on the EC Directive 2006/112/EC, i.e. on the common system of value added tax (the former Sixth EC Directive). The standard rate of VAT is currently 19% (as of 2007); a reduced rate of 7% applies to a limited number of supplies of goods or services.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

There are several tax exemptions for certain supplies of goods or services. The most relevant of these exemptions apply to:

- financial services by banks or other financial institutions (waiver of tax exemption possible);
- the transfer of shares in a corporation or interest in a partnership (waiver possible);
- the transfer of real property (waiver possible); and
- the lease of real property (waiver under certain conditions possible).

The waiver of a tax exemption is allowed only if the respective services are rendered to a taxable person ("entrepreneur") for its respective business. The transfer of a business as a going concern, however, is not only tax-exempt but is not a taxable event at all. The sale of a real property that is leased out generally constitutes a transfer of a business as a going concern that is not taxable.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input VAT on supplies is fully recoverable by a taxable person if the respective supplies are wholly used to render taxable supplies that are not tax-exempt. Input VAT on supplies that are used to render tax-exempt supplies is, in principle, not deductible. However, especially for several cases of tax-exempt cross-border supplies the deduction of input VAT is nevertheless allowed. If a taxable person renders both taxable and tax-exempt services, input VAT on supplies for both has to be split up according to the respective percentage of taxable supplies to determine the deductible part of input VAT.

The most notable restriction concerns the letting of real property: on such a supply, a waiver of the tax exemption is permitted only if the lessee uses (or intends to use) the property exclusively for supplies subject to tax on its part. This rule results in a loss of input VAT to lessors letting real property, e.g. to banks, insurance companies or doctors or for residential purposes.

2.5 Are there any other transaction taxes?

The transfer of German real property is subject to German Real Estate Transfer Tax at a rate of 3.5% (4.5% for real property located in Berlin, Hamburg and Sachsen-Anhalt; increases by further German states are expected) of the purchase price, or – in case there is no consideration – of the property's value. Real Estate Transfer Tax also becomes due if 95% or more of the interests in a partnership owning German real property are transferred within a period of five years or if 95% or more of the shares in a corporation owning German real property are acquired by the same person (or affiliates of such person).

2.6 Are there any other indirect taxes of which we should be aware?

German Insurance Tax applies at a standard rate of 19% on the payment of insurance premiums for several types of insurance contracts. Excise duties are levied on certain kinds of goods, e.g. on fuel.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

The general withholding tax rate for dividends paid by a German corporation to non-resident shareholders was raised to 25% as of 2009 (20% until 2008). Non-resident corporations, however, may generally apply for a refund of 40% of the tax withheld on the dividends received. Thus, their effective withholding tax rate will equal the general Corporate Income Tax rate in Germany (15%). Moreover, a further refund or total relief from the withholding tax on dividends may be available according to a tax treaty or the EC parent-subsidiary directive, however this is subject to Germany's anti-treaty shopping rules which provide for certain substance requirements (currently subject to EU dispute).

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalty payments by a local company to non-residents are, in principle, subject to a 15% withholding tax. These payments are taxed at their gross amount. Under most German tax treaties, the withholding tax on royalty payments is reduced to between 0% (in particular in treaties with OECD countries) and 15%.

Within the European Union no withholding tax is levied on royalties paid by a German company (or a European company that has a German branch) to an associated company in another Member State of the EU, according to the EC Interest and Royalties Directive 2003/49/EC as incorporated into German law. The exemption is granted only on application.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

No withholding tax on interest payments to non-residents is levied, unless the amount of the interest depends on the profits of the borrower or the terms and conditions of the loan are not at arm's length and, therefore, result in treatment of the interest as constructive dividends.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

As of 2008, a general limitation to the deduction of interest payments has been introduced regarding both shareholder loans and all third party loans. According to the so-called interest deduction ceiling ("*Zinsschranke*"), interest expenses exceeding interest earned (net interest) will only be deductible up to 30% of the corporation's EBITDA. The interest deduction ceiling will apply:

(a) if the overall net interest exceeds €3m;

(b) in case the corporation does not belong to a group of companies:

- if "harmful debt financing" occurs, i.e. debt financing

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by shareholders, related parties or third party lenders with recourse to such shareholders, and interest paid/owed for such debt exceeds 10% of the overall net interest; or

(c) in case the corporation belongs to a group of companies:

- if "harmful debt financing" occurs in any group company and the financing shareholder, related party and/or third party having recourse to a shareholder or related party is not part of the group; or
- the equity ratio of the tax-paying company is lower than the one of the consolidated group.

Net interest that is not deductible under these rules becomes deductible, however, up to the amount of EBITDA carried forward from the preceding five years. The remainder of non-deductible net interest is carried forward into the following years.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The interest deduction ceiling is only applied (and then to all interest) if the overall net interest charge of the borrowing corporation exceeds €3m. To the extent the net interest charge does not exceed 30% of the corporation's EBITDA, the interest deduction ceiling does not apply and interest expenses are fully deductible.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

The interest deduction ceiling (in force as of 2008) extends to loans granted by third parties, anyway. A guarantee given by a parent company with respect to a third party loan may have an additional negative effect insofar as it may be considered as "harmful debt financing" and, therefore, prevent the application of an "escape clause" (see question 3.4 above).

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

There are no such restrictions (except treatment as constructive dividend as mentioned in question 3.3 above).

3.8 Does Germany have transfer pricing rules?

Generally, transactions between related parties with German corporations involved must comply with the dealing-at-arm's-length principle. Apart from tax treaties, this principle is also part of domestic German law, which, as of 2008, provides for much more detailed rules according to which an "acceptable" market price has to be computed for tax purposes. Also, more detailed documentation requirements were introduced over the past years with regard to cross-border transactions.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The aggregate tax burden of corporations was reduced from almost 40% to just below 30% by the Corporate Tax Reform 2008.

As of 2008 the German Corporate Income Tax rate went down from 25% to 15%. In addition, Solidarity Surcharge of 5.5% is levied on the amount of Corporate Income Tax due, resulting in an aggregate tax rate of 15.825%.

German corporations are also subject to Trade Tax. The basic Trade Tax rate is 3.5% as of 2008; it is supplemented by the application of a multiplier fixed by the respective municipality that varies from a minimum rate of 200% (prescribed by federal law), up to around 500% in the large cities. Therefore, the effective Trade Tax rate ranges from 7% to around 17.5%. As of 2008, the amount of Trade Tax due is not treated as business expense anymore and, therefore, cannot be deducted from the Corporate Income Tax base as well as the Trade Tax base itself. As a result, corporations are subject to Corporate Income Tax (including Solidarity Surcharge) and Trade Tax at a combined rate of at least 22.825% and up to around 33.325%.

4.2 When is that tax generally payable?

Both Corporate Income Tax and Trade Tax are assessed on an annual basis. However, the determination of the corporation's taxable income may refer to a 12-month period deviating from the calendar year. In addition, corporations are obligated to quarterly pre-payments of Corporate Income Tax and Trade Tax based on an estimate of the current year's tax amount due.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In principle, the corporation's net income determined according to German commercial accounting principles is also the Corporate Income Tax base. However, tax law provides for several adjustments for tax purposes, e.g. restrictions on the deduction of certain business expenses or 95% exemptions for dividends received or capital gains derived from the sale of shares in other corporations.

The corporation's net income for Corporate Income Tax purposes also serves for the computation of the Trade Tax base, which is, however, subject to further specific adjustments. There are several add-backs and also exclusions for Trade Tax purposes exclusively, e.g. the add-back of 25% of interest payments on debt, the add-back of 12.5% of lease payments for immovable fixed assets, 5% for movable fixed assets and 6.25% for royalties.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

For tax purposes, the commercial accounting principles are overruled by several tax accounting provisions, mainly to restrict accounting options allowed by commercial law to prevent taxpayers from influencing their tax base. For example, tax rules with regard to the valuation and depreciation of assets or the accumulation of accruals have been tightened and restricted repeatedly over the past years.

As of 2009, tax accounting options may be exercised independently from the commercial balance sheet. As a consequence, assessments in the tax balance sheet may deviate from those in the commercial balance sheet.

4.5 Are there any tax grouping rules? Do these allow for relief in Germany for losses of overseas subsidiaries?

German tax grouping rules for Corporate Income Tax purposes

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(*Organschaft*) require a more than 50% shareholding in a subsidiary and a profit and loss absorption agreement according to German commercial law concluded by the group parent company and the subsidiary and executed for a period of at least five years. As a result, the subsidiary's net income is attributed to the group parent company for Corporate Income Tax and Trade Tax purposes. However, only subsidiaries in the legal form of a German corporation or European Stock Corporation (SE) having their legal seat or place of management in Germany can be part of such tax group. Therefore, a German tax group cannot have foreign group members and does not allow cross-border use of losses as losses from foreign subsidiaries cannot be offset within the tax group.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Under the rules of the current shareholder relief system (in force since 2002 and staying on as of 2008), the corporation's Corporate and Trade Tax rate is not reduced in case of profit distributions.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

The German Property Tax (Net Worth Tax) has not been levied any more since 1997 for constitutional reasons.

Real Estate Tax is levied on German real estate; the respective tax rate is fixed by the municipalities and is applied to the value of the real property.

The transfer of property including business assets and participations in partnerships and corporations by way of succession or donation is subject to German Inheritance and Gift Tax. Although the valuation rules have been completely revised by the recent reform of the Inheritance and Gift Tax Act (as of 2009), business assets are still subject to favourable valuation rules if certain conditions are met.

4.8 Are there any local taxes not dealt with in answers to other questions?

No significant local taxes apply to corporations (apart from the right of the municipalities to fix the multiplier applicable to the Trade Tax rate, see question 4.1 above, and to the Real Estate Tax rate).

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

In principle, capital gains are included in the tax base of Corporate Income Tax and Trade Tax. However, the German Corporate Income Tax Act provides for a 95% tax exemption of capital gains received by corporations on the disposition of shares in German or foreign corporations. The tax exemption applies irrespective of a minimum shareholding or a minimum holding period. In return, losses from the sale of such stakes are disregarded for tax purposes and not deductible from the tax base.

Capital gains received by individuals on the sale of shares in corporations are taxable if the shares belonged to a business or if the individual's participation in the corporation exceeded a threshold of 1% of the capital. In these situations, 40% of such capital gains are tax-exempt. Capital gains received by individuals from the sale of shares (<1%) which were held as private assets are subject to a flat tax of 25% as of 2009, irrespective of the holding period. Until 2008, such capital gains were taxable (to the extent of 50%) only if the respective shares had been held less than one year.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Capital gains received by corporations are not subject to a special tax rate but to a partial tax exemption. The same applies to capital gains received by individuals if the participation was held among their business assets or exceeded 1% of the capital (for the extent of the respective tax exemption, see question 5.1). Capital gains received by all other individuals, however, are subject to a special flat rate of 25% as of 2009 (see question 5.1). In principle, this tax rate will apply to all kinds of capital income of individuals.

5.3 Is there a participation exemption?

The 95% tax exemption for capital gains also applies to dividends received by a corporation. A minimum shareholding or a minimum holding period is not required for Corporate Income Tax purposes, whereas for Trade Tax purposes the 95% tax exemption of dividends (not that of capital gains) requires a minimum shareholding of 15% as of the beginning of the respective fiscal year.

5.4 Is there any special relief for reinvestment?

A rollover relief is available if capital gains from the disposition of certain assets (especially real property) are reinvested in the acquisition of similar assets within a period of four years. Due to the extensive capital gains exemption (see question 5.1), no rollover relief is available upon the disposition of shares by corporations.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The formation of a subsidiary is not subject to any special taxes in Germany.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No special taxes would be incurred, but notary fees on the notarisation of the articles of incorporation would become due on the formation of a German limited company (*GmbH*) or stock corporation (*AG*).

6.3 How would the taxable profits of a local branch be determined?

For tax purposes, a branch located in Germany is treated like an economically separate entity although it is legally a part of the parent company. Thus, the taxable profits of the branch are determined according to the direct method. In order to separate the proper earnings of the branch from those of the parent company, separate tax accounting including the attribution of capital, assets, business expenses and income to the branch for tax purposes is

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required. However, the separate entity approach does not include the exchange of goods and services between branch and parent company, which is disregarded for tax purposes.

The German branch of a foreign head office in the legal form of a corporation is subject to German Corporate Income Tax and Trade Tax as if it were a German corporation. It is, therefore, for example, entitled to the 95% exemption of dividends received from other corporations and of capital gains derived from the sale of shares in other corporations in the same way as a German corporation (see questions 5.1 and 5.3).

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

The taxable income of a branch is, in principle, computed according to the same rules as they are applicable to any other German business taxpayer.

There is no branch profits tax in Germany; the remittance of profits by the branch to its head office is irrelevant for German tax purposes.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

The head office, but not the branch itself, is entitled to treaty benefits because a branch is legally a part of its head office and not a resident for tax treaty purposes. However, non-discrimination clauses in tax treaties usually oblige the contracting states to treat branches like corporations resident in their jurisdiction. For European Union Member States a discrimination of branches would also be prohibited by the freedom of establishment.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax applies to the remittance of profits by a German branch to its head office.

7 Anti-avoidance

7.1 How does Germany address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The German General Tax Code provides for a general anti-avoidance rule with respect to all kinds of taxes. This rule allows the German tax authorities to disregard the legal form of a transaction agreed upon among the parties, if such transaction is regarded as an abuse of legal arrangements without valid reasons other than tax savings not intended by the respective tax act. In 2007, a legislative initiative by the German government to introduce a disclosure rule that would oblige taxpayers to disclose avoidance schemes in advance to the Federal tax authorities failed.

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Guatemala

Arias & Muñoz

José Augusto Toledo Cruz

1 General: Treaties

1.1 How many income tax treaties are currently in force in Guatemala?

There are no income tax treaties in Guatemala.

1.2 Do they generally follow the OECD or another model?

Not applicable – please see question 1.1 above.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes, treaties have to be incorporated into domestic law before they take effect. The applicable procedure is the following:

1. The treaty must be approved by the Congress.
2. It must be ratified by the President of Guatemala.
3. The treaty must be published in the government's Official Publication Journal (*Diario Oficial*). This would provide the official publication.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

This is not applicable in Guatemala.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Yes, they are overridden by the Constitution of the Republic of Guatemala.

2 Transaction Taxes

2.1 Are there any documentary taxes in Guatemala?

Yes. A stamp tax exists, with a general tariff of 3%. The tax will be determined by applying the tariff according to the value of applicable acts and contracts. This tax does not apply when the Value Added Tax (VAT) applies.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. Value-added tax of 12% is applied to transfers of goods and services. Some exclusions apply.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The general principle is that VAT is charged on all transfers of goods and services. The exceptions are regulated by the VAT law, which establishes cases of specific and general exemptions.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

The general principle is that VAT is charged on all transfers of goods and services. The exceptions are regulated by the VAT law, which establishes cases of specific and general exemptions.

2.5 Are there any other transaction taxes?

No, VAT is the only transaction tax applicable in Guatemala.

2.6 Are there any other indirect taxes of which we should be aware?

There are several indirect taxes such as: property taxes; revaluation taxes; excise taxes (imposed on beverages, cigarettes, cigars, gasoline, oil-related products, cement, licence plates, and air fares); tax on financial products; and the IETAP (Extraordinary and Temporary Tax for Guatemalan Peace Agreements). This last one was due to expire at the end of 2008.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Remittance of dividends is exempt from withholding tax, provided the company paying those dividends has are paid its income tax in Guatemala.

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3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes, there is a withholding tax of 31% on the payments of royalties to a non-resident.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes, there is a withholding tax of 10% on payments of interest to a non-resident. The exception is if such interest is paid or credited to a foreign banking and financial institution with a first rate rating in its country of origin, or to multilateral financial institutions, provided that the principal has been used for revenue generating operations and that the foreign currency is brought into Guatemala via the local banking system.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

No, there are no thin capitalisation rules in Guatemala.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There is no safe harbour in Guatemala.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Not applicable (see our answer to question 3.4).

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Tax relief is conditioned to whom the interest is paid (a foreign banking and financial institution with a first rate rating in its country of origin, or to multilateral financial institutions), for what the financing has been used (the principal has been used for revenue generating operations) and how the foreign currency came into Guatemala (via the local banking system).

3.8 Does Guatemala have transfer pricing rules?

No, Guatemala has no transfer pricing rules. However, the local tax authority has general powers to determine if such practice occurs. To the best of our knowledge no such practice has been commonplace.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Corporate profits are subject to income tax, and there are two regimes:

- Default or ordinary regime: 5% calculated on gross income.
- Optional regime: 31% calculated on net income (gross income minus permitted deductions, plus capital gains).

4.2 When is that tax generally payable?

The tax year is from 1 January to 31 December for both individuals and legal entities.

Income tax is to be paid at the time the tax returned is filed. However, quarterly payments are mandatory for taxpayers paying income tax in the optional regime (31% on net income), and monthly payments must be made by those in the default regime (5% on gross income).

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Please see the answer to question 4.1.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

There are no tax grouping rules in Guatemala.

4.5 Are there any tax grouping rules? Do these allow for relief in Guatemala for losses of overseas subsidiaries?

There are no tax grouping rules in Guatemala.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

A different tax rate is not imposed upon distributed as opposed to retained profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Please see our answer to question 2.6.

4.8 Are there any local taxes not dealt with in answers to other questions?

There is a Solidarity Tax which levies a 1% tax on 25% of a company's assets or 25% of it gross income, whichever is greater. Only those companies in the optional regime (31% on net income) must report this tax, and any payments made on this tax are creditable to the Income Tax that is paid for the same fiscal year.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes. Capital gains are subject to a 10% Income Tax tariff. Capital losses are deductible only from capital gains generated five years after the year in which the loss took place.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Yes, see the answers to questions 4.1 and 5.1 respectively.

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5.3 Is there a participation exemption?

No, there is no participation exemption.

5.4 Is there any special relief for reinvestment?

No, Guatemala has no participation exemptions or relief for reinvestments.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No taxes apply to the formation of a subsidiary in Guatemala. Certain registration fees apply when incorporating the subsidiary as a Guatemalan corporation.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Both the locally formed subsidiary and the branch of a foreign company have to pay the same taxes. When a branch of a foreign company is incorporated in Guatemala, among other requirements, it is required to have capital assigned exclusively to its operations in Guatemala and to acquire a bond of at least US$50,000.00 in favour of third parties. This is not a tax, but a requirement to operate in Guatemala. Registration fees for both a subsidiary and a branch are the same.

6.3 How would the taxable profits of a local branch be determined?

Profits to be determined depend on the income tax regime (ordinary or optional) they have chosen, as has already been mentioned, and only on Guatemalan generated income. There are no special tax regimes for local branches of foreign companies.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No, as there are no branch profits taxes. The branch would be subjected to the same taxes as any Guatemalan corporation.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No, because there are no tax treaties in effect in Guatemala.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

This will depend on the manner in which remittances are being done. Any remittances made by the branch are deemed to be dividends and would be subject to a 10% withholding tax. An exemption to that tax exists but only if the branch has paid its income tax in Guatemala in accordance with the Income Tax Law.

7 Anti-avoidance

7.1 How does Guatemala address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Guatemala has criminalised tax evasion by means of a general rule determining when tax avoidance is deemed to have taken place. Such avoidance has to be proven in court by the tax authority.

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Honduras

Arias & Muñoz

Evangelina Lardizabal

1 General: Treaties

1.1 How many income tax treaties are currently in force in Honduras?

There are no income tax treaties currently in force in Honduras.

1.2 Do they generally follow the OECD or another model?

Not applicable, please see question 1.1.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. Treaties must be incorporated into domestic law before they can take effect in the country. In order to become domestic law and enforceable, treaties must first be approved by the Legislative before being ratified. If a treaty affects constitutional dispositions, the process for approval and ratification must follow the same process as for constitutional amendments. The Executive branch may sign and ratify international agreements in matters of its competence without prior approval by Congress, but must inform Congress immediately of this.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

This is not applicable because there are no income tax treaties currently in force for Honduras.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No. According to Honduran constitutional law, in the case of conflict between a treaty that has been approved and ratified and local law, the treaty will prevail. If domestic law is contradictory to such treaty, said contradictions are annulled or reformed to accommodate the treaty.

2 Transaction Taxes

2.1 Are there any documentary taxes in Honduras?

Yes. Anyone who has a document that should need to be registered at the Institute of Property (real estate transfers, mortgages, liens, pledges, powers of attorney, corporate documents, etc.) must pay documentary taxes upon their presentation at said Institute to be registered. The taxes to be paid are calculated according to the value or type of transaction at a rate of 1.5 Lempiras per each 1,000 Lempiras of the value of the transaction filed for registration or a flat fee for documents of no monetary value. In the event such document to be registered implies transfer of title of real estate, then the applicable registration fee will be equal to 1.5% of the value of the contract.

The Honduran Bar Association requires stamp tax to be affixed on any legal document issued by a Notary in Honduras. All documents filed for registration at the Institute of Property must be authorised by a Notary Public, hence requiring this stamp tax to be affixed according to the following simplified rate: 10 Lempiras per every 100,000 Lempira transaction, or in the case of transactions of no monetary value a L.5.00 stamp.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. Honduras has a tax which is called "sales tax" but operates as a value added tax. All taxpayers, except the final consumer, are reimbursed from payment at the next stage.

The general tax rate of the sales tax is 12% over the value of the taxable base of the imported goods or the sale of goods or services subject to this tax. When this tax is applied to the importation or sale of beer, liquor or other alcoholic beverages, cigarettes or other products produced with tobacco, the tax rate is 15%. In the case of beer, sodas and refreshments, this tax is applied over the sales price at the distribution level, including the value of the production or consumption tax at the importation or production level.

Sales taxes on national or international air travel tickets including those issued via the internet are collected in the place where the ticket or the e-ticket is issued. Travel agents are considered fiscal agents for this effect and they must pay these taxes to the *Dirección Ejecutiva de Ingresos* (tax authority) within 15 days of the next calendar month of the sale.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

There are several exclusions in the payment of the VAT in Honduras. In general, the most basic food products are exempt from the payment of VAT (i.e. water, bread(s), rice, flour, corn, pasta, tortillas, meats, chicken, fish, milk, milk products, vegetables

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and fruits, sugar, beans, honey, salt, coffee); medicines for human use and surgical materials; machinery and equipment necessary for the production of electricity and the necessary fuel to operate the machinery; books, newspapers, school implements; services such as: electricity, water, professional fees in general (i.e. school tuition, medical services, hospital and laboratory bills, x-rays, medical bills, land transportation services, financial services, beauty and barber shops, insurance premiums); all agricultural implements, equipment and spare parts necessary for the production of agricultural or animal products; fertilisers, chemical products necessary for farm production; animal foods, vitamins or minerals; livestock; and any raw material necessary for the production of basic food products.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

In general, yes.

2.5 Are there any other transaction taxes?

Honduras has multiple specific taxes applicable to specific transactions such as: Real Estate transfer tax; and stamp taxes.

2.6 Are there any other indirect taxes of which we should be aware?

Among various internal indirect taxes that exist in Honduras the most important are: selective consumption tax; and production and consumption tax.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

As of 22 April, 2010, taxes have once again been imposed on dividends paid out by local companies. This tax is on dividends in general and does not differentiate between residents or non-residents. The only exception to this tax rule is for dividends paid out to foreign corporate stockholders of companies submitted to special regimes; i.e. tax free zones.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes, all payments made by local companies to non-residents are subject to withholding taxes; the rate to withholding taxes has been standardised to a rate of 10% to all payments remitted out of Honduras, as of 22 April, 2010, with the tax amendments passed on this date by Congress.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes, all payments made by local companies to non-residents are subject to withholding taxes of 10%, including interest paid by a local company to a non-resident.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There is no relief in Honduras for interest so paid. There are no restrictions to relief for interest by reference to "thin capitalisation rules".

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Not applicable, please see the answer to question 3.4.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

There are no thin capitalisation rules applicable in Honduras.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

The Honduran Tax rules determine that while a shareholder can grant loans to the company that issued those shares, and interests might be applicable, the company will not be able to deduct these interests as an expense for income tax purposes.

3.8 Does Honduras have transfer pricing rules?

Honduras does not have general regulations regarding transfer pricing. However, the new and specific law that regulates the Financial System does have a few articles that set some standards relating to this subject. Such law states that financial institutions that contract with related entities (directly or indirectly) must perform such dealings under the same prices and conditions as those prevailing in the market; and related parties may not purchase any assets from related entities, unless they are being sold at a public auction.

In general practice, financial institutions executing transactions with companies that have related parties, control transfer pricing among them through contractual clauses. If this is not done, it could be considered an event of default and trigger an acceleration of the term of the loan.

Nevertheless, in an indirect manner, transfer pricing under market conditions and at arms' length agreements is understood, by application of civil, criminal and fiscal laws that prohibit any act from a company that could be construed to be an intent to commit fraud affecting creditors or the avoidance of taxes. Even so, these practices still occur, since there is no law that in a general sense orders that transactions are to be based upon market value, and even though such price could be high, it is legal to enter into these agreements at or near book value, at least as stated in the contracts.

Honduras recently approved a new law for auditing and accounting principles establishing that in the future the general applicable principles in this matter will have to observe the International Principles for Financial Information and International Auditing Principles. This will create the regulatory framework for the adoption and implementation of these international principles (NIIF or NIA), in order to obtain an adequate preparation, presentation, review and certification of accounting and financial information that will guarantee the transparency and comparability of the same, thereby generating the necessary national and international

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confidence in this information. These rules will be totally in effect by the end of 2010, as they are gradually being put forth. Therefore, we assume that based upon these principles it will become more difficult to disguise operations that while being done at market value, are registered at "book value", for the sole purpose of reducing expenses and the taxation that could be derived.

Exports of goods are valued according to the normal wholesale price of the goods at its destination. If the declared value is lower than such normal price, there will be an assumption that can be proven wrong, that the importer and the exporter are related companies, and under such assumption, the value that will be applied to these goods exported is the normal wholesale price of the applicable market.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax on corporate profits is 25% of the net taxable income.

4.2 When is that tax generally payable?

Income taxes on the corporate profits are generally payable in the month of April of the following year of the profits that are being taxed.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base for corporate profits is determined by deducting from the gross income, the duly proven, necessary and ordinary expenses paid or incurred for the production of such income during the taxable period. Examples of what would be considered a reasonable and ordinary expense could be some of the following: reasonable salaries, publicity expenses, use of materials, maintenance and repair of machinery and/or equipment or any other expense necessary for the production of the goods and services that produce such profits; insurance premiums paid to national insurance companies, interest paid over amounts of money obtained and necessary for the production of goods and services that produce the profits; depreciation of the goods that are the source of income by systems approved by the fiscal authorities; all other taxes except income tax; and damages received by goods necessary for the production of the taxable income.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Profits cause income tax (25%), and if derived from capital gains or dividends, capital gains tax and dividend tax (10%). These are the concepts our law relates to the profits of corporations.

4.5 Are there any tax grouping rules? Do these allow for relief in Honduras for losses of overseas subsidiaries?

Corporations that have identical stockholders (in name and number) are considered as ONE taxable entity. If the tax authorities group these corporations into one taxable entity, the taxes for these corporations would be added together and the tax would be calculated as one person.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

There is no distinction made in Honduran law regarding profits that are distributed or retained. Taxes are imposed and must be paid yearly at the same rate over corporate profits. No consideration is given in the law to the fact that they are to be distributed or not.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Annual property taxes are Municipal taxes. Each municipality (near 300), is free to set its own property tax rate based on what is called a "*Plan de Arbitrios*"; taxes are then calculated at the set rate over the appraised value assigned by each municipality to the specific property (*Valor Catastral*). The appraised value of properties for these purposes may only be adjusted by the municipal authorities in the years ending in 0 or 5.

Corporations also pay annual Municipal taxes based upon volume of sales, and the percentage, that is more nominal than material, changes based upon the level of gross sales.

Net asset tax, which is 1% of total assets is payable at the time income tax is paid.

Also there is the taxes payable for vehicle registration and renewal of such registration, that depend on several factors, such as the year of the model, the size of the motor, etc.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are no other local taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes, capital gains taxes are not subject to the rules applicable to corporate profits produced by commercial accounts. Capital gain taxes can be compensated only with capital losses that occur in the same fiscal year.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Yes, capital gains tax has a fixed rate of 10% and is not subject to progressive tax rates. It is calculated upon the "profit" obtained. That is, if an asset with a book value of 500 is sold for 750, such tax applies to the 250, thus resulting in 25.

5.3 Is there a participation exemption?

There is no participation exemption.

5.4 Is there any special relief for reinvestment?

There is no relief for reinvestment.

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6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The same documentary taxes applicable to the formation of any corporation in Honduras are imposed upon the formation of a subsidiary (i.e. registration taxes and Bar Association taxes). Capital duties have been repealed since the year 2002.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

None; even though the process of incorporation of both types of companies differ somewhat, the expenses incurred due to taxes or fees are similar.

6.3 How would the taxable profits of a local branch be determined?

In the same manner as a local corporation; the operations of a branch in Honduras are deemed independent from headquarter operations and the profits are regulated exactly as a local corporation. Gross profits minus reasonable expenses equal net profits which are taxed at the corporate rate applicable.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Branch profits are treated in the same manner as corporate taxes of local companies. For fiscal purposes branches are considered local companies and their profits are regulated and taxed in identical manner. Honduras has no special taxes for authorised branches of non-resident companies.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No, they would not.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

The remittance of profits by the branch of a non-resident company is not subject to any withholding tax.

7 Anti-avoidance

7.1 How does Honduras he issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Under Honduran Law tax evasion is considered as a crime. An Anti-tax avoidance law is under the National Congress's consideration which will empower our tax authority with more faculties to investigate and fight tax evasion.

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For more than 20 years Evangelina has been dedicated to the private practice of law and has counseled a variety of local and international companies, banks and insurance companies. She also provides management guidance for her client's companies.
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Hungary

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Hungary?

Hungary has entered into income tax treaties with 66 countries spanning the globe including the Member States of the European Union, most European non-EU countries and with several American, Asian, Australian and African countries.

1.2 Do they generally follow the OECD or another model?

Most of Hungary's treaties closely follow the OECD model and use the exemption method for eliminating double taxation.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

In compliance with the Constitution of Hungary, the treaties must be incorporated into Hungarian law by enactment of appropriate legislation. The date of entry into force is generally the day, or the day following the day, of publication, but it may also be that while the treaty is incorporated into domestic legislation immediately after its execution, all or part thereof may enter into force at a later date.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

As a general rule, the double taxation treaties do not contain "limitation of benefits" clauses; however, in line with the OECD Model Convention, some of the treaties rely on the concept of beneficial ownership to eliminate treaty shopping with regard to incomes from dividends, interest and royalties. The new double tax treaty between Hungary and the United States coming into effect as of January 2011 includes a "limitation of benefits" clause.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

The provisions of double taxation treaties override domestic legislation with absolute supremacy. Reciprocity also overrules domestic tax legislation; however, their application cannot result in adverse consequences on the taxpayer.

2 Transaction Taxes

2.1 Are there any documentary taxes in Hungary?

The companies must pay stamp duty for certain administrative procedures such as registration and administrative procedures, and court proceedings.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. Hungary's VAT rules mostly comply with VAT Directive 2006/112/EC. The general VAT rate is 25% and applies to most transfers of goods and performance of services. The preferential rates are 5% (e.g. sale of a defined group of human pharmaceuticals, medical equipment, district heating, books and newspapers), and 18% (e.g. milk, diary products, hotel services).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

In general, VAT must be charged by all individuals, legal entities and fixed establishments that supply goods or services on a regular or permanent basis in Hungary. Certain transactions, however, are exempt from VAT with or without the right of deduction. Exports, intra-Community supplies or services, and sales relating to international transportation and trade are exempt with the right of deduction. Numerous transactions are exempt without the right of deduction, important examples of which are:

- sale of real estate (excluding e.g. new buildings and building plots), unless the taxpayer opts for taxation;
- rental of real estate, unless the taxpayer opts for taxation;
- postal services;
- financial services; and
- insurance services, etc.

Under certain conditions small businesses can elect to be VAT exempt.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

The Hungarian legislation generally follows the EC VAT Directive and the new EU VAT Package - there are only minor exceptions.

Taxable persons registered for VAT have the possibility to deduct input VAT from the amount of the tax payable. Foreign entities

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without a business presence in Hungary may reclaim the tax charged to them in accordance with the new EU VAT Package, providing that they are registered in their home country for VAT purposes. The new refund procedure allows EU businesses to submit their refund application electronically to the tax authority of their home country.

As a general rule, input tax deriving from a business activity is fully deductible. However, input tax on the supply of goods and services used for exempt or non-business activities are non-deductible to the extent they serve these activities. Moreover, the Hungarian Act on VAT defines further restrictions on recovering VAT (e.g. purchase of fuel or a passenger car except for certain cases, purchase of food and beverages, taxi and parking services, etc.).

Input VAT in excess of VAT payable is generally reclaimable provided that certain conditions (i.e. tax registration, proper invoice, the full payment of the purchase price, minimum threshold for reclaimable amount exceeded frequency of VAT returns) are met.

2.5 Are there any other transaction taxes?

The transfer of real property – and some other properties – for consideration is subject to transfer tax payable by the purchaser, calculated on the market value of the property purchased.

The general duty on the transfer of real property is 4% of the market value up to HUF 1 billion (approximately EUR 3.6 million) and 2% for the excess (altogether capped at HUF 200 million - EUR 730,000 - per real estate). As for residential property, the duty on its transfer is only 2% for the first HUF 4 million (approximately EUR 14,500) and 4% above that amount of the market value.

Exemption from stamp duty is available for building sites providing that the purchaser undertakes to build residential real estate on it within 4 years from the date of transfer, and the size of the building reaches at least 10% of the maximum size allowed under relevant municipal regulations.

The acquisition of real property by (1) a real estate investment fund, or by (2) an entrepreneur whose main activity is trading real estate or financial lease is only subject to a duty of 2% under certain circumstances, one of the most important of which is that the real estate has to be sold or leased (financial lease) within 2 years from the date of purchase. Banks acquiring real property for a period not exceeding 3 years against their claims from debtors can also benefit from a preferential rate of 2%.

Generally, transfer tax is also levied on the indirect acquisition of real property, i.e. the acquisition (whether directly or through a chain of companies) of the shares in a company holding real estate, providing that the acquirer obtains at least 75% of the shares. For the purposes of the 75% threshold, shareholdings of relatives as well as that of related parties is aggregated. The tax base is the market value of the real estate prorated to the quota of the shares in question. Transfer tax exemption is granted if the transfer of share of a real estate holding company takes place between related parties.

2.6 Are there any other indirect taxes of which we should be aware?

Excise duties are payable by companies selling or importing certain goods, i.e. alcoholic beverages, tobacco and mineral oil (petrol, gasoline, and other derivatives of crude oil). The tax payable is calculated on an amount per unit sold basis, or as a percentage of the price. Hungary is fully integrated into the EU customs system, which means that customs duties with third countries are governed by the EU customs code.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid to corporate entities are not subject to withholding tax, irrespective of the residence of the corporate recipient.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Generally, royalties are exempt from withholding tax. However, a 30% withholding tax applies if paid by a Hungarian company or permanent establishment to a foreign corporate entity that is seated or tax resident in a country having no double tax treaty with Hungary. It is expected that from 1 January 2011 the 30% withholding tax will be abolished.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Similarly to royalties, interest paid is generally exempt from withholding tax. Nevertheless, a 30% withholding tax applies to interests if paid by a Hungarian company or permanent establishment to a foreign entity that is seated or tax resident in a country having no double tax treaty with Hungary.

Notwithstanding the above, interest paid by the Hungarian state, the Hungarian National Bank or by credit institutions and late payment interests are exempt from withholding tax.

It is expected that from 1 January 2011 the 30% withholding tax will be abolished.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Hungarian thin capitalisation rules do not affect the withholding tax exemption.

Based on the Hungarian thin capitalisation rules, interest expense accrued on the proportion of debts exceeding three times the borrower's equity is non-deductible. The ratio is calculated on the basis of the annual daily average debt and equity during the financial year.

The thin capitalisation regulations apply to all interest-bearing debts (including cash-pooling), except for debts towards financial institutions (including banks), public credit securities and notes towards suppliers, irrespective of whether the lender is a related or unrelated party.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

None other than that mentioned above.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Keeping in mind that the thin capitalisation rules also apply to all debts except debts from financial institutions, the application of the Hungarian thin capitalisation rules might be avoided through a so-called "quasi back-to-back" arrangement involving a bank. As

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indicated, the thin capitalisation regulations do not apply to loans, bonds or bills from Hungarian banks, other financial institutions or authorised foreign banks with a local registered branch. As a result, routing the loans via a bank could reduce thin capitalisation exposure. However, such structure may be subject to challenge on the basis of general anti-avoidance rules.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No, except that the interest expenses that do not incur directly in the interest of the business operation are non-deductible. In addition, interest expense deduction has to correspond to arm's length conditions if paid to a related party.

3.8 Does Hungary have transfer pricing rules?

Yes. The Hungarian rules on transfer pricing are based on the arm's length principle, and the OECD's transfer pricing guidelines apply. If the prices applied by related parties are not at arm's length, the parties should adjust their tax bases to reflect fair market prices. If the respective adjustments are not made, the tax authority may identify a tax shortage for the tax underpayment and impose (1) a penalty up to 50% of the tax shortage, and (2) a late payment interest of twice the prevailing prime rate of the National Bank of Hungary.

The market price must be determined by applying one of the following methods:

1. Comparable uncontrolled price method.
2. Resale price method.
3. Cost-plus method.
4. Any other appropriate method.

It is expected that as of 1 January 2011 the transactional net margin method and the profit split method will be added to the list of accepted methods.

For each transaction, transfer pricing documentation should be prepared to substantiate that the prices applied are at arm's length.

The documentation package shall be available by the date when the corporate income tax return of the given tax year is filed. There is no need to file the documentation package with the tax authority but it should be available if requested. If the documentation is not ready by the statutory deadline or does not comply with the relevant rules, a fine of up to HUF 2 million (approximately EUR 7,300) can be levied by the tax authority for each missing or wrong piece of documentation.

The necessary content of transfer pricing documentation is regulated by law. Among others, the documentation package should include:

- a comprehensive functional analysis of the transaction and the activities of the related parties;
- it should introduce the method used when setting the transfer price; and
- it should detail the reasoning behind the choice of the given method.

Taxpayers may choose to adopt the EU masterfile/countryfile approach (as set out in the EU code of conduct) instead of single documentation. However, this option does not avoid the need to analyse each agreement/transaction separately.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Companies shall pay 10% corporate income tax on their tax base up to HUF 500 million (approximately EUR 1.8 million) and a 19% corporate income tax rate applies on the excess.

4.2 When is that tax generally payable?

The deadline for paying the corporate income tax is generally 31 May of the year following the relevant business year. If the tax year of a taxpayer does not coincide with the calendar year, the deadline is the 150th day from the end of the fiscal year.

Generally, monthly or quarterly tax advances have to be paid during the year. In addition, companies should top up their annual tax payable for the given tax year by 20 December each year up to 90% of their expected annual tax liability.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

If a company is a Hungarian resident, its taxable income is its worldwide income. The tax base is the accounting profit in the annual financial statements prepared on the basis of the Hungarian accounting standards, adjusted by special increasing and decreasing items prescribed by the Act on Corporate Income Tax.

Some of the key adjustment items are the following:

Tax base increasing items:

- accounting depreciation; and
- costs and expenses incurred not directly in the interest of business operation, etc.

Tax base decreasing items:

- losses carried forward;
- tax depreciation;
- the amount of development reserve, which can be 50% of pre-tax profit but up to a maximum amount of HUF 500 million;
- dividends received, except for dividends received from a controlled foreign company (CFC);
- 50% of royalty income; and
- 75% of the (net) interest income received from abroad etc.

Notwithstanding the above, if both the pre-tax profit and the tax base of an entity are less than a certain minimum tax base (calculated as 2% of the entity's total revenues reduced by the costs of goods sold, the costs of mediated services and adjusted by items booked as a result of certain forms of a preferential corporate reorganisation and by the income attributable to a PE abroad). Then corporate income tax is payable on this minimum tax base, unless the taxpayer chooses to opt-out by providing a special declaration detailing its cost and income structure to the tax authority proving that its general tax base is accurate. The minimum tax base rule does not apply in the pre-company period and in the first tax year.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The profits of the commercial accounts should be used, adjusted by the increasing and decreasing items (see question 4.3 above for examples) when calculating the tax base.

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4.5 Are there any tax grouping rules? Do these allow for relief in Hungary for losses of overseas subsidiaries?

There is no group taxation under the Hungarian legislation.

Although the Hungarian legislation requires for the parent company and its subsidiaries to prepare a consolidated annual accounting report in certain cases, the tax law does not permit company groups to file a consolidated tax return.

Nevertheless, for the purposes of VAT it is possible to apply a tax group for Hungarian related parties, whereby they cease to be separate taxable entities and form one single taxable person for VAT. Thus, the supplies within the group will fall outside the scope of VAT, while supplies to outsiders will qualify as if provided by the group as a whole. However, this grouping does not affect any other tax liabilities of the members.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, the corporate income tax rate is the same for distributed and retained profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Bank levy

In 2010 a bank levy has been introduced to all financial institutions (including branches) with at least one set of annual financial statements prepared by 1 July 2010, including banks, insurance companies, stock exchanges and other financial sector businesses. A further HUF 200 billion is to be collected by bank levy in 2011 but its scope, rate and base will be determined by future legislation.

Crisis taxes

In 2010 crisis taxes hitting the energy, retail and telecom sectors have been introduced. According to the government's current plans, the crisis taxes would remain in effect for three years.

Telecommunications companies have to pay 2.5% tax on their annual net sales revenues between HUF 100 million and HUF 500 million, 4.5% on revenues between HUF 500 million and HUF 5 billion and 6.5% on the excess. The tax base up to HUF 100 million is tax-exempt.

Retail companies will also be subject to a progressive tax, at 0.1% on net sales revenues between HUF 500 million and HUF 30 billion, 0.4% between HUF 30 billion and HUF 100 billion, and 2.5% above that level. Revenues below HUF 500 million are not taxed.

Energy companies that are already subject to a special surtax, the so-called "Robin Hood" tax (which is levied at 8% on the adjusted net profits in addition to the standard corporate income tax rate), are obliged to pay an additional (flat) 1.05% of their net sales revenues.

Other taxes

The most relevant Hungarian taxes (excluding those mentioned elsewhere in the entire chapter on Hungary) are the following:

- personal income tax;
- other contributions (social security contributions: pension fund and health fund contributions, training fund contributions, contributions to the rehabilitation fund);
- health care tax;
- transfer tax on the sale, inheritance and gift of certain properties;
- company car tax;
- customs;
- excise duties;
- special bank surcharge (different form the bank levy);
- innovation contribution;
- tax levied on energy suppliers; and
- environmental charges, etc.

4.8 Are there any local taxes not dealt with in answers to other questions?

1. Local business tax

Companies registered in Hungary are subject to local business tax at a maximum rate of 2%. The tax base is the sales income less the costs of materials, costs of goods sold and mediated service fees. Mediated service fees also include the charges of subcontractors under a written contract for professional services if used for new flats (i.e. flats sold before the issue of the occupancy permit or after that for the first time).

Introduction of the local business tax is an option for local authorities, as well as setting the actual rate, however, most municipalities levy the maximum.

2. Property taxes

There are two types of real estate taxes which may be imposed by the local municipalities: (a) building tax; and (b) tax on undeveloped land.

a) Building tax

The building tax is an annual levy imposed on the registered owners of a real property. At the discretion of the given local municipality, the tax may either be calculated on the basis of the area of the building (in square meters) or on its adjusted market value (being 50% of the market value for transfer tax purposes).

The annual rate is determined by the municipality and therefore varies from region to region. The Act on Local Taxes fixes the upper limit of the rate at HUF 1241/m^2 (approximately EUR 4/m^2) or at 3% of the adjusted market value of the building.

b) Tax on land

The owner of the undeveloped land (that is not built on) situated in the territory of an urban area may be taxed by the municipality. The tax is payable by such person who is registered as owner on the first day of the given year.

The method of calculation is the same as that for the building tax (see above).

The upper limit of the tax is fixed by the Act on Local Taxes at HUF 275/m^2 (approximately EUR 1/m^2) or at 3% of the adjusted market value of the land.

The maximum amounts of the above taxes (if determined in amounts and not as percentage) are subject to a yearly increase equivalent to the officially published rate of inflation (as determined in respect of the second preceding year of the year in question).

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

As a general rule, gains realised on investment in another company (resident or non-resident) are subject to corporate income tax, while capital losses upon the transfer of shares are generally deductible.

Special rules apply to capital gains realised on "reported" investments if not held in a CFC. Capital gains on the sale of

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qualifying participations are exempt from corporate income tax (participation exemption). To qualify for the relief on "reported" investments, the non-CFC participation should reach 30%, should be reported to the tax authority within 30 days after its acquisition, and has to be held for at least one year.

The one year holding period is not a criterion for tax relief on capital gains realised due to a reduction of capital or a termination without legal succession. On the other hand, the losses incurred on the qualifying participations will not be tax deductible.

Foreign corporate shareholders deriving capital gains from a "real estate company" are subject to corporate income tax, provided that they are resident in a country in respect of which the relevant double tax treaty allows Hungary to tax the capital gains (or with which Hungary has no treaty). So far, Hungary has concluded double tax treaties with 66 countries, among them 21 treaties (e.g. those with Ireland, France) contain the so-called real estate clause allowing the taxation of capital gains from a "real estate company". These are companies, the assets of which are predominantly comprised of Hungarian situated real estate.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

There is no separate capital gain tax in Hungary, capital gains are subject to the general corporate income tax rates, noting that the sale of qualifying "reported" participations and CFC shares can be exempted from corporate income tax under the abovementioned conditions.

5.3 Is there a participation exemption?

Yes, see question 5.1 above ("reported" investments).

Participation exemption is also available for dividends received from any jurisdiction, being exempted from corporate income tax as long as the payer of the dividend is not a CFC.

5.4 Is there any special relief for reinvestment?

A development tax allowance up to 80% of the annual corporate income tax liability is granted for a maximum 10-year period for capital investments exceeding a certain value and/or creating new workplaces.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There is no capital duty imposed upon the formation of a subsidiary or a branch, just minor registration fees.

The most important registration fees are as follows:

- HUF 600,000 (approximately EUR 2,180) for a public company limited by shares and a European company limited by shares;
- HUF 100,000 (approximately EUR 360) for a private company limited by shares and for limited liability companies;
- HUF 50,000 (approximately EUR 180) for branch offices of foreign companies; and
- HUF 50,000 (approximately EUR 180) for representative offices of foreign companies.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no such other duties.

We note, however, that transactions between a Hungarian branch and its head office fall outside the scope of VAT, whereas those between a foreign entity and its Hungarian subsidiary do trigger VAT under general rules, which may be financially burdensome for a subsidiary.

6.3 How would the taxable profits of a local branch be determined?

The corporate income tax base of a local branch of a foreign entity must be determined as if it was an independent entity with regard to some special adjustment items concerning administrative costs.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no specific branch profits tax in Hungary. A branch is the organisational unit of a non-resident entity with economic independence and it is taxed at the general applicable corporate income tax rate. If a non-resident entity has several branches in Hungary, the tax base of each branch must be calculated separately.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

As branches registered in Hungary are not Hungarian tax residents, these entities may not benefit from the treaty protection of the Hungarian double tax treaties.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax or other tax liability should apply to the remittance of profits by a branch to its head office.

7 Anti-avoidance

7.1 How does Hungary address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Hungary ensures the general measures of "rule of law", and those of the "substance over form" principle to prevent tax avoidance schemes by laying down its anti-avoidance rules among the basic principles of the tax legislation. Without being prescriptive about unlawful behaviour, the interpretation and application of these anti-avoidance principles did prove to be an unpredictable tool in the tax authorities' hands as certain popular, previously approved tax planning schemes have been targeted as having been found unacceptable.

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CMS Budapest is one of the biggest international law firms in Hungary. With over 60 legal staff and around 50 highly trained support staff, including in-house translation services, the office is a one-stop-shop for the biggest and most complex transactions in Hungary and in the region.

CMS Budapest is part of the worldwide CMS network and was established in Hungary 20 years ago. We are proud to offer our highly integrated tax, commercial, corporate, banking and finance, EPC (energy, projects and construction), dispute resolution and real estate teams, especially as our law firm is top ranked by independent legal directories, such as Chambers and Partners, IFLR1000 and Legal500.

CMS Budapest has a specialised tax practice, which offers a complete range of tax planning, consulting and tax litigation services. The team provides innovative tax structuring advice as well as regulatory tax advice on VAT, transfer pricing, state subsidies, M&As as well as day-to-day tax advice. We also advise clients on international tax matters concerning profit repatriations and group reorganisations and have an impressive track record of high-value tax disputes - both in and out of court. We provide a "one-stop-shop" service that allows clients to have one point of contact without having to deal with tax and legal advisors separately.

Recent Awards:

- Tax law Excellence in Hungary by Corporate INTL in 2009
- Full service Law Firm of the Year in Hungary 2010 by Intercontinental Finance Magazine
- Business Superbrands in 2009

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Iceland

Bjarnfredur Olafsson

Bjarni Thor Bjarnason

LOGOS legal services

1 General: Treaties

1.1 How many income tax treaties are currently in force in Iceland?

Iceland has 32 tax treaties in force, one which is a multilateral treaty between the Nordic countries, to which Iceland, Sweden, Norway, Finland, Denmark and the Faroe Islands are parties. The Ministry of Finance aims at building an even more extensive treaty network and is therefore negotiating with new treaty partners.

1.2 Do they generally follow the OECD or another model?

Icelandic Tax treaties generally follow the OECD model. All new treaties follow the OECD model except the new Icelandic-US treaty.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Icelandic law provides the government of Iceland with the authority to negotiate, and enter into, tax treaties with other countries. Once the treaty has entered into force, according to its provisions and after the treaty has been published in the Official Gazette of Iceland (in Icelandic; *stjórnartíðindi*), it is, according to practice, in force in Iceland.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, Iceland has not incorporated anti-treaty shopping rules or limitation of benefits articles, except in the new Iceland-US treaty, which incorporates a limitation of benefits clause. Each treaty should always be reviewed individually. There is also a new general CFC legislation in force in Icelandic domestic tax legislation.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No, they are not.

2 Transaction Taxes

2.1 Are there any documentary taxes in Iceland?

Stamp duty is levied on: bills of exchange (0.25%); deeds on immovable property, vessels, etc. (0.4%); formation fund of limited partnership (0.5% or 1.5%); issued shares of public companies (0.5%); loan documents, bonds, etc. (1.5%); and the formation fund of partnerships (2%).

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Iceland has a VAT system, as per the Value Added Tax Act, no 50/1988, under which VAT is levied at all levels of supply of goods and services. There are two rates of VAT:

- the standard rate of VAT is 25.5% (this rate applies to any supply of goods or services which is not exempt or subject to the reduced rate of VAT); and
- a reduced rate of VAT which is 7% (this rate applies for example to food, rental of hotel rooms, CDs, books and magazines, electricity and water for heating).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Certain transactions are excluded from VAT, most importantly:

- financial and banking services;
- insurance services;
- health services, social services, education, libraries, art, sports, passenger transport and postal services; and
- rental of real property.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is only recoverable by a taxable person, i.e. a person who is required to be registered for VAT. If the Input tax, in any settlement period, exceeds the Output tax, the taxable person is entitled to a refund. Any person excluded from registration would not be entitled to such recoveries.

2.5 Are there any other transaction taxes?

No, there are no other transaction taxes levied in Iceland.

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2.6 Are there any other indirect taxes of which we should be aware?

Excise duties are levied on various goods. Customs and excise duties may apply.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Foreign individuals and legal entities are subject to a withholding tax on dividends. The applicable withholding rate for individuals is 18%, and the applicable rate for legal entities is 15%. If the recipient is a foreign limited company in a jurisdiction which is a Member of the European Union or the European Economic Area, the withholding tax can be refunded after a tax assessment. Accordingly, the net result can be 0% for EEA/EU limited companies if they file for a refund. However, it should be noted that as of 1 January 2010 such refund will be permitted only to the extent that carryover losses have first been settled.

Alternatively, the applicable withholding tax rate can be reduced in accordance with an applicable tax treaty that Iceland has entered into.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In the absence of a tax treaty, royalties paid by resident companies to non-resident companies are subject to taxation. The application of withholding tax is unclear as the tax liability is net-based.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Icelandic tax law provides for withholding tax on outbound interest payments from Iceland. However, the applicable rate will depend on whether the recipient is an individual or a legal entity. The applicable rates are:

- 18% if the recipient is an individual. However, withholding tax shall not apply to income from interest up to the amount of ISK 100,000 in each taxable year.
- 15% if the recipient is a legal entity.

The withholding tax might however be reduced depending on each individual Tax Treaty that Iceland has ratified.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Iceland does not have any thin capitalisation rules in force.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

N/A - see question 3.4.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

N/A - see question 3.4.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No, there are not.

3.8 Does Iceland have transfer pricing rules?

No. However, the Icelandic tax law provides for a general arm's length rule which requires that business terms should generally be decided on an arm's length basis.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The general corporate income tax is 18%.

4.2 When is that tax generally payable?

Companies are required to make advance income tax payments on the first day of each month of the tax year until the assessment is completed, except in January and the month in which the assessment is completed. The instalments are determined as a percentage of the previous year's tax liability, i.e. 8.5% per month for 10 months. Any tax liabilities remaining when the final tax has been assessed must be paid in monthly instalments during the rest of the tax year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In general terms the tax follows the commercial accounts subject to certain tax adjustments. Resident companies are taxable on their worldwide income and expenses incurred in acquiring, securing and maintaining taxable income are generally deductible.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Timing of income and costs can differ; also income from shares is effectively taxable too.

4.5 Are there any tax grouping rules? Do these allow for relief in Iceland for losses of overseas subsidiaries?

Group tax consolidation is permitted in Iceland. With consolidated treatment one company's losses, within the group, can immediately be set off against other companies' profits, within the group. Resident companies may elect group consolidation if one company owns 90% of the shares in another company, or if 90% of the shares in the latter company are owned by a number of companies that are all members of the same jointly taxed group. Group consolidation may not be extended to a non-resident subsidiary of a resident parent company and relief for overseas subsidiaries is therefore not allowed.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate upon distributed, as opposed to retained, profits in Iceland.

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4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

A company employing employees is subject to paying an 8.65% social security tax that is levied on all wages. Municipal real estate tax is levied on commercial real estate and varies from one municipality to another but is generally around 1.7% of the property's value. Other minor taxes are the farmers charge (1.2%), levied on farming, and the industrial charge, which is levied on the turnover of industrial companies (0.08%).

4.8 Are there any local taxes not dealt with in answers to other questions?

There are no other local taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

The corporate income tax is levied on the worldwide income of businesses which includes general business profits and capital gains. Furthermore, Icelandic tax law provides a possibility of no capital gains taxation on disposal of shares held by a company shareholder as it may be able to get a full deduction against the capital gains income. However, as of 1 January 2010 such deduction has been permitted only to the extent that carryover losses have first been settled. As of 1 January 2011 such deduction will furthermore be contingent upon the disposing company shareholder holding at least 10% of the issued share capital of the relevant company at the date of the disposal. Should the abovementioned condition be satisfied the company shareholder should be entitled to a deduction against the capital gain with the only exception being that the shares sold may not be shares in a low tax jurisdiction company. If the shares are held by an individual then an 18% tax is applicable on the capital gain.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The same 18% rate of corporate income tax applies to both business profits and capital gains although the effective rate for capital gains from shares may be 0% if the companies are entitled to a full deduction against the capital gains income, see question 5.1.

5.3 Is there a participation exemption?

No, net taxation is achieved by providing a deductible expense, see questions 5.1 and 5.2.

5.4 Is there any special relief for reinvestment?

Reinvestment relief was abolished for the 2008 income year when capital gains on the disposal of shares held by corporate shareholders were effectively not taxed. Reinvestment of companies in real estate and permanent operational assets can be used to defer taxation on income from the sale of such assets.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed on the formation of a subsidiary. There is a stamp duty on the issuance of shares in public limited liability companies.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no significant taxes or fees that would be incurred by a locally formed subsidiary but would not be incurred by a branch of a non-resident company.

6.3 How would the taxable profits of a local branch be determined?

The tax base is income allocated to the branch minus the deductible cost allocated to the branch; however there are no specific rules on how to allocate income to branches and very little practice. The tax rate is 18% if the company is: (i) a public limited company; (ii) a private limited company; or (iii) a limited partnership. Other legal entities are subject to a tax rate of 32.7%.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profit tax in Iceland.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A foreign branch would only benefit from tax treaty provisions in Iceland's treaty with its country of residence.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax would be imposed as the result of a remittance of profits by the branch.

7 Anti-avoidance

7.1 How does Iceland address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is a recently enacted CFC legislation in Iceland. Furthermore, there is a general anti-avoidance rule which Icelandic courts have used to achieve a "substance over form" approach to some extent. There is no disclosure rule.

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Bjarnfreður Ólafsson has written various articles and papers on foreign and domestic business law. He is the co-author of the Commissioner of the Inland Revenue's handbook on VAT (1998).
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Bjarni Thor Bjarnason holds an LL.M. degree from the University of Southern California.

Times have changed since Sveinn Björnsson, the future first President of Iceland, established his law firm in 1907. However, the basic principles upon which Björnsson built his success remain. In today's business environment integrity, professionalism and experience are still the guiding lights of LOGOS legal services, making it the leading law firm in Iceland.

In recent times Icelandic business has been growing fast, inside and outside of the borders. LOGOS has been growing with, and alongside those businesses. Our international affairs are now also operated from our London and Copenhagen offices, providing our full range of services and expertise. These services are already being put to good use by our clients, including some of the country's largest companies seeking their fortune abroad as well as prestigious international clients looking for insights, legal advice, and assistance in gaining a firm foothold in the unique Icelandic business arena.

This step is also important for a knowledge-driven law firm. The London and Copenhagen offices offer our staff fresh challenges and opportunities to enhance their extensive experience and post-graduate expertise that bring them to the podium, as scholars and lectures, in several universities in Iceland.

Not so many years ago no-one would have believed that an Icelandic law firm could have such an impressive presence in London and Copenhagen. I, however think that this demonstrates the unique strength of LOGOS, and that it would have made Mr. Björnsson extremely proud.

The competitive edge of LOGOS is the result of the systematic recruitment of the finest crop of professionals. LOGOS also commits itself to the sharing of information, knowledge and experience within the firm, allowing people to grow to their maximum potential. Dynamic workgroups are active in several fields of law, taking on important internal work, driving innovation and ultimately sharing knowledge and result.

The firm's specific areas of practice include Tax, Aviation and Transport, Banking and Finance, Competition, Construction and Projects, Employment, Restructuring and Bankruptcy, EU/EEA, Intellectual Property, Information Technology, Insurance, Litigation and Arbitration, Media and Entertainment, Mergers and Acquisitions, Private Equity and Security, and Telecoms.

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India

Premnath Rai

PRA Law Offices

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1 General: Treaties

1.1 How many income tax treaties are currently in force in India?

India has entered into Double Tax Avoidance Agreements (DTAA) with 60 countries under Section 90 of the Income Tax Act, 1961. Please see Annexure–A which lists the countries with which India has double tax avoidance agreements. The object of such agreements is to evolve an equitable basis for the allocation of the right to tax different types of incomes between the 'source' and 'residence' status, thereby ensuring the process tax neutrality in transactions between residents and non-residents.

1.2 Do they generally follow the OECD or another model?

India follows a near uniform pattern in as much as India has guided itself by the UN model of double tax avoidance agreements.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Section 90 of the Income-tax Act, 1961 empowers the Central Government to enter into double tax avoidance agreements with other countries. Following the signing of the double taxation avoidance agreement, the Central Government issues a notification under the Income-tax Act, 1961, specifying the date on which the agreement enters into force. Such date could precede or follow the date of the agreement.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

India has many DTAAs in which anti -treaty shopping rules have been incorporated such as India's DTAA with Singapore and UAE. However, India also has a number of DTAAs with other countries which do not have anti-treaty shopping provisions.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In India, the provisions of DTAA over ride the domestic laws. However, under Section 90(2) of the Income Tax Act, 1961, if the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under section 90(1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income Tax Act, 1961, shall apply to the extent they are more beneficial to that assessee. Thus insofar as the domestic laws are more favourable to the assessee than the DTAA, the domestic law shall apply with respect to such assessee. However, the Explanation to Section 90(3) specifically provides that charge of income-tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

2 Transaction Taxes

2.1 Are there any documentary taxes in India?

In India, stamp duty is levied on a number of instruments. Stamp duty is payable at the rates specified in the Indian Stamp Act, 1899, (i.e., the Central Government legislation) and the respective State stamp legislation.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

In India, sales tax is payable on sale of goods. This is levied under the Central Sales Act, 1956, and the respective State Sales Tax laws. In the case of goods moving from one State to another in the course of inter-state trade, sales tax is payable at the rate specified in the Central Sales Tax Act, 1956. In the case of the transaction of sale of goods occurring in one State and such transaction does not involve movement of goods in the course of inter-state, sales tax is payable at the rate specified in the respective State Sales Tax law. Some of the States have introduced Value Added Tax laws in replacement of the State Sales laws, which introduces a multi-stage tax on goods that is levied across various stages of production and supply with credit given for tax paid at each stage of value addition.

The Central Government has evolved a road map for introducing a uniform value added tax laws regime throughout the country. Since introduction of such a uniform valued tax laws regime require consent of the State Government, the Central Government is in discussion with the State Governments to arrive at consensus in introducing uniform value added tax laws.

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2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The VAT laws of various states in India provide exemption to various classes of goods and transactions. Further, immovable properties are excluded from levy of VAT.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax credit can be availed by a person, who is a registered dealer (i.e., who is registered under the VAT laws). Input tax credit can be availed in accordance with the CENVAT credit rules.

2.5 Are there any other transaction taxes?

India levies a host of indirect taxes such as Service Tax, Securities Transaction Tax, Gift Tax, dividend distribution tax, and stamp duty on instruments.

2.6 Are there any other indirect taxes of which we should be aware?

A number of other indirect taxes are payable in India such as customs duty on imports of goods and services, anti-dumping and safe guard duties to prevent dumping, excise duty on manufacture of goods, service tax on provision of services, property tax on immovable properties, etc.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Per Section 115-0 of the Income-tax Act, 1961, a domestic company is required to pay a tax on distributed profits (the dividend distribution tax) at the rate of fifteen percent. Once the dividend distribution tax is paid, the dividend income is tax free in the hands of the shareholder. Hence, no withholding tax is imposed on dividends paid by a domestic company to its shareholders, including its non-resident shareholders. However, if the non-resident shareholder receives any dividend, which has not suffered the dividend distribution tax, income-tax is payable at the rate of twenty percent.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes, tax withholding is applicable on payment of royalty to the non-resident recipient. Royalty has been defined to mean consideration for transfer of rights in respect of or for use of intellectual property *viz*. patent, invention, model, design, secret formula, process or trade mark and similar property. It includes consideration for imparting of information concerning the working or use of those properties and also for imparting of information concerning technical, industrial, commercial or scientific knowledge or skill. It makes no difference whether the consideration is by way of lump sum payment or in the form of recurring payments based on production or any other factor. It, however, does not include an income which arises from the transfer of the asset itself and is liable to be taxed in the hands of the recipient as 'Capital Gain'.

Fees for technical services refer to any consideration for the rendering of any managerial, technical or consultancy services, whether such consideration is paid in a lump sum or in any other manner. It also includes consideration for providing services of technical or other personnel as part of their service contract. It, however, does not include consideration for any construction, assembly, mining or like projects undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'salary' by virtue of the existence of an employer-employee relationship between the parties.

In India, royalty is taxable in the hands of non-residents if the same are received in or accrued in India. Income of this nature is considered as always accruing in India if the same is payable by the Government. If the income is payable by any other person, it is the place of use of the intellectual property that governs the place of accrual. If the right property or information for which royalty is payable is used for the purposes of business or profession in India or for earning income from any source in India, royalty is considered as accruing in India and, accordingly chargeable to tax.

The above position, however, does not apply in relation to lump sum royalty payment made by a resident for transfer of right in respect of computer software which is supplied by a non-resident manufacturer along with the supply of computer or computer-based equipment under any scheme approved under the policy on Computer Software Export, Software Development and Training 1986 of the Government of India. Such lump sum payment is treated as business income of the manufacturer.

Similarly 'Fees for technical services' is taxable in the hand of non-residents if the same is received in India or it accrues in India. It is considered as always accruing in India, if the income is payable by the Government. In respect of payment made by others, it is the place where the services are utilised that determine the accrual of income in India. If the services are utilised in business or profession in India or for purpose of earning income from any sources in India, the fees accrues in India regardless of any other factor existing.

Rates of taxation: In the absence of a double tax avoidance agreement in respect of agreement made up to 31st March 1976, incomes from royalty and fees for technical services was computed on actual basis after deduction of expenses which could not have exceeded twenty percent of the gross receipt. Such income of foreign companies received in pursuance of agreement after 31st March, 1976, but before 1st April, 1997, became taxable on Gross receipt basis without deduction of any expenses at the flat rate of thirty percent. Royalty and fees for technical services received in pursuance of agreement made after 31st March, 1997, is taxable at twenty percent of gross receipts. The agreement with Indian concern is required to be approved by the Central government but if it relates to a matter included in the industrial policy of the Government of India and the agreement is in accordance with that policy, such approval is not necessary. In the case of non-resident non-corporate persons, this income is taxed at the normal rate prescribed in the Finance Act on net income basis i.e. after deduction of incidental expenses.

In case of royalty in consideration of the transfer of rights in respect of Computer Software permitted to be imported under Open General Licence, a flat rate of twenty percent on Gross receipts is applied without there being any requirement of approval or without any requirement of the agreement being in accordance with the industrial policy.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes, in the absence of a double tax avoidance agreement, where the total income of a non-resident includes any income by way of

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interest received from the Government or an Indian concern on monies borrowed or debt incurred by Government or the Indian concern in foreign currency, income tax is payable in India at the rate of twenty percent.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

India does not have a regime of thin capitalisation rules.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

India does not have a "safe harbour" regime at present to provide tax relief. However, India proposes to introduce "safe harbour" rules on Transfer Pricing and the proposal is at an advanced stage of consideration. CBDT has set up a committee to formulate Safe Harbour provisions which would enable the Income Tax Authorities to accept without scrutiny tax returns of Indian units of Foreign Companies.

India has introduced a process called "advance ruling" whereby (i) a non-resident can seek determination of tax liability of the non-resident on a transaction which has been undertaken or proposed to be undertaken by a non-resident or (ii) a resident can seek determination of tax liability of a non-resident arising out of a transaction which has been undertaken or proposed to be undertaken by a resident applicant with a non-resident (see Chapter XIX-B of the Income-tax Act, 1961).

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Since India does not have a regime of thin capitalisation rules, there are no rules providing for tax on third party debt guaranteed by a parent company.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No, there are no such restrictions.

3.8 Does India have transfer pricing rules?

India does have transfer pricing rules as specified in section 92 to section 92F of the Income Tax Act, 1961.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The rate of income tax payable by a domestic company for the assessment year 2010-11 is thirty percent. Further, in case of domestic companies having a net income in excess of ten million rupees, surcharge is payable, in addition to headline rat of tax, at ten percent on the headline rate of tax (i.e., effective rate of three percent). Further education cess of two percent is payable on income tax and surcharge and secondary and higher education cess of one percent is payable on the amount of income tax and surcharge. Effective corporate income-tax rate applicable for the Assessment Year 2010-11 is as follows:

Domestic company:

On income not exceeding ten million rupees: 30% + 0% (surcharge) +0.6% (education cess) +0.3% (secondary and higher education cess) = 30.9%

On income exceeding ten million rupees: 30% + 3% (surcharge) +0.66% (education cess) +0.33% (secondary and higher education cess) = 33.99%

Foreign Company:

Base tax rate 40% + 1% (surcharge) + 0.82% (education cess) + 0.41% (secondary and higher education cess) = 42.23%

4.2 When is that tax generally payable?

In India, all companies who are liable to pay income tax are required to pay advance tax as per the following schedule:

- On or before the 15th June – Not less than fifteen percent of such advance tax.
- On or before the 15th September – Not less than forty-five percent of such advance tax, as reduced by the amount, if any, paid in the earlier instalment.
- On or before the 15th December – Not less than seventy-five percent of such advance tax, as reduced by the amount or amounts, if any, paid in the earlier instalment or instalments.
- On or before the 15th March – The whole amount of such advance tax as reduced by the amount or amounts, if any, paid in the earlier instalment or instalments.

Advance tax is payable on the current income calculated in the manner laid down in section 209 of the Income Tax Act, 1961.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In general terms, the tax follows the commercial accounts subject to certain adjustments.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

If the accounting standards stipulate standards for accounting purposes different from the rules specified in the Income-tax Act, 1961, profits for income-tax purposes should be computed in accordance with the provision of the Income-tax Act, 1961. For example, depreciation may be computed on straight line method for accounting purposes. However, the Income-tax Act, 1961, mandates that for computing profits for income-tax purposes, the depreciation should be calculated on written down value method.

4.5 Are there any tax grouping rules? Do these allow for relief in India for losses of overseas subsidiaries?

India does not permit group companies to be taxed on the basis of consolidated accounts.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

A corporate entity is required to pay income-tax on its net profits, without any distinction whether net profits is retained or distributed. An additional tax called tax on distributed profits is payable by the

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company at he rate of fifteen percent on the amount distributed by way of dividend. Once tax on distributed profits is paid, the dividend income becomes tax-free in the hands of the shareholder.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Apart from the taxes discussed above, a tax called Minimum Alternate Tax (MAT) is payable on the book profits of the company. MAT was introduced in the direct tax system to ensure that companies having large profits and declaring substantial dividends to shareholders but who were not contributing to the Govt by way of corporate tax, by availing the various incentives and exemptions provided in the Income-tax Act, 1961, pay a fixed percentage of book profit as minimum alternate tax. MAT is currently levied at the rate of ten percent.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are no other local taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

If any 'capital asset' is sold or transferred, the profits arising out of such sale are taxable as capital gains in the year in which the transfer takes place. Capital asset means all moveable or immovable property except trading goods, personal effects, agricultural land (other than within municipal areas or within 8 kilometers from it wherever notified) and gold bonds. Jewellery and ornament are not personal effects and hence their sale will attract capital gains tax.

Gains arising from transfer of immovable properties are taxed in the country where such properties are situated. Gains arising from the transfer of movable assets forming part of the business property of a permanent establishment are taxed in the country where the permanent establishment is located. Different provisions exist for taxation of capital gains arising from transfer of shares. In a number of DTAAs, the right to tax is given to the State in which the company is resident. In some other cases, the country of residence of the shareholder has this right and in some others the country of residence of the transferor has the right if the shareholding of the transferor is of a prescribed percentage.

There are separate rules for computing capital gains which provide for inflation–linked adjustment in determining the cost of the capital asset. Capital gains are classified into two categories, namely short term capital gains and long term capital gains (see question 5.2 for details).

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The capital gains tax rate differs according the category of capital gains i.e., short term capital gains and long term capital gains. The rate of capital gains tax is also different for residents and non-residents.

Capital assets are of two types i.e., long term and short term. Long-term capital assets are assets held for more than 36 months before they are sold or transferred. In case of shares, debentures and mutual fund units the period of holding required is only 12 months. Different rates of tax apply for gains on transfer of the long term and short-term capital assets. Gains on short-term capital asset are taxed as regular income.

The tax rates applicable on capital gains are as follows:

	Domestic companies	Foreign companies
Short term capital gains	15.0% + surcharge* @10% + education cess @2% + secondary and higher education cess @1%; effective rate =16.995%	15.0% + surcharge* @2.5% + education cess @2% + secondary and higher education cess @1%; effective tax rate = 15.83625%
Long term capital gains	20.0% + surcharge* @10% + education cess @2% + secondary and higher education cess @1%; effective tax rate = 22.66%	20.0% +surcharge* @2.5% + education cess @2% + secondary and higher education cess @ 1%; effective tax rate = 21.115%

* Surcharge is applicable if the net income exceeds ten million rupees.

5.3 Is there a participation exemption?

Depending n the provisions in the DTAA, a shareholder will be able to claim exemption from capital gains tax arising from sale of shares held in Indian company.

5.4 Is there any special relief for reinvestment?

Yes, exemption from capital gains taxes are available when the gains from sale of capital assets are reinvested in some other capital assets in terms of section 54B to section 54 GA Income Tax Act, 1961.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

A subsidiary of a foreign company incorporated in India would be an Indian company and will be subject to tax and exemptions as applicable to any other domestic company in India. Apart from the company incorporation related fees and stamp duties (which are payable irrespective whether the company is a domestic company or a subsidiary of a foreign company), a subsidiary of a foreign company would not be required to pay any special taxes or capital duty, on formation.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

A branch of a foreign company will be subject to taxation in India at 42.23% on income accrued in India, which is higher than the corporate tax payable by domestic company. A domestic company is required to pay dividend distribution tax at 15% on the amount it distributes by way of dividend. Dividend distribution tax is not payable by a branch office of a foreign company, on the amount of net profit after tax, it repatriates to its parent company.

But if there is a double taxation agreement with the country in which the foreign company is incorporated, the tax paid in India could be set off against the total tax payable by the parent company abroad.

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6.3 How would the taxable profits of a local branch be determined?

Subject to any treaty provisions to the contrary, in terms of Section 9(1) of Income Tax Act, 1961, the taxable profits of a local branch of a foreign company would comprise:

- Trading income arising directly or indirectly through or from the branch office or reasonably attributable to the permitted business operations of the branch office in India.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

At present, a branch of a foreign company is not liable to pay branch profit tax. However, as per the proposed Direct Tax Code though uniform tax at the rate of thirty percent is proposed to be imposed on both domestic and foreign companies, foreign companies will be required to pay branch profit tax. The effective rate of tax for a domestic company after considering the dividend distribution tax will be 39.13%, whereas, the effective tax rate in the case of a foreign company, after reckoning the branch profits tax will be 40.5%.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Yes, as per CBDT Circular: No. 728, dated 30-10-1995 in the case of remittance to a country with which India has a Double Taxation Avoidance Agreement in force, the tax to be deducted is at the rate provided in the Finance Act of the relevant year or at the rate provided in the DTAA, whichever is more beneficial to the assessee.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

A Branch Office may repatriate its profits, after payment of the applicable corporate income-tax thereon, to its parent company, on production of the prescribed documents, and on establishing that it has earned the net profit by undertaking the permitted activities. No withholding tax would be applicable on remittance of profits on which the applicable corporate income-tax has been paid. The Branch Office need not retain any profits as reserves in India.

7 Anti-avoidance

7.1 How does India address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The Draft Direct Taxes Code which is set to replace the existing Income Tax Act, 1961, introduces for the first time in the Indian tax laws a provision relating to GAAR (General Anti-Avoidance Rules).

The Code provides that if an assessee has entered into any arrangement, which is an impermissible avoidance arrangement, the same can be disregarded or re-characterised by the Commissioner of Income-Tax (CIT). The term impermissible avoidance arrangement has been defined to mean a step in, or a part or whole of, an arrangement, whose main purpose is to obtain a tax benefit, and it lacks commercial substance, or it is not entered into for *bona fide* purposes.

Further, it is presumed that the assessee has entered into an arrangement for obtaining tax benefit and the complete burden lies on the assessee to prove otherwise. The Direct Tax Code proposes to introduce GAAR in its widest amplitude and discretionary powers have been vested with the Commissioner to apply GAAR. Though the intention of the Government to enact GAAR provisions seems to prevent treaty abuse by non-residents, its applicability to domestic arrangements is well covered within the provisions.

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ANNEXURE-A

Country	Commencement – Assessment Year	Country	Commencement – Assessment Year
Australia	1993-94	Austria	1963-64
Bangladesh	1993-94	Belgium	1989-90 1999-2000 (revised)
Brazil	1994-95	Belarus	1999-2000
Bulgaria	1997-98	Canada	1987-88
China	1996-97 1999-2000 (revised)	Cyprus	1994-95
Czechoslovakia	1986-87 2001-02 (revised)	Denmark	1991-92
Finland	1985-86 2000-01 (amended protocol)	France	1996-97 (revised)
F. R. G (original) F.R.G. (Protocol) G.D.R F.R.G (revised)	1958-59 1984-85 1985-86 199-99	Greece	1964-65
Hungary	1989-90	Indonesia	1989-90
Israel	1995-96	Italy (revised)	1997-98
Japan (revised)	1991-92	Jordan	2001-02
Kazakhstan	1999-00	Kenya	1985-86
Libya	1983-84	Malta	1997-98
Malaysia	1973-74	Mauritius	1983-84
Mongolia	1995-96	Namibia	2000-01
Nepal	1990-91	Netherlands	1990-91
New Zealand	1988-89 1999-00 (amendment) 2001-02 (supplemental protocol)	Norway	1988-89
Oman	1999-00	Philippines	1996-97
Poland	1991-92	Qatar	2001-02
Romania	1989-90	Singapore	1995-96
South Africa	1999-00	South Korea	1985-86
Spain	1998	Sri Lanka	1981-82
Sweden	1990-91 1999-00 (revised)	Switzerland	1996-97
Syria	1983-84	Tanzania	1983-84
Thailand	1988-89	Trinidad &Tobago	2001-02
Turkmenistan	1999-00	Turkey	1996-96
U.A.E	1995-96	U.A.R	1970-71
U.K	1995-95 (revised)	U.S.A	1992-93
Russian Federation	2000-01	Uzbekistan	1994-95
Vietnam	1997-98	Zambia	1979-80

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Chapter 23

Ireland

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Ireland?

Ireland currently has double taxation treaties in effect, or coming into effect on 1st January 2011, with 53 countries. Another 7 treaties have also been agreed but are yet to come into effect. Ireland has entered into a double taxation treaty with Australia, Austria, Belarus, Belgium, Bulgaria, Canada, China, Chile, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Georgia (effective from January 2011), Germany, Greece, Hungary, Iceland, India, Israel, Italy, Japan, Korea (Rep. of), Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mexico, Moldova (effective from January 2011), the Netherlands, New Zealand, Norway, Pakistan, Poland, Portugal, Romania, Russia, Serbia (effective from January 2011), Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey (Rep. of) (effective from January 2011), United Kingdom, United States of America, Vietnam and Zambia. New agreements have been signed with Albania, Bahrain, Bosnia & Herzegovina, Hong Kong, Montenegro, Morocco and the United Arab Emirates. Protocols to existing agreements with Austria, Germany, Malaysia and South Africa have been signed and legal procedures to bring these into force are currently being followed. Negotiations for new agreements with Armenia, Kuwait, Singapore, Saudi Arabia, Thailand and a new agreement replacing the existing treaty with Germany have been concluded and will be signed shortly. Negotiations on Protocols to the existing agreements with Belgium and Switzerland have also been concluded and are to be signed shortly. Negotiations for new agreements with the following countries are at various stages: Argentina; Azerbaijan; Egypt; Tunisia; and Ukraine. Negotiations are at various stages for the revision of existing agreements with Cyprus, France, Italy, Korea and Pakistan.

1.2 Do they generally follow the OECD or another model?

Most of Ireland's double taxation agreements follow the OECD model treaty.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Since the enactment of the Finance Act 2006 of Ireland, a double taxation treaty will have the force of law only after an Order has been approved by the Dáil, and a law has been enacted by the Oireachtas inserting a reference to the Order into Schedule 24A of the Taxes Consolidation Act 1997. Section 33 Finance (No.2) Act 2008 now provides that certain preferential tax treatments in Irish domestic law, where one is dealing with a resident of a treaty country, can apply once a tax treaty has been signed by both Ireland and the treaty partner country.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, Ireland's tax treaties do not contain "limitation of benefits" articles. However, the Ireland/USA Double Taxation Agreement does include a "limitation of benefits" article.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In general, once a double taxation agreement has obtained force of law in Ireland, it can not be overridden by rules of Irish domestic law. The legislation giving effect to such double taxation agreements in Ireland expressly states "the arrangements shall, notwithstanding any enactment have force of law as if each such Order were an Act of the Oireachtas".

2 Transaction Taxes

2.1 Are there any documentary taxes in Ireland?

Stamp duty is chargeable in Ireland on certain instruments including those transferring ownership of property (including stocks and marketable securities) or in certain cases, agreements to transfer certain types of property. In order for an instrument to come within the charge to stamp duty, the instrument must either be executed in Ireland, or it must relate to property situated in Ireland or to any matter or thing to be done in Ireland.

The rate of duty applicable to transfers of stocks and marketable securities is 1%. For property other than shares and marketable securities, the level of duty ranges from 0% to 6% depending on the value of the transaction. There are special rates applying to residential property. Stamp duty is usually payable within 30 days of the execution of the instrument. The buyer or transferee is usually accountable for the payment of the duty.

There are a number of exemptions from the charge of stamp duty, including the transfer of certain foreign securities, intellectual property rights and certain loans. In December 2009, the Revenue

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introduced a new electronic system for stamping of instruments and the payment of stamp duty.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

VAT is charged in Ireland in respect of supplies of goods and services, acquisitions of goods and services (reverse supplies) from other E.U. Member States and imports into Ireland of goods from outside the E.U.

The standard rate of VAT is 21%, with lower rates of 13.5% and 0% applicable to certain supplies of goods and services.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

A number of supplies are either exempt from, or outside the scope of, VAT. These supplies include the provision of financial services, share issues and transfers, and the transfer of a business or part of a business between VAT registered persons. In addition, certain supplies are charged at 0%.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

A business that suffers VAT on its inputs (other then VAT on certain specified items such as entertaining, hospitality and petrol) will be entitled to recover such VAT, to the extent that the inputs are used for the purposes of its taxable supplies or for the purposes of its qualifying activities (as defined in Section 12 of the VAT Act 1972, as amended). A business which is engaged wholly in VAT-exempt activities will not be able to recover VAT on its inputs.

2.5 Are there any other transaction taxes?

Apart from stamp duty, there are some levies that apply to certain insurance contracts and financial products.

2.6 Are there any other indirect taxes of which we should be aware?

In addition to VAT, customs duty is payable on goods imported from outside the E.U. Excise duty is payable on mineral oils, alcohol and tobacco. Excise duty is also payable on electricity from 1st October 2008. Vehicle registration tax is payable in respect of all vehicles which are to be kept permanently in Ireland.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

In general, Irish companies are obliged to deduct dividend withholding tax at the standard rate of income tax (currently 20%) from dividends and certain other distributions. However there are a number of exceptions to this requirement, including situations where the Parent/Subsidiary Directive applies and also where the dividend is paid to a resident of a country with which Ireland has a double taxation agreement that is in effect, or a company controlled by such persons, provided an appropriate declaration has been made.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In general, withholding tax at the standard rate of income tax (currently 20%) must be deducted from payments of patent royalties that are within the charge to Irish tax. This applies to payments in respect of patent royalties only. There is no obligation to withhold an amount in respect of tax from royalties in respect of the right to use secret processes, trademarks etc. that are not protected as patents, unless the right to use these secret processes, trademarks etc. are incidental to the rights protected by a patent.

However, there is an exemption from the obligation of an Irish resident limited company (or an Irish branch of an E.U. resident company) to deduct tax from royalty payments to a company resident in another E.U. Member State, where the following conditions are met:

- the recipient is the beneficial owner of the royalty payment;
- either the paying company or the recipient company owns directly at least 25% of the share capital of the other for an uninterrupted period of at least two years; or
- a third E.U. resident company owns directly at least 25% of the share capital of the payor and the recipient company for an uninterrupted period of two years.

Many of Ireland's double taxation agreements provide for a 0% tax rate to apply to payments of patent royalties.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In general, withholding tax at the standard rate of income tax (currently 20%) must be deducted from payments of yearly interest that are within the charge to Irish tax. Yearly interest includes any interest that is capable of arising for a period of at least one year. This includes interest arising where no period is defined, even though in practice, the period may be significantly less.

There are a number of exemptions from the obligation to withhold tax on payments of yearly interest. These include an exemption for interest payments made by a company in the ordinary course of a trade or business carried on by it to a company that is resident in an E.U. Member State or in a country with which Ireland has a double taxation agreement that is in effect, except where such interest is paid to that company in connection with a trade or business which is carried on in Ireland by that company through a branch or agency.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Ireland does not have "thin capitalisation" rules *per se*. However, in certain circumstances, interest payments made by a company may be treated as a distribution and no tax deduction will be available to the company in respect of such interest payments. Any such interest paid is taxable as distribution in the hands of the recipient and treated as a distribution for the purposes of Irish dividend withholding tax, unless otherwise exempt.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Not applicable.

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3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Not applicable.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No. Relief is available in respect of interest incurred exclusively for the purposes of the trade and for some other qualifying purposes irrespective of where the lender is based.

3.8 Does Ireland have transfer pricing rules?

Transfer pricing rules are being introduced in Ireland with effect from 1 January 2011.

The main features of the transfer pricing rules to be applied to trading transactions between associated persons are:

- recognition of the arm's length principle and the OECD Transfer Pricing Guidelines;
- application of the arm's length principle where trading profits are understated for Irish tax purposes;
- the scope is confined to related party dealings that are taxable at Ireland's corporate tax rate of 12.5%;
- exemption for Small and Medium Enterprises;
- companies are required to have documentation available in relation to their transfer pricing policies; and
- the new rules will apply for accounting periods of companies beginning on or after 1 January 2011, but will not apply to transactions/arrangements where the relevant terms of those transactions/arrangements are agreed prior to 1 July 2010.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The standard corporation tax rate applicable to trading profits of an Irish tax resident company is 12.5%. Non-trading profits earned by a company, such as investment income, and the trading profits derived from certain types of activities, are generally taxed at a rate of 25%. Companies are also subject to tax on chargeable gains at a rate of 25% as set out at question 5.2 below.

4.2 When is that tax generally payable?

A company is obliged to file its tax return within nine months of the end of the tax year. The payment dates for tax due are dependent on whether the company is considered a "small company" (whose corporation tax liability in the preceding accounting period does not exceed €200,0000) or a "large company" (whose corporation tax liability in the preceding accounting year exceeds €200,000).

For small companies, a preliminary corporation tax payment equal to at least 90% of the final liability for an accounting period, or 100% of the prior accounting period's liability, must be paid 1 month before the end of an accounting period (by the 21st of the month). The balance of the company's tax liability is due by the 21st day of the 9th month after the end of the accounting period. Thus, a small company which prepares accounts to 31st December 2010 will pay 90% of its corporation tax liability on 21st November 2010, and the balance of its tax liability on 21st September 2011.

The preliminary tax payment for large companies occurs in two instalments. The first instalment is payable in the 6th month of the accounting period (by the 21st day of that month). This payment must equal either 50% of the corporation tax liability for the preceding accounting period or 45% of the corporation tax liability for the current accounting period. The second instalment is then payable in the 11th month of the accounting period (by the 21st day of that month) and the amount payable will bring the total preliminary tax paid to 90% of the corporation tax liability for the current year. The balance is then paid on filing of the company's tax return.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Corporation tax is charged on a company's income by reference to its commercial accounts prepared in accordance with generally accepted accounting principles for its accounting period. In computing its taxable income liable to corporation tax, a company will be allowed deductions for certain expenses and capital allowances will be available in respect of certain types of capital expenditure. Losses incurred in the current accounting period and losses forward from previous periods may be taken into account in computing taxable income.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Please see question 4.3 above.

4.5 Are there any tax grouping rules? Do these allow for relief in Ireland for losses of overseas subsidiaries?

There are extensive tax grouping rules in Ireland which allow the offset of losses incurred by a company against the profits of another group company in certain circumstances. The tax grouping rules also allow the payment of interest and charges to a group company without an obligation to deduct tax, the transfer of assets between group companies without triggering a liability to capital gains tax and the payment of dividends to a group company without an obligation to deduct tax.

An Irish resident company may claim relief for the losses of 75% of subsidiaries resident in an E.U. Member State or an EEA Member State with which Ireland has a double taxation agreement that is in effect, in certain limited circumstances. The loss must correspond to a loss that would generally be available for offset under the Irish rules, and must not be attributable to an Irish branch. In addition, the loss must not be available for offset in the current year, a prior year or a future year by the company making the loss, nor available for offset in another company in another E.U. Member State.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

In general, the same tax rate applies to distributed and retained profits. However, a company which is a close company (a company controlled by five or fewer participators or by participators who are directors (however many)), may be liable to pay a close company surcharge of 20% in respect of its undistributed estate and investment income to the extent it is not distributed within 18 months of the end of the accounting period to which it relates.

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4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Income tax is payable by individuals and other non-corporate persons resident for tax purposes in Ireland. In general, income tax is charged at a rate of 20% on income up to the standard rate band, which is currently €36,400. Income in excess of this is taxed at the marginal rate of 41%. In addition, from 1st January 2009 there has been an income levy, and since 1st May 2009, the rates have been 2% on income below €75,036 per annum, 4% for income between €75,037 and €174,980 per annum, and 6% for income above €174,980 per annum.

Individuals are also liable to capital gains tax on chargeable gains arising on the disposal of assets at a rate of 25% in respect of disposals made since 7th April 2009. Previous rates were 22% on disposals from 14th October 2008 and 20% in respect of disposals made prior to that date. A rate of 40% applies to disposals of certain foreign life assurance policies and foreign investment products.

Capital acquisitions tax is payable on gifts or inheritances, subject to various thresholds. The applicability of the thresholds will depend on the relationship of the recipient to the disponer. The rate of capital acquisitions tax on benefits taken on or after 8th April 2009 is 25%, the rate on benefits taken between 20th November 2008 and 7th April 2009 is 22%, and the rate on benefits taken between 1st December 1999 and 19th November 2008 is 20%.

In addition, commercial rates are levied on the occupiers of commercial and industrial properties by local authorities. Social contributions and health levies can also arise.

4.8 Are there any local taxes not dealt with in answers to other questions?

Other than those mentioned above, there are no further Irish taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

There is a special set of rules for taxing capital gains in Ireland.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Where a company is within the charge to corporation tax, any capital gains realised on disposals of capital assets (other than development land) are subject to corporation tax at 25%.

5.3 Is there a participation exemption?

Section 626B of the Taxes Consolidation Act 1997 of Ireland as amended contains an exemption from capital gains tax on the disposal by a company of a substantial shareholding in a subsidiary company where certain conditions are met. In order to benefit from this exemption, the parent company must have held 5% of the subsidiary's ordinary share capital, and have been entitled to 5% of the profits available for distribution and 5% of the assets available for distribution on a winding up, for a period of at least 12 months. The subsidiary must be resident for tax purposes in the E.U. or in a country with which Ireland has a double tax treaty that is in effect. In addition, at the time of disposal, the subsidiary company must be a company whose business consists wholly or mainly of the carrying on of a trade, or the business of the parent company, the subsidiary and any subsidiaries of each of these companies taken as a whole consists wholly or mainly of the carrying on of a trade.

5.4 Is there any special relief for reinvestment?

There is no special relief for reinvestment in Ireland.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The formation of a subsidiary in Ireland by a parent company does not give rise to any Irish tax consequences for the parent company.

There is no capital duty in Ireland.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no significant taxes or fees that would be incurred by an Irish subsidiary company but not by an Irish branch of a non-resident company.

6.3 How would the taxable profits of a local branch be determined?

Non-Irish resident companies that operate in Ireland through a branch or agency are liable to Irish corporation tax on trading income arising directly or indirectly from the branch, and on any other income from property or rights used for the branch, wherever that income arises. These are normally determined by the accounts prepared for the branch. The standard rate of corporation tax of 12.5% applies to the trading profits of an Irish branch.

Non-Irish resident companies may also be subject to Irish income tax if they have any Irish source income, other than income from a trade carried on by a branch in Ireland. This is unless such income is otherwise exempt under Irish domestic law or relieved from Irish tax under the provisions of a double taxation treaty that is in effect with Ireland.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax, or other taxes applicable only to branches of non-resident companies, in Ireland.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Only companies resident for the purposes of tax in Ireland can avail of Ireland's tax treaty network. Accordingly, an Irish branch of a non-resident company cannot benefit from the provisions of Ireland's double tax treaties. A branch can benefit from certain unilateral reliefs for overseas tax.

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6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

The remittance of profits by the Irish branch of a non-resident company will not be subject to withholding tax in Ireland.

7 Anti-avoidance

7.1 How does Ireland address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Section 811 of the Taxes Consolidation Act 1997 of Ireland, as amended, contains a general anti-avoidance provision to counteract certain transactions which have little or no commercial reality but are carried out primarily to create an artificial tax deduction or to avoid or reduce a tax charge.

Where the Revenue form the view that a transaction is a tax avoidance transaction, they will withdraw or deny any tax advantage arising as a result of the transaction. A transaction will not be a tax avoidance transaction, where it was undertaken with a view to the realisation of profits in the course of a business carried on by a taxpayer and was not undertaken primarily to confer a tax advantage. Similarly, a transaction which is undertaken to avoid the benefit of any relief, allowance or other abatement and does not result in a misuse or abuse of the provision having regard to the purpose for which it was provided, will not be a tax avoidance transaction.

Section 811A Taxes Consolidation Act 1997 allows a taxpayer to make a protective notification to the Revenue in respect of a transaction within 90 days of beginning a transaction, in circumstances where the taxpayer feels that there may be a risk that the transaction will be regarded as a tax avoidance transaction. Making a notification under section 811A will protect the taxpayer from interest and a surcharge should the Revenue successfully challenge the transaction as a tax avoidance transaction.

In addition, a new Mandatory Disclosure Regime for certain types of tax avoidance arrangements has been introduced in the Finance Act 2010 of Ireland. Regulations in respect of this new regime are expected to be enacted in late 2010/early 2011.

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Israel

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Israel?

As of 2010, there are 50 double tax treaties to which Israel is a party and which are in force in Israel.

1.2 Do they generally follow the OECD or another model?

Israel's double tax treaties generally follow the OECD Model, with the exception of a number of treaties (with Britain, Germany, Norway and Sweden) that were signed in the 1960s and 1970s before the OECD Model became widely accepted.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Section 196 of the Israeli Income Tax Ordinance [New Version], 1961 (the "**Ordinance**") states that a double tax treaty, which has come into force by virtue of an Order of the Minister of Finance, will be valid notwithstanding any legislation. Whether this applies also to subsequently introduced legislation is a question that has not been determined under Israeli law.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Until the 1990s, none of Israel's income tax treaties included a "limitation of benefits" article. That said, a number of Israel's pre-1990s income tax treaties included "subject to tax" provisions (i.e. relief in the State of source was only available if the income was subject to tax in the State of residence) or clauses requiring that income be received in the State of residence as a condition to being eligible for tax exemption or relief in the State of source. In light of the increasing use of sophisticated tax planning and the growing phenomenon of treaty shopping, Israel has sought in recent years to include "limitation of benefits" articles in its new treaties. Since 1994, the majority of income tax treaties that came into force in Israel include some form of "limitation of benefits" provisions. The terms of these provisions vary substantially from treaty to treaty.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Regarding the question of whether the provisions of a double tax treaty may be overridden by anti-tax avoidance rules of domestic law, the Israeli tax authorities take the view that anti-avoidance provisions in domestic tax legislation may override the provisions of a double tax treaty, and accordingly, tax relief under a double tax treaty may be denied by virtue of the application of a domestic law anti-avoidance provision. This issue has been discussed by the District Court of Tel Aviv, which generally adopted the view of the Income Tax Authorities and which determined that the relevant treaty provisions should be read in light of the local anti-avoidance rules. This view is, however, disputed by some legal academics.

There are a number of laws in Israel which are basic laws and form part of Israel's constitution. A question arises as to whether these laws do in fact override the relevant treaty provisions. It should be mentioned that the basic laws are general in their nature and mainly refer to specific human rights.

2 Transaction Taxes

2.1 Are there any documentary taxes in Israel?

No. Stamp duty was abolished in Israel for documents executed on or after January 1, 2006.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Israel has a Value Added Tax (VAT) that is imposed under the Value Added Tax Law, 1975 (the "**VAT Law**"). The standard rate of VAT is currently 16 per cent.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Under the VAT Law, VAT is charged on transactions in Israel and on the importation of goods into Israel. A transaction that is a sale of goods is deemed to take place in Israel if, in the case of a tangible asset, it was delivered in Israel or exported, and in the case of an intangible asset, if the seller is an Israeli resident. The VAT Law also specifies that certain transactions are zero-rated (principally, exports of goods and services) or exempt (such as certain financial services and certain real estate transactions). The provision of

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services to a non-resident is generally not zero-rated if the service relates to an asset situated in Israel or if the service is rendered to an Israeli party as well.

Charitable organisations and financial institutions are subject to a separate VAT regime. Financial institutions are subject to a 16% profit tax and 16% tax on the paid salaries (salary tax), subject to certain adjustments. Charitable organisations are only subject to a 16% salary tax on the paid salaries. The profit and salary taxes are economically equivalent to VAT.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Under the VAT Law, businesses are entitled to recover VAT costs in connection with goods or services used by the business to create its taxable (including a zero-rated) supply.

Regulations made under the VAT Law limit the ability of a business to recover VAT costs in certain circumstances, for example, if it is with regards to goods or services that are used for the benefit of the business's employees.

2.5 Are there any other transaction taxes?

There are transaction taxes in respect of transactions in real estate (including transactions involving rights in "real estate associations"). Real estate transactions are subject to acquisition tax, which is charged as a percentage of the value of the transaction. The rate of acquisition tax depends on the nature of the transaction, but will not exceed 5%.

2.6 Are there any other indirect taxes of which we should be aware?

Israel imposes customs duties on certain imported goods and sales tax on certain imported and domestic goods. Israel also imposes various duties, e.g. trade levies and dumping levies pursuant to the Trade Levy Law, 1991.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid by an Israeli resident company to a non-resident are generally subject to withholding tax at the rate of 20% (dividends received by a taxpayer who is a significant shareholder (i.e. holding 10% or more of the means of control in the company), at the time of distribution or during the preceding 12-month period, is subject to a tax rate of 25%) of the gross amount paid. In the case of dividends paid out of profits deriving from an "approved enterprise" as defined in the Encouragement of Capital Investments Law, 1959 (the "**Capital Investments Law**"), the rate of withholding tax is 15%, although under some circumstances this rate may be reduced to 4%. The rate of withholding tax imposed under domestic law may be reduced under an applicable income tax treaty. The rate of withholding tax on dividends under Israel's income tax treaties varies from 0% to 25%.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid by an Israeli company to a non-resident are subject to withholding tax at the rate of 25% of the gross amount paid. This withholding tax rate may be reduced by an applicable double tax treaty. The rate of withholding tax on royalties under Israel's income tax treaties varies between 0% and 15%.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Interest paid by a local company to a non-resident is generally subject to withholding tax at the rate of 20% (25% to a non-resident corporate or to a significant shareholder, as defined above) of the gross amount paid, although the Minster of Finance is authorised to exempt interest payments from withholding tax in certain circumstances. The withholding rate may be reduced by an applicable income tax treaty. The rate of withholding tax on interest under Israel's income tax treaties varies between 0% and 25%.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There are no "thin capitalisation" rules under Israeli domestic tax rules or under Israel's tax treaties.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Not applicable, see question 3.4 above.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Not applicable, see question 3.4 above.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Not applicable, see question 3.3 above.

3.8 Does Israel have transfer pricing rules?

Section 85A of the Ordinance states that where there is a special relationship between the parties to an international transaction, as a result of which the price of the transaction results in a smaller profit than would have been realised if the transaction price had been set on arm's length terms, the transaction must be reported and taxed on the basis of its fair market value. Regulations published in 2006 stipulate certain methods that should be used in order to determine fair market value. The preferred method is to compare the price of the transaction in question with the price of a similar international transaction between unconnected parties. If this method cannot be used, then the taxpayer must use one of the following methods: (i) a comparison between the profitability rate of the transaction in question and a similar transaction; or (ii) a comparison between profit and loss allocation between the parties under the transaction in question and a similar transaction. If none of the above methods can be used, the taxpayer is permitted to use any other suitable method of comparison.

The Regulations do not specifically require the taxpayer to prepare an annual transfer pricing study. However, the tax assessing officer

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has the authority to demand a transfer pricing study at any time within 60 days. In addition, the taxpayer is required to describe the terms of any international transaction with a party with whom it has a special relationship (price, conditions, and the price and conditions of an arm's length transaction) in its annual tax return to be set out in a special annex to the tax return.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The rate of tax on corporate profits in Israel is 25% in 2010 (and it is anticipated to be reduced in 2011 to 24%; 2012 to 23%; 2013 to 22%; 2014 to 21%; 2015 to 20%; and 2016 and thereafter to 18%). The rate of corporate tax on profits deriving from an "approved enterprise", as defined under the Capital Investments Law, ranges from 0% to 25%.

4.2 When is that tax generally payable?

Corporate tax is generally assessed for the calendar year. Generally, the greater part of the tax is paid during the tax year through estimated advance tax payments. The final tax payment is made, together with the filing of the annual tax return, by 31 May. following the end of the tax year. It is possible, in certain circumstances, to obtain an extension for the filing and payment deadline.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base for Israeli corporate tax is the company's net income as determined under Israeli accounting principles, as adjusted in accordance with the provisions of the Ordinance and regulations made there.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

There are differences between the accounting rules and the tax rules which are set out in the Ordinance and the regulations thereto. The principal differences are as follows: (i) the amortisation rate according to the Ordinance differs from the applicable rate under the relevant accounting rules; (ii) there are segments or assets which are entitled to acceleration appreciation under the Ordinance; (iii) certain kinds of expenses are limited in respect of the ability to be deducted from income, such as expenses attributable to overseas travel, car expenses and similar expenses which are determined under relevant regulations and are in the nature of benefits; (iv) there are certain exemptions, for example exemption from income generated from inflationary increases or from exchange differentials; and (v) another example of such differences is that since in most cases there are no tax grouping rules (as described below), then accounting income which derives under these rules is eliminated for the purpose of the tax return.

4.5 Are there any tax grouping rules? Do these allow for relief in Israel for losses of overseas subsidiaries?

Tax grouping rules exist under Israeli law for an Israeli resident "industrial" company or a company which is a holding company of industrial companies. An industrial company is a company which receives at least 90% of its revenues from an industrial facility engaged in manufacturing activities. An industrial company, or an industrial holding company, may file a single consolidated tax return in respect of itself and its subsidiaries which are themselves industrial companies provided that all industrial companies included in the consolidation are part of a single assembly line or manufacturing process. An industrial holding company which has subsidiaries engaged in different assembly lines is entitled to consolidate its return only with the company or companies having a single assembly line in which it has the largest capital investment. Other than this, there are no tax consolidation rules under Israeli tax law.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

In general, distributed and retained profits are taxed at the same corporate tax rate. Companies that hold an "approved enterprise" status under the Capital Investments Law are entitled to elect for a temporary corporate tax exemption in respect of profits deriving from the approved enterprise. Such tax exemption applies only in respect of undistributed profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

As of 1 January 2000, the rate of property tax in Israel is 0%. There are currently no capital or net assets taxes levied in Israel.

4.8 Are there any local taxes not dealt with in answers to other questions?

A municipal tax ("*arnona*") is imposed on real property, the rate of which depends on the size, location and use of the property and also on the type of local authority.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes, there are special rules for the taxation of capital gains and losses in Israel. These rules are set out in Part E of the Ordinance. Capital gains and losses arising from transactions in Israeli real estate (including real estate associations) are taxed in accordance with the Land Taxation Law, 1963.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Real capital gains (that is, after adjustment for inflation) accruing to individuals are taxed at the rate of 20% (25% in a case of a sale of shares by a significant shareholder, as defined above). Real capital gains of companies are taxed at the rate of 25%, or the regular corporate tax rate for gains arising with respect to traded securities. Where the asset that is sold was purchased prior to January 1, 2003, the tax rate is different and, roughly speaking, is based on an average of the above tax rate, the regular corporate tax rate and the marginal tax rate for individuals.

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5.3 Is there a participation exemption?

As of January 1 2006, corporations that are classified as Israeli Holding Companies are entitled to a participation exemption. The tax benefits available to an Israeli Holding Company include the following: (i) dividends which the Israeli Holding Company receives from its subsidiaries are tax exempt; (ii) capital gains from the sale of subsidiaries are tax exempt; (iii) dividend distributions from the Israeli Holding Company to its foreign shareholders are subject to a reduced withholding rate of 5%; (iv) interest income, dividends and capital gains that the Israeli Holding Company receives from securities which are traded on the Tel Aviv Stock Exchange are tax exempt; (v) interest received from certain financial institutions is tax exempt; and (vi) the Israeli Holding Company is not subject to the Israeli controlled foreign corporation regime. Israeli shareholders of the Israeli Holding Company are not entitled to the above benefits.

In order to qualify as an Israeli Holding Company, the company must be registered, and managed and controlled, in Israel. The company must be a private company and may not be created as a result of a tax-exempt reorganisation. The Israeli Holding Company must invest at least NIS 50 million (approximately USD 11 million) in its subsidiaries and the tax base of the Israeli Holding Company's subsidiaries may not be less than 75% of the tax base of its total assets. In addition, an Israeli Holding Company may not hold more than 20% of its assets in Israel (determined according to the cost base of the assets) or derive more than 20% of its income from Israel. At the subsidiary level, it is required that the subsidiary resides in a treaty country or in a country with at least a 15% corporate tax rate.

In addition, it is required that 75% or more of the subsidiary's income will be derived from a trade or business. It is also required that the Israeli Holding Company will hold at least 10% of its subsidiary's stock for a continuous period of at least 12 months.

5.4 Is there any special relief for reinvestment?

With regard to appreciated assets, a capital gain which arises in the case of a replaced asset is deferred until the sale of the new asset which replaced the old asset, subject to certain conditions. The principal condition is that the price purchase of the new asset will be higher than the sale price of the replaced asset.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed upon the formation of a subsidiary in Israel.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no significant taxes or fees that will be incurred by a locally formed subsidiary but not by a branch of a non-resident company. However, repatriation of profits by a subsidiary by way of dividend distribution is subject to a withholding tax that would not apply in the case of repatriation of profits by a branch.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch are generally calculated by reference to the income and deductions attributable to the branch under the assumption that it operates as an independent business unit and in accordance with transfer pricing rules.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

In general, there is no branch profit tax in Israel. However, in the case of a non-resident company that has "approved enterprise" status under the Capital Investments Law, its profits are subject to tax at the rate of 15% in addition to the corporate tax that applies to such profits. The Income Tax Commissioner is authorised to defer payment of the 15% tax if it is shown that such profits remain in Israel and are used for the purpose of the company's business in Israel.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Since a branch will generally not be treated as a resident of Israel for tax purposes, it will not be eligible to benefit from the provisions of Israel's tax treaties. A branch will usually be entitled to the benefit of a "non-discrimination" article in Israel's treaties; however, there is currently no rule of law or court decision in Israel that would entitle the branch to obtain tax relief pursuant to a tax treaty to which Israel is a party.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No. (See also question 6.4 above.)

7 Anti-avoidance

7.1 How does Israel address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Section 86 of the Ordinance is a general anti-avoidance provision which permits a tax assessing officer to disregard a transaction which is artificial or fictitious, or one of whose principal objectives is an improper avoidance or reduction of tax. In addition, even in the absence of express statutory provisions, the "substance over form" doctrine is a generally accepted principle of Israeli case law. Regulations have also been made under the Ordinance which imposes a disclosure requirement with respect to certain defined categories of transactions.

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Eldar Ben-Ruby is a member of the public committee regarding the tax implications of the IFRS rules and acts as a special tax counsel to the Israel Venture Association. He often lectures and advises government agencies on the special features and requirements of investment funds.

HFN's Tax Department is the largest and most broadly experienced tax team for international transactions of any law firm in Israel. The Department is pre-eminent not only due to the scope of its practice and its expertise in international tax planning, but also due to its influence on Israel's tax regime in general. HFN's tax lawyers have long been involved in structuring major international transactions, as well as obtaining landmark tax rulings which have shaped Israel's Hi-tech and venture capital industry.

Members of the department, with years of experience at the forefront of public discussions on major domestic and international tax issues, advise the Finance Ministry and various tax authorities on proposed legislation and tax policy issues and frequently play a role in the preparation and review of proposed changes to Israeli tax law and practice.

The Tax Department's work includes tax advice for Israeli and cross-border transactions of all types, including advice on multinational mergers, acquisitions, investments, project finance, transfer pricing, competent authorities procedures, and derivatives; tax advice to domestic and multinational corporations with respect to public offerings and private placements of equity, debt, and hybrid securities; tax advice regarding real estate acquisitions and municipal laws, financing, and restructuring related workout transactions.

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Italy

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Italy?

Italy has a network of 93 income tax treaties currently in force.

1.2 Do they generally follow the OECD or another model?

The treaties are based on and generally follow the OECD Model Convention.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. Tax treaties must be ratified by an ordinary law approved by the Italian Parliament. A treaty enters into force from the date determined by the treaty itself. However, tax treaties generally enter into force after the expiration of 30 days following the date on which the instruments of ratification are exchanged and will have effect in relation to income for taxable periods beginning on or after 1 January of the calendar year following that in which the instruments of ratification are exchanged.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Treaty abuse is usually prevented by means of "subject-to-tax" and "beneficial ownership" clauses as provided for by the OECD Model Convention.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Tax treaties prevail over domestic legislation and, therefore, in case of conflict between a provision of a tax treaty and domestic law, other than the Constitution, the tax treaty prevails, irrespective of whether legislation is prior or subsequent to the treaty. However, if more favourable to the taxpayer, the domestic rules shall apply even though they are in contrast with a tax treaty's clause.

2 Transaction Taxes

2.1 Are there any documentary taxes in Italy?

Almost all legal documents are subject to stamp duty (*Imposta di bollo*). The tax ordinarily amounts to €14.62 every four pages or 100 lines of the document (every 100 pages in case of corporate ledgers).

Deeds and legal documents executed in Italy must be registered with the Revenue Agency and be subjected to Registration Tax (*Imposta di registro*) at rates which can vary depending on the nature of the deed (up to 8% for the transfer of buildings and up to 3% for the transfer of business, which does not include real estate properties and other transfer deeds). Also the taxable base may vary depending on the nature of the deed.

Registration Tax applies to deeds and legal documents which are executed in Italy but subject to VAT at a nominal fixed amount (€168).

Deeds, agreements and legal documents executed outside the territory of the Republic of Italy are not subject to Registration Tax in connection with their execution and entry into force, including the carrying out of the formalities necessary for their perfection. However, they would be subject to registration in Italy in "case of use". For the purposes of the Italian registration tax, a "case of use" (*caso d'uso*) occurs when a document is: (i) deposited with a judiciary office for administrative purposes only (e.g. the mere production of a document in court does not represent a "case of use"); or (ii) deposited with a government agency or local authority, unless such deposit is mandatory by law or regulation or is required in order for the relevant government agency or local authority to comply with its own obligations).

The transfer of a going concern existing in Italy shall be registered in any case.

Transfers of real estate properties are also liable to cadastral and mortgage taxes, on the same taxable base and at tax rates set respectively at 1% and 2% or 3%, depending on the nature of the building (different rates can apply in specific cases).

As of 1 March 2002, deeds, decrees, orders and the other documents relating to, *inter alia*, civil, criminal and administrative proceedings, are no longer subject to stamp duties and administrative and judiciary charges. As of that date, such duties and charges (which do not include registration taxes) are replaced by a single charge (the *contributo unificato per le spese degli atti giudiziari*), due up front, up to €1,110, depending on the value of the proceeding.

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2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Italy, as an EU Member State, has value added tax (VAT) in compliance with the European directives. VAT is due on supplies of goods and services carried out in the course of a business activity or of the execution of an artistic or professional activity within the territory of the Republic of Italy.

There are three rates of VAT:

- the standard rate which is equal to 20%;
- the reduced rate of 10% which applies to certain supplies of goods and services including supplies of certain agricultural and cattle-breeding products, food and non-alcoholic drinks, beer, passenger transport, catering, hotel accommodation, supplies of pharmaceutical products for human or veterinary medicine, some oil products, theatre and cinema, renovation on certain categories of real estate; and
- the reduced rate of 4%, which mainly applies to the supply of certain basic food (milk, vegetables, fruits, etc.), books and other printed matter.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Italian VAT law provides for exemptions and exclusions, as allowed or required by the EU Directive. Exemptions include banking and financial services, insurance services, sanitary and diagnostic services and transactions concerning shares, bonds and other securities, sales and leases of real estate properties (but with the option in certain cases for the taxable regime), as well as exports and intra-community supplies of goods.

Exclusions include the disposal of money or receivables, the sale or contribution in kind in corporate entities of business units, the transfer of goods as a consequence of mergers and demergers, copyright licenses and bond issues.

The 2010 VAT Package has acknowledged the provisions of EU Directive no. 2008/8/EC related to the place of supply of services, introducing *inter alia* the application of a reverse charge by the customer where services are supplied by a foreign subject to an Italian VAT established entity and, on the other side, excluding the VAT application in case of supply from an Italian VAT entity to a VAT customer established in the EU.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is only recoverable by a VAT person, i.e. a person who is registered for VAT.

Input tax on supplies of goods and/or services is recoverable if used to make VAT taxable supplies (or certain exempt transactions entitling to the recovery of VAT such as exports and international services).

If supplies are used for exempt supplies or for supplies out of the VAT scope, the relevant input tax is not recoverable.

Where a VAT person carries on both exempt and taxable activities, a partial deduction regime (with a general *pro rata*) is applied.

Moreover, a partial deduction (to be determined on an objective base) of VAT applies on purchases related both to taxable and exempt or out of scope transactions.

Finally, VAT law states specific limitations over the deduction for certain purchased/imported goods and services (e.g. motor vehicles, transports, drinks and food and entertainment).

2.5 Are there any other transaction taxes?

No. The tax due on financial instruments' transfers (*Tassa sui contratti di borsa*), previously in force, was repealed starting from December 31, 2007.

2.6 Are there any other indirect taxes of which we should be aware?

Customs duties are generally payable on goods imported from outside the EU.

Excise duties are levied on oil, energy products, electricity and particular classes of goods (e.g. alcohol and tobacco).

Insurance premium tax is charged on receipts of a premium by an insurer under a taxable insurance contract.

Loans granted by banks or other financial institutions with a duration exceeding 18 months are subject to a substitute tax at a rate of 0.25%. The tax rate is equal to 2% for loans granted for the purchase of real estate properties other than those used as a main abode.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid to non-resident entities without a permanent establishment in Italy are subject to a withholding tax or a substitute tax at a rate of 27%. The tax rate is reduced to 12.5% for savings shares and to 11% for shares held by pension funds incorporated in an EU Member State or in an EEA Member State included in a so-called "white list".

However, under domestic Italian law, provided a refund procedure is implemented according to the conditions and terms established by law, non-resident shareholders subject to the 27% tax rate may recover from the Italian tax authorities up to 4/9 of the withholding tax or substitute tax on dividends received by providing evidence of full payment of income tax on such dividends in their country of residence in an amount at least equal to the total refund claimed.

As an alternative to the above refund procedure, reduced rates of withholding tax or substitute tax may apply to non-resident shareholders who are entitled to, and comply with, procedures for claiming benefits under a double tax treaty entered into by Italy.

The Parent-Subsidiary Directive applies (i.e. no substitute tax or withholding tax is levied) to dividends paid to companies resident of other EU Member States, incorporated in a form provided for by the Directive, which are subject to a corporate tax in their home countries and which hold at least 10% of the share capital of the Italian company, for at least one year. The Parent Subsidiary Directive provisions can apply also to companies resident of non-EU Member States which have signed an agreement to acknowledge the Directive (e.g. Switzerland).

Starting from the distribution of dividends out of profits realised in fiscal year 2008, dividends paid to entities which are subject to a corporate tax in other EU or EEA Member States included in a so-called "white list" are subject to a withholding tax or substitute tax at a rate of 1.375%.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid by an Italian resident entity to a non-resident person

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are subject to a withholding tax at a rate of 30%. The withholding tax is levied on 75% of the related amount (100% in case the royalties have been acquired without consideration or *mortis causa*). The withholding tax rate, if due, can be reduced for non-resident persons who are entitled to, and comply with, procedures for claiming benefits under a double tax treaty entered into by Italy.

Royalties paid to associated companies resident of other EU Member States may be exempted from withholding tax if conditions provided for by Directive 2003/49/EC are met.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In general, interest payments to non-resident persons are subject to a final withholding tax at the same rates applicable to interest paid to residents (i.e. 27% and 12.5%, depending on the source of interest – loans, bonds, atypical securities, etc. – and the residence of the lender). Withholding tax rates can be reduced under double tax treaties.

No withholding tax is levied on interests paid to non-resident persons on deposit accounts with banks and post offices.

Interests paid to non-resident persons on bonds issued by banks or listed companies, and with a maturity of at least 18 months, are exempt provided that the non-Italian resident beneficial owner complies with a specific procedure required for by Italian tax law and is either: (i) resident, for tax purposes, in a country which allows for a satisfactory exchange of information with Italy; (ii) an international body or entity set up in accordance with international agreements which have entered into force in Italy; (iii) a Central Bank or an entity which manages, *inter alia*, the official reserves of a foreign State; or (iv) an institutional investor which is incorporated in a country which allows for a satisfactory exchange of information with Italy, even if it does not possess the status of a taxpayer in its own country of residence. In the event that the bonds are redeemed in whole or in part prior to 18 months from the issue date, the issuer will be required to pay a tax equal to 20% in respect of the interest and other amounts accrued from the date of the issue up to the time of the early redemption.

A withholding tax at the rate of 27% applies to interest on loans paid to persons resident of a non-EU Member State with a preferred tax regime.

Interest paid to associated companies resident of other EU Member States may be exempted from withholding tax if conditions provided for by Directive 2003/49/EC are met.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Starting from 2008 the rules providing restrictions on the deduction of payable interest have been reformed repealing the "thin capitalisation" rules, as well as the "*pro rata*" rules.

The new rules provide that interest payables are generally fully deductible up to the amount of accounted (and taxed) interest receivable. The exceeding amount is deductible (i) in the fiscal year in which it accrues up to 30% of the yearly EBITDA and (ii) for the exceeding amount in the subsequent fiscal years, subject to certain limits and conditions.

Different rules are provided for banks, asset management companies, investments firms, real estate intermediaries, financial intermediaries, insurance companies and holding companies of banking and insurance groups: in this case, the interest payables are deductible on a lump-sum basis in the limit of 96% of their amount.

Specific provisions apply to companies belonging to the same group that opt for the so-called tax consolidation regime (see question 4.5 below).

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There are no safe harbour rules.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

The rules providing restrictions on the deduction of payable interest mentioned in question 3.4 apply to interests deriving from: (i) loans; (ii) lease contracts; (iii) issued bonds (or similar debt securities); and (iv) any other financial transaction excluding commercial debts, independently from the status of the lender (e.g. shareholder, financial institution, etc.).

Warranties granted by a parent company are not relevant.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Interest payments to non-residents are not subject to specific restrictions apart from those applicable in general to costs paid to entities resident in a tax haven country, which - basically - are not deductible unless certain requirements are met (i.e., the Italian resident companies prove: (i) that the non-resident entities carry out an effective commercial activity; or (ii) that there was an effective economic interest in the carried out transactions and the same have been effectively realised).

Moreover, where the interest payments pertain to cross-border transactions between associate companies, restrictions can arise from the application of the Italian transfer pricing rules mentioned in question 3.8 below.

3.8 Does Italy have transfer pricing rules?

The Italian transfer pricing rules are based on and generally follow the OECD Transfer Pricing Guidelines, which have been recently revised by the OECD itself (22 July, 2010).

Italian transfer pricing rules apply only to cross-border transactions between associated companies. However the double taxation caused by a transfer pricing adjustment can be mitigated by the provisions of a double tax treaty.

In 2003 an international ruling process has been introduced to allow companies with international activities to agree in advance with the Italian Tax Administration criteria to set transfer pricing rules, interest, dividends and royalties for a three-fiscal-year period.

However, according to a new provision introduced during 2010, taxpayers that suffer a transfer pricing adjustment are no longer subject to relevant penalties if specific transfer pricing documentation is provided during the audit. Particularly, taxpayers have (i) to prepare documentation drawn up in accordance with the relevant regulation issued by the Italian Revenue Agency, and (ii) to notify the revenue office that they have the aforesaid documentation. Transfer pricing documentation in Italy is not mandatory. However, taxpayers who have it are protected from penalties, which ordinarily fall in the range of 100% to 200% of the additional tax assessed, percentages reducible

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in case of assent ("*adesione*") of the taxpayer to the assessment issued by the Italian Revenue Agency.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

As a general rule, Italian corporations are subject to IRES, a corporate income tax, at a flat rate of 27.5%, and to IRAP, a regional tax applied on business activities, at a standard rate of 3.9% (subject to possible regional surcharges).

In addition, a 5.5% IRES surtax applies to certain energy (oil and gas) companies.

IRAP is determined on a different tax base in respect to IRES.

4.2 When is that tax generally payable?

IRES and IRAP are paid, on the basis of the tax return to be filed by the taxpayers with reference to each fiscal year, in two advance instalments, followed, when due, by a settlement payment.

The total advanced amount can be determined in two ways: 100% of the tax due for the previous fiscal year – as resulting from tax return – or, in certain case, based on the expected tax liability for the current fiscal year.

The first advance payment, corresponding to 40% of the total advance, is due within the same term provided for the settlement payment of the previous fiscal year.

The second advance payment, corresponding to 60% of the total advance, is due within the end of the 11th month after the previous fiscal year end date.

The settlement payment is due within the 16th of the 6th month after the fiscal year end date.

Normally, the settlement payment and the first instalment may be paid one month later than the relevant deadline, with additional interest equal to 0.4%. These amounts may also be paid through monthly equal instalments (the last one not later than the deadline provided for the second advance payment).

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In general terms, IRES taxable base consists of all net income earned during the tax period as arising from the profit and loss account approved by the shareholders' meeting for corporate law purposes, subject to specific adjustments for tax purposes (see question 4.4 below).

As a rule, taxable business income is determined on an accrual basis (except for certain amounts, such as dividends or directors fees), and costs and expenses may be deducted only if they are business-related.

Tax losses generally can be carried forward up to the five tax periods following the one in which they arise, subject to certain clawback provisions.

IRAP taxable base consists of the value of the net production deriving from the business carried out in the Italian territory (calculated on different items in relation to the type of activity carried out).

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

For Italian resident corporations, the most significant adjustments for IRES purposes are the following:

- provided that certain conditions are met, capital gains derived from the disposal of assets can be spread on a straight line basis over 5 years (see section 5 below for capital gains on quotas or shares);
- 95% of dividends received are exempt from IRES. Certain specifics rules applies when the financial statements are based on IAS;
- tangible assets have to be depreciated on a straight line basis, applying the depreciation rates established by ministerial decree. Specific rules apply when tangible assets are owned through financial lease agreements as well as when the financial statements are based on IAS;
- intangibles may be depreciated up to 50% of the costs per fiscal year, but goodwill and trademark have to be depreciated on a straight line basis over 18 fiscal years. Specific rules apply when the financial statements are based on IAS;
- interest payables are deductible in compliance with the rules explained in question 3.4;
- hotel and restaurant expenses are deductible up to 75% of their amount;
- telecommunication services expenses are deductible up to 80% of their amount; and
- certain further limitations apply to entertainment expenses; car expenses, as well as to expenses related to services provided by tax heaven resident entity.

Labour and financial expenses are generally not deductible for IRAP purposes. Different rules apply to certain categories of corporations, such as financial intermediaries or insurance companies.

4.5 Are there any tax grouping rules? Do these allow for relief in Italy for losses of overseas subsidiaries?

Group Taxation

Companies belonging to the same group may opt for the so-called tax consolidation regime. Broadly speaking, under this regime, the companies of the group are treated as one taxpayer for the purposes of determining the group's taxable income subject to IRES.

Two different group taxation regimes exist in Italy:

- Domestic Group Taxation; and
- Worldwide Group Taxation.

Domestic Group Taxation

Briefly, the option for this regime implies that the taxable income subject to IRES is computed by each company of the group and then aggregated at the level of the parent company, where the global aggregate income is calculated as the sum of all the (positive and negative) taxable basis of each member of the tax group. The parent company will carry out a single tax payment (in the name and on behalf of all the consolidated companies).

Under this regime, an Italian company, or an Italian branch of a foreign company (provided that it is resident in a country which entered into a double tax treaty with Italy), holding, directly or indirectly, at least 50% of other Italian companies (the controlling entity must either (a) hold the majority of voting right in the shareholders' meeting and (b) be entitled to more than 50% of the profits of each subsidiary), may elect to form a tax-consolidated group with each of these subsidiaries.

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The parent company and the subsidiaries must have the same taxable period and the election of the option must be notified to the Revenue Authority by the 16th day of the 6th month following the end of the fiscal year preceding the first year to which the option refers. The option is binding for three fiscal years.

The amounts paid or received by group companies in exchange for tax benefits granted to the other companies pertaining to the group are not taken into account for tax purposes.

Non-deductible interest expenses of each single company can be deducted in the determination of the group's taxable income within the limit of the 30% of the EBITDA transferred by other entities to the tax group (to the extent that it has been not previously used by the entities themselves) – please see what is indicated under question 3.4 above.

Provided that certain conditions are met, the non-deductible interest expenses realised during the tax consolidation period (and not before entering into the tax group) can be carried forward by the company which suffered the expenses and deducted in the determination of the group's taxable income of the subsequent years.

If they have fulfilled certain requirements and if their financial statements are subject to the account certification ("*certificazione di bilancio*") by an external auditor, non-resident subsidiaries can be "virtually" included in the calculation of the tax group income only for the purposes of computing the interest expenses deduction.

Tax losses arisen in the fiscal years preceding the ones in which the tax consolidation regime applies can be carried forward only by the company that incurred them (they are not available to offset consolidated income). To the contrary, any previous tax credit may be also used directly by the parent company.

Tax losses and tax credit arising during the application of this regime are carried forward by the parent company. Whenever the regime ends, the "consolidated" tax losses, if any, may be assigned to the consolidated subsidiaries that originally incurred in them.

Worldwide Group Taxation

The Worldwide Group Taxation allows the consolidation of non-resident "controlled" subsidiaries (the Italian resident parent company shall hold, directly or indirectly, at least 50% of each subsidiary) into an Italian tax group. The election of the option is binding for five years, and then is subject to optional renewal for periods of three years each. No election can be made by a parent company which has elected for the so-called Domestic Group Taxation.

The requirements to be met are the following:

- the parent company must be resident in Italy;
- the controlling company must be: (i) a listed company; (ii) a company controlled by an individual resident in Italy who has no other controlled companies either in Italy or abroad; or (iii) a company controlled by the Italian Government or by other public entities;
- all foreign subsidiaries in which the Italian parent company holds more than 50% of the share capital or of the voting rights must be consolidated (to the contrary, under the Domestic Group Taxation, there isn't any obligation to include all the controlled companies in the "tax group");
- the taxable periods must be the same for all subsidiaries;
- the accounts of all the consolidated subsidiaries must be audited; and
- the controlling company must file a tax ruling with the Revenue Authority during the first year of Worldwide Group Taxation and the Revenue Authority may specify additional conditions when issuing the tax ruling.

The subsidiaries' taxable income is consolidated by the controlling company resident in Italy in proportion to its interest in each subsidiary (to the contrary, under the Domestic Group Taxation, the taxable income of each subsidiary is wholly consolidated even if the controlling entity does not hold 100% of the subsidiary).

The taxable income of the non-resident subsidiaries must be re-determined applying the Italian tax rules. Foreign tax credits relating to the taxes paid abroad are deductible from the consolidated taxable income.

The non-resident subsidiaries' losses arisen in the fiscal years preceding the application of the Worldwide Group Taxation regime cannot be included in the worldwide taxable income; only non-resident subsidiaries' losses originated during the tax consolidation regime can be considered. In case of termination of the regime, "consolidated" tax losses of non-resident subsidiaries are not re-assigned to them, but are held by the parent company, subject to specific limits and restrictions.

Tax transparency

The so-called Tax Transparency regime may be adopted by companies whose shareholders are Italian resident companies holding, directly: (a) a participation in the profits of the company; and (b) voting rights in its shareholders' meeting not lower than 10% and not exceeding 50%.

The Tax Transparency regime is also allowed in cases of non-Italian resident shareholders, provided that said shareholders are allowed to receive dividends gross of any withholding tax (i.e., in case of: (i) shareholders benefiting from the so-called "Parent-Subsidiary Directive"; or (ii) non-Italian resident shareholders with a permanent establishment in Italy).

The Tax Transparency regime is irrevocable for a period of three tax years and must be elected by all the company's shareholders.

In case of election for this regime, the profits (or losses, provided - in this case - that the relevant amount does not exceed the relevant shareholder' quota of the net equity value of the company), realised by the company in the tax periods in which the option applies, are imputed to each shareholder in proportion to its participation in such profits, irrespectively from the effective distribution of the dividends.

In such a case the following dividend distribution is entirely tax exempt (as opposed to the ordinary 95% exemption regime).

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Corporations are subject to the same IRES rate upon distributed and retained profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Not applicable.

4.8 Are there any local taxes not dealt with in answers to other questions?

Real estate properties are subject to ICI (municipality tax on properties), which is generally due at a rate ranging from 0.4% to 0.7%, based on the value, type and class of immovable property (as determined by the Cadastral Office) and the months of possessions during the calendar year.

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5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains and losses realised by Italian resident corporations through the sale of quotas/shares are not regulated by a special set of rules (apart from the participation exemption (PEX) regime, applicable as described under question 5.3 below), but are included in the overall corporate income subject to the ordinary IRES rate in the fiscal year in which they are realised, and in certain cases, to IRAP.

If the shareholdings have been booked as fixed financial assets in the financial statements of the 3 financial years preceding the year of the sale, the seller may elect to subject the gains to IRES, in equal instalments, over a period of up to 5 years (including the year of the sale).

However, capital losses realised in case of disposal of shareholdings, that do not qualify for PEX, owned for less than 36 months and under the condition that the participations satisfy the following requirements for the PEX regime (residence in a non-tax haven country and exercise of an effective business activity), are not tax deductible, up to the amount of 95% exempt dividends (including advanced dividend payments) collected during the 36 months preceding the sale of the participation.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

As already explained in question 5.1 above, no special tax rates are provided for capital gains in Italy (apart from the PEX regime, described under question 5.3 below).

5.3 Is there a participation exemption?

Yes, according to the participation exemption (PEX) regime, 95% of the capital gains realised through the sale of a shareholding is exempt from IRES upon fulfilment of the following conditions:

(i) the transferred shareholding has been held since the first day of the twelfth (12) month prior to the month of the disposal ("minimum holding period"), in respect of which the LIFO principle applies;

(ii) the shareholding was booked as a fixed financial asset in the financial statements of the first year which ended after the purchase;

(iii) the company in which the shareholding is held should have been resident, since the first day of the third fiscal year preceding the fiscal year of the sale, in a country that is not considered as a tax haven (in case the participated company has been alive for less than three full years, then the "residence" requirement must be satisfied uninterruptedly as from the date of incorporation); and

(iv) the company in which the shareholding is held should have carried on a business activity (this requirement is considered as not satisfied with an unrebuttable presumption in respect of shares held in a company that "the net equity of which is mainly constituted by real estate properties other than properties in which the enterprise actually trades and other than plants and buildings utilised by the enterprise in the conduct of its own business") since the first day of the third fiscal year preceding the fiscal year of the sale (this requirement shall not be verified in case of shares listed on a stock exchange).

In case of participation held in holding companies, conditions set out under points (iii) and (iv) above must be satisfied by the companies participated by the holding whose shareholdings represent the most past of the net worth of the holding.

Capital losses realised on the sale of participations qualifying for PEX are fully not deductible in the hand of the seller.

5.4 Is there any special relief for reinvestment?

No, there is no special relief for reinvestment.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

A fixed registration tax (of €168) is due upon either the incorporation of a subsidiary and the establishment of a branch (no capital duty is due on the subsidiary's share capital as well as on the capital allocated to the branch).

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

An Italian resident subsidiary must pay an annual fee to the Chamber of Commerce, which is proportional to the annual turnover and may range from €200 to €40,000 (this amount applies when the turnover exceeds €50m). A fixed annual fee of €110 applies to each branch of non-resident companies.

6.3 How would the taxable profits of a local branch be determined?

In principle, Italian branches are not treated differently from Italian resident subsidiaries.

The branch must draw-up its profit and loss account (from a tax and accounting perspective, it is considered as a distinct and separate entity from the foreign head office) and is subject to IRES, according to the same rules applied to Italian resident corporations (the income being calculated based on the branch's P&L), and to IRAP, which applies to the value of the net production deriving from the activity carried on by the branch in the Italian territory.

Moreover, Italian tax law provides for a "limited force of attraction" of the branch, under which other items of income of the foreign company sourced to Italy (but not related to the branch) may be attributed and included in the corporate income of the Italian branch. However, this limited force of attraction should not apply if the foreign company is resident in a country which entered into a double tax treaty with Italy, preventing the possibility of a contracting state to attribute to permanent establishments incomes which do not pertain to them.

General Italian transfer pricing requirements must be taken into account when determining the branch taxable profits (including in evaluating the expenses charged by the head office). However, transfer pricing provisions also applies to Italian subsidiaries.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

In Italy there isn't any branch profits tax.

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6.5 Would a branch benefit from tax treaty provisions, or some of them?

As a general rule, a branch cannot benefit of double tax treaty provisions as it is not, as such, considered as a resident within the meaning of the tax treaty.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax nor any other tax applies/is imposed as the result of a remittance of profits by the branch.

7 Anti-avoidance

7.1 How does Italy address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

In Italy there isn't any general anti-avoidance rule nor a disclosure rule, but several law provisions exist which are aimed at preventing the adoption of schemes designed with the purpose of avoiding taxes.

Article *37-bis* of Presidential Decree No. 600/73 provides that the tax authority has the power to not recognise fiscal advantages under income tax purposes, obtained through transactions put in place without business reasons with the purpose of avoiding tax payments or reducing the tax burden.

Anti-avoidance provision applies in particular to the following transactions:

- changes in legal form, mergers, spin-offs, company winding up and distribution to shareholders of equity amounts different from profits;
- contributions in kind and business undertaking transfers;
- receivables disposal;
- tax credit sales;
- intra-EU mergers, spin-offs, contributions in kind, shares for shares exchanges and transfer of the company's registered office abroad;
- transactions, including evaluation and registration in the financial statements, regarding financial instruments;
- supplies of goods and/or services between entities who have opted for the tax consolidation regime;
- interests and royalties payments to associated companies that are resident in other EU Member States exempted in compliance with Directive 2003/49/EC, if made to entities directly or indirectly controlled by one or more persons which are resident of a non-EU Member State; and
- Agreements on the payment of penalties between affiliate companies, one of which is a resident of a tax haven country.

Law no.248/2006 introduced the rebuttable presumption that a non-resident entity controlling an Italian subsidiary shall be considered a tax resident of Italy if: (i) it is directly or indirectly controlled by Italian resident persons; or (ii) the majority of the members of its Board of Directors are resident in Italy.

Moreover, Law no.724/1994 provides that companies are considered as "dummy companies" if they do not get through an operating test, comparing revenues with an amount calculated applying fixed ratios to certain assets. If a company does not get through the above operating test: (i) it is obliged to declare a minimum taxable base for corporate tax purposes; and (ii) it has no right to claim any VAT refund, not to offset VAT or transfer the VAT credit surplus resulting from the VAT return (except for specific rules regarding the credit carry forward).

The last few years have been characterised by several decisions of the Italian Supreme Court regarding the application of the "abuse of law" principle to tax matters. In particular, the Court established the existence of a general anti-avoidance rule and the source of the aforesaid principle is to be found in the Constitutional rules that underlie the Italian legislation, rather than in the EC (case) law. Therefore, the "abuse of law" principle would be embodied in these fundamental taxation rules, whereby a taxpayer is not allowed to obtain an illegitimate tax saving through an artificial use of legal forms if these have no other substantial motive than tax avoidance.

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Japan

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Japan?

As of September 1, 2010, there are 48 income tax treaties (applicable to 59 contracting states) currently in force in Japan. In addition, a tax treaty with Kuwait was signed on February 17, 2010 but has not yet entered into force as of September 1, 2010. Also, new tax treaties were signed with Switzerland on May 21, 2010 (the "New Japan/Switzerland Treaty") and with the Netherlands (the "New Japan/Netherlands Treaty") on August 25, 2010 but neither of them have yet entered into force as of September 1, 2010.

1.2 Do they generally follow the OECD or another model?

Most of the income tax treaties currently in force in Japan generally follow the OECD Model Treaty with certain deviations. After the new modernised tax treaty with the United States entered into force on March 30, 2004 (the "Japan/US Treaty"), the Japanese government is understood to have been considering the Japan/US Treaty as the new model for Japan's future treaties, particularly for treaties with developed countries. The Japan/US Treaty includes some noteworthy modernised provisions (such as, for example, a fairly comprehensive limitation on benefit clause and an exemption from source country taxation with respect to dividends paid by certain qualified subsidiaries to controlling parents) not found in the OECD Model Treaty. Following the Japan/US Treaty, similarly modernised tax treaties entered into force with the United Kingdom on October 12, 2006 (the "Japan/UK Treaty"), with France on December 1, 2007 (the "Japan/France Treaty") and with Australia on December 3, 2008 (the "Japan/Australia Treaty"). The New Japan/Switzerland Treaty and the New Japan/Netherlands Treaty are similar modernised tax treaties. In some of Japan's income tax treaties with developing countries, Japan agreed to include a tax-sparing credit clause. However, it is anticipated that Japan would generally take the approach of limiting the application of such a clause only to the necessary minimum in terms of the scope of income and the time period.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

If treaties are ratified by the Diet and promulgated in Japan, such treaties take effect domestically in Japan, in accordance with those treaties, without being incorporated into domestic law. However, it is generally understood that whether or not treaties are self-executing without any domestic execution law depends on the contents of the particular clause in those treaties. In Japan matters necessary to implement tax treaties are provided for in the Act on Special Provisions of the Income Tax Act, Corporation Tax Act and Local Tax Act in Order to Implement Tax Treaties and its related laws and regulations.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The Japan/US Treaty is the first income tax treaty executed by Japan in which a fairly comprehensive limitation on benefits clause of general application is included, and has been followed, with certain variations, by the Japan/UK Treaty, the Japan/France Treaty and the Japan/Australia Treaty; and so are the New Japan/Switzerland Treaty and the New Japan/Netherlands Treaty.

The limitation on benefits clause included in the Japan/US Treaty provides that a resident of a contracting state that derives income from the other contracting state shall be entitled to the benefits accorded to residents of the contracting state only if such resident satisfies any one of certain objective tests, which are the "qualified person" test, "active trade or business" test, and "competent authority's determination" test. The assumption underlying each of these tests is that a taxpayer that satisfies the requirements of one of the tests is likely to have a real business purpose for the structure which it has adopted; or has a sufficiently strong nexus to the contracting state to warrant obtaining the benefits; and that this business purpose or connection is sufficient to justify the conclusion that obtaining the treaty benefits under the Japan/US Treaty is not the principal purpose of establishing or maintaining residence in the contracting state.

The Japan/US Treaty, the Japan/UK Treaty, the Japan/France Treaty and the Japan/Australia Treaty (as well as the New Japan/Switzerland Treaty and the New Japan/Netherlands Treaty) also include a series of anti-conduit clauses, which provide that a resident of a contracting state shall not be considered to be the beneficial owner of dividends, interest, royalties or other income in certain "back-to-back" arrangements so that, if such arrangement exists, contemplated treaty benefits are denied.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

It is a well-established constitutional principle in Japan that no treaty is overridden by any rule of domestic law (whether existing at the time the treaty takes effect or enacted subsequently).

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2 Transaction Taxes

2.1 Are there any documentary taxes in Japan?

Japan has Stamp Tax, which is imposed on certain categories of documents that are exhaustively listed in the Stamp Tax Act, including, for example, real estate sales agreements, land leasehold agreements, loan agreements, transportation agreements, merger agreements and promissory notes.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

We have value-added tax, called Consumption Tax and Local Consumption Tax. The aggregate tax rate of Consumption Tax and Local Consumption Tax is at present 5%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Taxable transactions, for the purposes of Consumption Tax and Local Consumption Tax, are defined to mean those transactions conducted by a business enterprise (regardless of whether it is a legal person, i.e. a company, or natural person, i.e. an individual; and, in the case where such business enterprise is a non-resident company or a non-resident individual, regardless further of whether or not such business enterprise has any permanent establishment in Japan) to transfer or lease goods or other assets or to provide services, for consideration, within Japan. However, certain specified categories of transactions, such as, for example, transfers and leases (other than for certain temporary purposes) of land, housing leases (other than for certain temporary purposes), transfers of securities, extension of interest-bearing loans, provision of insurance, deposit-taking and certain other specified categories of financial services, provision of certain specified scope of medical, social welfare or educational services, are excluded from taxable transactions. With respect to imported goods, they are subject to Consumption Tax and Local Consumption Tax when they are released from a bonded area, except that certain specified categories of imported goods, such as, for example, securities, stamps, exchange checks, equipment for disabled persons and textbooks, are excluded from taxable imported goods. Export transactions are generally exempt from Consumption Tax and Local Consumption Tax.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Consumption Tax and Local Consumption Tax charged on taxable transactions and incurred by a business enterprise is generally recoverable in full, by way of tax credit or refund, with certain exceptions; for example, if a taxpayer's ratio of the revenue from taxable transactions over the total revenue from transactions within Japan is less than 95% (which is typically the case for, for example, certain financial institutions), such taxpayer's recovery of Consumption Tax and Local Consumption Tax would generally be limited.

2.5 Are there any other transaction taxes?

There are some transaction taxes in Japan, including, but not limited to, Registration and Licence Tax, Real Property Acquisition Tax and Automobile Acquisition Tax.

2.6 Are there any other indirect taxes of which we should be aware?

There are various indirect taxes in Japan such as Liquor Tax, Tobacco Tax and Gasoline Tax. Depending on the business involved, these taxes may or may not be relevant.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Under the Japanese domestic tax law, generally a non-resident shareholder (either a non-resident company or a non-resident individual) of a Japanese company is subject to Japanese withholding tax with respect to dividends it receives from such Japanese company at the rate of 20%; provided, however, if the Japanese company paying the dividends to a non-resident shareholder is a listed company, this withholding tax rate is reduced to: (i) 7% until December 31, 2011; and (ii) 15% thereafter, except for the dividends received by a non-resident individual shareholder holding 5% or more of the total issued shares of such listed Japanese company.

Most of the income tax treaties currently in force in Japan generally provide that the reduced treaty rate at the source country shall be 15% for portfolio investors and 10% or 5% for parent and other controlling shareholders. It may be worth noting that: (i) under the Japan/US Treaty and the Japan/UK Treaty, there is an exemption from source country taxation with respect to dividends paid by a company in either state to a shareholder who is a qualified resident (to be determined subject to the relevant limitation on benefit clause) of the other contracting state, if such shareholder is either a corporate shareholder holding 50% or more (or more than 50% in case of the Japan/US Treaty) of the voting shares of the issuer company (subject to certain additional requirements) or a pension fund; and (ii) under the Japan/France Treaty and the Japan/Australia Treaty there is a similar, but not the same, exemption from source country taxation with respect to dividends paid by a company in either state to a corporate shareholder with certain ownership percentage who is a qualified resident of the other contracting state. There is an exemption from source country taxation with respect to dividends similar to the one mentioned in (i) above in the New Japan/Switzerland Treaty and the New Japan/Netherlands Treaty as well.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Under Japanese domestic tax law, royalties relating to patents, know-how or copyright used for any Japanese company's business carried on in Japan and paid by the Japanese company to a non-resident licensor (either a non-resident company or a non-resident individual) is subject to Japanese withholding tax at the rate of 20%. If such non-resident licensor is a non-resident company who has a branch office within Japan, such non-resident company licensor may be exempt from the said withholding tax as long as such non-resident company licensor satisfies certain requirements, including in particular the requirement that such royalties be subject to the Corporation Tax in Japan.

Most of the income tax treaties currently in force in Japan provide that the withholding tax rate for royalties be generally reduced to 10%. It is worth noting that the Japan/US Treaty, the Japan/UK Treaty and the Japan/France Treaty provide that no source-country taxation shall be made by either state with respect to royalties,

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subject to comprehensive limitation on benefits clauses, while the Japan/Australia Treaty provides that the withholding tax rate for royalties is reduced to 5%. There is a similar exemption from source country taxation with respect to royalties in the New Japan/Switzerland Treaty and the New Japan/Netherlands Treaty as well.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Under Japanese domestic tax law, interest on corporate bonds issued by a Japanese company that is paid to a non-resident bondholder (either a non-resident company or a non-resident individual) is generally subject to Japanese withholding tax at the rate of 15%. Also under Japanese domestic tax law, with respect to certain specified scope of discount corporate bonds issued by a Japanese company (except for certain qualified short-term discount bonds), such Japanese company will be required to withhold, at the time of the issuance of the discount corporate bonds, 18% or 16%, as the case may be, of the amount equivalent to the difference between the face value and the issue price thereof (original issue discount). The amount so withheld will be deemed to be, and treated as, the Income Tax imposed on, and collected from, the bondholder (including a non-resident bondholder) who receives the original issue discount upon redemption. However, so long as corporate bonds are issued outside Japan on or after April 1, 1998 and interest thereon is payable outside Japan, a non-resident bondholder may be entitled to claim an exemption from Japanese withholding tax on both interest and original issue discount, subject to certain procedural requirements; provided, however, that this exemption does not apply for interest or original issue discount received by certain specified scope of parties related to the issuer (including parties that have more than 50% shareholding relationship). This exemption had been a temporary statute but was made permanent by the 2010 Tax Reform. Also, the 2010 Tax Reform has introduced a new income tax exemption for book-entry corporate bonds to which the Act on Transfer of Bonds and Shares, etc. apply and a book-entry of which is made by a certain depository companies. In this exemption system, a non-resident bondholder may be entitled to claim an exemption from Japanese withholding tax on both interest on and original issue discount from book-entry corporate bonds (except for bonds whose interest is linked to profits of the issuer or its related party) issued in the Japanese market before March 31, 2013, subject to certain procedural requirements; provided, however, that this exemption does not apply for interest or original issue discount received by certain specified scope of parties related to the issuer.

Interest on bank deposits and other similar deposits deposited by a non-resident depositor (either a non-resident company or a non-resident individual) with any office of a bank or other institution in Japan is generally subject to Japanese withholding tax at the rate of 15%, under Japanese domestic tax law.

Interest on loans extended by a non-resident lender (either a non-resident company or a non-resident individual) to a Japanese company conducting business carried on in Japan and in relation to such business is generally subject to Japanese withholding tax at the rate of 20% under the Japanese domestic tax law. If such non-resident lender is a non-resident company who has a branch office within Japan, such non-resident company lender may be exempt from the said withholding tax as long as the non-resident company lender satisfies certain requirements, including in particular the requirement that interest on such loans is subject to the Corporation Tax in Japan.

As an exception to the foregoing, if a non-resident company makes a deposit or extends a loan to any of the financial institutions designated under the Foreign Exchange and Foreign Trade Law of Japan who book such deposit or loan as a special account for offshore banking on or after April 1, 1998, such non-resident company would be exempt from Japanese withholding tax with respect to interest to be paid on such deposit or loan.

Most of the income tax treaties currently in force in Japan provide that the withholding tax rate for interest (regardless of whether it is interest on bonds, deposits or loans) is reduced generally to 10%. It is worth noting that under the Japan/US Treaty, the Japan/UK Treaty, the Japan/France Treaty and the Japan/Australia Treaty, certain specified categories of financial or other qualified institutions which are residents of the US, the UK, France or Australia, as the case may be, which qualify for treaty benefits thereunder, may be exempt from source country taxation in Japan with respect to interest, subject to certain requirements. There is a similar exemption from source country taxation with respect to interest in the New Japan/Switzerland Treaty and the New Japan/Netherlands Treaty as well.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The payor of interest may be denied a deduction of the interest which it paid to a non-resident recipient for its own income tax purposes in Japan, due to the application of the "thin capitalisation" rules under Japanese domestic tax law. Even in such case, the treaty relief (i.e. the application of the reduced treaty rate under the applicable income tax treaty) available to the non-resident recipient of such interest would nevertheless not be restricted.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

This is not applicable in Japan. Please see the answer to question 3.4.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Under the "thin capitalisation" rules in Japan, debt advanced by a third party and guaranteed by a parent company would generally be treated as related party debt, subject to "thin capitalisation" rules.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

There are generally no restrictions on deductibility of interest payments by a local company to a non-resident other than the "thin capitalisation" rules in Japan, except that interest payments may be subject to transfer pricing rules. Please also see the answer to question 3.8 below.

3.8 Does Japan have transfer pricing rules?

Japan does have transfer pricing rules. Japanese transfer pricing rules are applicable to both a Japanese company and a Japanese branch of a non-resident company if either of them engages in transactions with any of their "foreign-related persons" (for example, a direct or indirect 50% share ownership would render a

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foreign person a "foreign-related person" for the purposes of the transfer pricing rules).

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

In Japan, there are at present five different income taxes imposed on corporate profits, namely: Corporation Tax (national tax); Prefectural Inhabitant Tax per corporation tax levy (local tax); Municipal Inhabitant Tax per corporation tax levy (local tax); Enterprise Tax (local tax); and Local Special Corporation Tax (national tax). Depending on the amount of stated capital and certain other factors, the applicable rates for each taxpayer company of these income taxes may vary. While the Enterprise Tax and the Local Special Corporation Tax paid in any fiscal year are treated as a deductible expense in such fiscal year, the other three income taxes are not deductible. Taking the foregoing into consideration, the headline effective tax rate of all income taxes mentioned above would be approximately 40%. (Please also see the answer to question 5.1 below.)

4.2 When is that tax generally payable?

The taxes on corporate profits are required to be paid, in principle, within two months after the end of each fiscal year. If a company is an ordinary company whose fiscal year is longer than six months, the company is required to prepay part of the current fiscal year's tax within two months after the end of the first six months of each fiscal year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base for Corporation Tax is the net taxable income for Corporation Tax purposes; such net taxable income is calculated based on the results reflected in the taxpayer company's financials, prepared in accordance with Japanese generally accepted accounting principles, which are required to be finalised by the proper legal procedure as required under the applicable corporation law, and by making the necessary adjustments to such results as required by any applicable rules provided in the Corporation Tax Act and its related laws and regulations. The tax base for each Prefectural Inhabitant Tax per corporation tax levy and Municipal Inhabitant Tax per corporation tax levy is, in principle, the amount of Corporation Tax.

With respect to Enterprise Tax, generally the tax base is the net taxable income for Enterprise Tax purposes as determined by the relevant rules for Enterprise Tax (which is not necessarily the same as the net income for Corporation Tax purposes; for example, offshore income is excluded for Enterprise Tax purposes); provided, however, that if a taxpayer company's capital amount is more than 100 million yen, the tax base for Enterprise Tax is determined by a combination of the net taxable income, the amount of value added as determined by the compensation paid to employees, the net interest paid, the net lease rental paid and the net profit or loss in each fiscal year, and capital of such taxpayer company. As an exception to the foregoing, the tax base for Enterprise Tax of electric, gas and insurance businesses is determined by gross revenue. The tax base for Local Special Corporation Tax is, in principle, the amount of Enterprise Tax.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The main differences include, but are not limited to, the treatment of donations and entertainment expenses. Donations, including any kind of economic benefit granted for no or unreasonably low consideration, are generally deductible only up to a certain limited amount. Entertainment expenses are generally not deductible, even though such expenses are believed to be necessary for carrying on the business; provided, however, that if the amount of stated capital of a company is 100 million yen or less, entertainment expenses of such company are deductible subject to a certain ceiling.

4.5 Are there any tax grouping rules? Do these allow for relief in Japan for losses of overseas subsidiaries?

It is possible for a group of Japanese companies, where a Japanese parent company directly or indirectly through other Japanese companies owns 100% of other Japanese subsidiaries, to file, at the group's election and subject to an approval of the Commissioner of the National Tax Agency, a consolidated tax return. Once the election to file a consolidated tax return is approved, such election would, in principle, continuously apply to the group making such election.

If a group of companies elects to file a consolidated tax return, the parent company is required to file the consolidated tax return and pay all the consolidated tax. Each subsidiary is jointly responsible for payments of consolidated tax. The consolidated tax is calculated on the basis of the aggregate income of the parent company and all consolidated subsidiaries.

In addition, the 2010 Tax Reform has introduced special rules for intra-group transactions (the "Group Taxation Rules"), which apply to group companies in a 100% group (companies that have a direct or indirect 100% shareholding relationship) even if they do not elect to file a consolidated tax return. While a consolidated tax return can only be elected by a group of Japanese companies where a Japanese parent company directly or indirectly through other Japanese companies owns 100% of other Japanese subsidiaries, the Group Taxation Rules apply to Japanese companies wholly owned by a foreign or Japanese company or individual. The Group Taxation Rules include the following rules, among others:

(i) recognition of capital gains/losses from transfer of certain assets between Japanese companies in a 100% group is deferred until the said assets are transferred or otherwise disposed of by the transferee company;

(ii) donation between Japanese companies in a 100% group is not deductible for a donor company and donation income is not included in taxable income for a donee company;

(iii) recognition of capital gains/losses from dividends-in-kind between Japanese companies in a 100% group is deferred; and

(iv) capital gains/losses from the transfer of shares by a Japanese company to the issuer of the said shares that is in the same 100% group as the transferor company are not recognised.

In Japan, the consolidation rules or Group Taxation Rules do not allow for relief for losses of overseas subsidiaries.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is generally imposed at the same rate upon all corporate profits regardless of whether such profits are distributed or retained, with the exception that a certain additional surtax may be imposed on certain types of so-called family companies' retained profits.

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4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

As far as national taxes are concerned, there are no major taxes currently in force which may have a material impact on the business operations of a company in Japan.

4.8 Are there any local taxes not dealt with in answers to other questions?

Among local taxes other than those already mentioned above, Prefectural Inhabitant Tax per capita levy, Municipal Inhabitant Tax per capita levy, Fixed Assets Tax and Automobile Tax may be of general application to business operations in general of a company in Japan.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

For purposes of income taxes imposed on a company in Japan, generally all of the taxable income of a company is aggregated, regardless of whether such income is classified as capital gains or ordinary/business profits. Exceptions to the foregoing include a surtax which may be imposed on certain capital gains derived by disposition of real properties; provided, however, that such surtax is currently suspended until December 31, 2013. In the case where a tax-free qualified corporate reorganisation such as a qualified merger is undertaken, recognition of capital gains can be deferred. Also, there may be a deferral of recognition of capital gains/losses from transfer of certain assets between Japanese companies in a 100% group, as mentioned in question 4.5 above.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The surtax (as referred to in response to question 5.1 above) to be imposed on capital gains derived by the disposition of real property including, but not limited, to land located within Japan is 5%. If certain real property such as land in Japan is disposed of within five years from its acquisition, the rate of surtax is increased to 10%. The application of these surtaxes is suspended until December 31, 2013.

5.3 Is there a participation exemption?

There is no participation exemption for taxation on capital gains. However, the 2009 Tax Reform has introduced a participation exemption for the 95% portion of the dividends paid to a Japanese company by its foreign subsidiary with respect to which the Japanese company owns at least 25% of issued shares or voting shares for at least six months. With the introduction of such participation exemption for dividends, the indirect foreign tax credit system (which was previously applied up to the second tier indirect subsidiaries) was abolished. The 25% threshold requirement mentioned above may be altered if a particular taxpayer is eligible for treaty benefits under an applicable tax treaty in which lower threshold is required for a treaty-based foreign tax credit eligibility (for example, 10% shareholding threshold is provided under the Japan/US Treaty). These changes apply to dividends received during the fiscal years starting on or after April 1, 2009.

Also, as a result of the 2009 Tax Reform and with the introduction of the above-mentioned participation exemption rule for dividends, the Japanese anti-tax haven rules or controlled foreign corporations (CFC) rules were amended to the effect that, among others, retained earnings of a Japanese company's CFC subsidiaries shall be deemed to be included in the Japanese company's taxable income subject to Japanese corporate income taxation, regardless of whether or not such retained earnings are distributed as dividends and certain other adjustment amendments are made.

5.4 Is there any special relief for reinvestment?

Dividends received by a Japanese company from another Japanese company may be either 100% or 50% (subject to certain adjustments), deducted from the recipient company's taxable income, depending on whether or not the recipient Japanese company owns 25% or more of the total issued shares of the dividend-paying Japanese company. Such dividend-received deduction is also available to a Japanese branch of a foreign corporation with respect to dividends received by such branch from any Japanese company. Capital gains from the disposition of certain qualified business assets (such as certain qualified land and buildings) may be entitled to certain roll-over relief (in whole or in part) if certain qualified reinvestment is made within a prescribed period. Also, deferral of recognition of capital gains/losses from the transfer of certain assets and dividend-in-kind between 100% group companies has been introduced by the 2010 Tax Reform as mentioned in question 4.5. Please also see question 5.3.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

If a non-resident company forms a subsidiary (i.e. establishing a company incorporated under the laws of Japan) by making a capital contribution in cash, the formation of a subsidiary is not a taxable event. However, if a non-resident company forms a subsidiary by making a contribution-in-kind (for example, contributing certain real property located within Japan), such contribution-in-kind is treated as a disposition by such non-resident company of the contributed assets. If the contributed assets fall under the category of the assets situated within Japan, it is possible that the capital gains derived from such disposition are found to constitute income sourced and taxable in Japan for the non-resident company making such contribution-in-kind, in which case such non-resident company would generally be, in the absence of a relief under an applicable tax treaty, subject to Japanese corporate income taxes with respect to such capital gains.

In order to form a Japanese subsidiary, the articles of incorporation of such subsidiary must be prepared, which is subject to Stamp Tax at the rate of 40,000 yen; also, such subsidiary must be registered in the commercial register kept at the competent office of the legal affairs bureau of the Ministry of Justice. Upon filing an application for such registration, such subsidiary is generally subject to Registration and Licence Tax at the rate of seven-thousandths (7/1,000) of its stated capital amount. Any subsequent increase in the stated capital of such subsidiary is also required to be registered in a timely manner in the commercial register and is generally subject to Registration and Licence Tax at the same rate. (While a branch of a non-resident company, including any change in the stated capital of such non-resident company in its home country, is also required to be registered in the commercial register in Japan,

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the rate of Registration and Licence Tax imposed on the branch upon application for such registration is fixed at 90,000 yen per application for establishment of a branch and 9,000 yen per application for change in the stated capital in its home country.)

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Generally, there are no other significant taxes or fees that would be incurred by a Japanese subsidiary upon its formation but not by a branch of a non-resident company.

6.3 How would the taxable profits of a local branch be determined?

Under the Corporation Tax Act, if a non-resident company which has its branch in Japan earns "profits derived from business carried on within Japan," such business profits constitute Japanese source income taxable in Japan. With respect to the question of how the amount of such business profits should be determined, certain specific rules are provided in the relevant regulations. Under such regulations, depending on the category of business involved (e.g. whether the business involved is manufacturing, sale and distribution, construction, shipping or air transportation, insurance, publication and broadcasting, or any other business), different factors are used to determine the scope of income to be treated as business profits sourced from Japan.

In the case where the subject non-resident company is a resident of a country with which Japan has an income tax treaty, generally such treaty includes a provision similar to Article 7(2) of the OECD Model Treaty (requiring that the arm's-length principle shall be applied in determining the amount of income attributable to the relevant permanent establishment). The question of to what extent the above-mentioned specific rules included in the Japanese domestic tax law should be interpreted as being altered by such treaty provision often gives rise to a serious issue in practice.

With respect to the detailed method of calculating taxable income, the rules applicable to a Japanese company are, in principle, also made applicable to a branch of a non-resident company, *mutatis mutandis*. In calculating the taxable income of a branch, only such expenses as are necessary for earning Japanese source income are treated as deductible expenses.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax or other similar tax to which a branch of a non-resident company, but not a subsidiary, is subject.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A branch of a company which is a resident in such treaty country can benefit from the treaty provisions to some extent. For example, while the so-called entire system is adopted for income taxation of a non-resident company who has a branch in Japan under Japanese domestic tax law, under almost all of the income tax treaties currently in force in Japan, the attributable system is adopted. With respect to the treaty relief given to passive income such as dividends, interest and royalties, because most of the income tax treaties currently in force in Japan include provisions similar to Articles 10(4), 11(4) and 12(3) of the OECD Model Treaty, a branch of a non-resident company would not be allowed to enjoy such treaty relief.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No. No Japanese withholding tax or other tax would be imposed on the remittance of funds from the Japanese branch of a foreign corporation to its head office merely because such remittance is a repatriation of profits by the branch to its head office abroad.

7 Anti-avoidance

7.1 How does Japan address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

In Japan there is neither a general anti-avoidance rule nor a disclosure rule that imposes a requirement to disclose avoidance schemes. It is worth noting that recently the tax authority has tended to take a more active stance in combating avoidance schemes and taxpayers so challenged have been more inclined to seek judgments by the courts. Thus, the courts are playing more important roles than ever in rule-making in light of tax avoidance. It is also worth noting that Japan recently entered into tax information exchange agreements with several low tax countries and jurisdictions.

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NAGASHIMA OHNO & TSUNEMATSU

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Korea

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Korea?

Beginning with the execution of the tax treaty with Japan in 1970, as of July 2010, Korea has executed double taxation treaties and anti-tax avoidance treaties on individual income tax, corporate tax, and other taxes with 77 countries including the US, Germany, the UK, and Thailand.

1.2 Do they generally follow the OECD or another model?

Korea accepts the OECD standard model treaty as its tax model treaty, but if necessary depending on the counterpart countries, allows exceptions from the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties are executed through such procedures as negotiation, signing, ratification and exchange of the ratification instrument. In the case of ratification of a tax treaty, an instrument of ratification in a certain form should be prepared and exchanged in order to prove the ratification. Generally, treaties take effect on the date of exchange of such ratification instrument unless there are special provisions thereon. However, as for Korea, tax treaties specifically prescribe the effective date and the date of implementation in the provision for "entry into force".

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

(1) Adoption of Beneficiary Ownership Concept

In order to prevent residents of third countries from taking advantage of the tax treaties, tax treaties provide for the concept of beneficial ownership. That is, tax treaties provide that the limited tax rates in treaties apply only when the beneficial owner(s) of interests, dividends, and royalties are residents of the other contracting state.

(2) Exchange of Information

Tax treaties provide that necessary information should be exchanged between tax authorities of the contracting states for the purpose of preventing tax evasion and tax avoidance.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

If any provisions of tax treaties are different from domestic law, treaties should be applicable preferentially to the domestic law in order to keep the promise with the other contracting country. However, under the Korean Constitution, treaties have the same effects as those of domestic law, and it should be deemed that the rules of *lex posterior derogat priori* and *lex specialis derogat generali* apply in such cases.

2 Transaction Taxes

2.1 Are there any documentary taxes in Korea?

In Korea, anyone who prepares a contract to create, transfer, or change rights to properties or any other documents proving such is required to pay stamp tax on such documents at the time of preparation of such documents according to the Stamp Tax Act.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes, any enterprises which supply products or services subject to imposition of VAT are required to report and pay VAT on their supplies of products or services, regardless of whether they are registered enterprises or whether VAT has been collected at the time of supplying such products or services.

The VAT rate is 10/100 with respect to both general tax payers and simplified tax payers.

In addition, pursuant to the principle of taxation in the consuming country which is accepted as a common practice in international trades, there is a zero-tax-rate system.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Supply of goods or services is one of the types of taxable transactions, and subject to imposition of VAT. In this context, "goods" refers to any tangible or intangible objects with economic values, and "services" refers to labour or any other acts with economic values other than goods. However, provision of collaterals, transfer of business, and payment of tax in kind pursuant to the applicable law are not deemed as supply of goods or services.

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2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is deducted from the output tax during the taxable period, to which the date of supply of the goods or services subject to such input tax belongs. Businesses can recover any amount of input tax indicated on the tax invoice only if they received the invoice at the time of purchasing goods or services.

However, the amount of the following input tax will not be deducted from output tax: input tax on the expenses not directly relating to business; input tax relating to the purchase and maintenance of small cars for non-business purposes; or input tax relating to entertainment expenses.

2.5 Are there any other transaction taxes?

Securities Transaction Tax:

Transfer duty on the transfer of the sale of shares is generally payable at the rate of up to 0.5%, which is called securities transaction tax. This tax shall generally be paid by the seller and applies even where the transfer is a share exchange between foreign companies. This tax should be generally assessed on transfer price. However in case where transfer price is not ascertainable, the value may be assessed in accordance with the Individual Income Tax Act.

2.6 Are there any other indirect taxes of which we should be aware?

Customs duties, a kind of national tax, are imposed on the products which are imported through the customs line from a foreign country into the Korean territory. Generally luxury items are subject to high rates of tax and raw material items are subject to low rates of tax.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

In the case of payment of dividends to non-residents, located in the countries which have no tax treaties with Korea, resident companies should deduct 20/100 of the payment as the withholding tax pursuant to the Corporate Tax Act.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In the case of payment of royalties to non-residents, located in the countries which have no tax treaties with Korea, local companies should deduct 20/100 of the payment as a withholding tax pursuant to the Corporate Tax Act.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In the case of payment of interests to non-residents located in the countries which have no tax treaties with Korea, local companies should deduct 14/100 of the payment as a withholding tax pursuant to the Corporate Tax Act.

Meanwhile, according to the Restriction of Special Taxation Act, if the payment falls under the interests on the foreign-currency-denominated bonds issued by local businesses or the interests on debts in foreign currencies, which are borrowed from foreign financial institutions and should be repaid in foreign currencies, collection of withholding tax in Korea is exempted regardless of execution of tax treaties.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Korea has adopted a taxation system for thin capitalisation under the Adjustment of International Taxes Act established in the late 1995, and effective since January 1, 1997.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

According to the Adjustment of International Taxes Act, if the average amount of interest-bearing debts extended by foreign controlling shareholders exceeds three times (six times in the case of financial businesses) the amount of equity held by the same shareholders in the relevant local company, any interests on such excessive amount are not considered as an expense under the tax law.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes, even if a local company has a loan extended by a third party other than its foreign controlling shareholder, if (i) there is a prior agreement between the local company and the foreign controlling shareholder, and (ii) the terms of the loan is actually determined by the local company and its foreign controlling shareholder, such loan is considered as a loan directly borrowed from the foreign controlling shareholder and subject to the taxation system for thin capitalisation.

In addition, any borrowings extended to a local company from a third-party financial institution under the foreign controlling shareholder's guarantee are also considered as loans subject to the taxation system for thin capitalisation.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Under the Corporate Tax Act, a local company, which has acquired and retained any assets recognised as not directly related to its business or has made any provisional payments to a specially-related person not in connection with the company's business, may not include any interests paid on loans in its business expenses.

3.8 Does Korea have transfer pricing rules?

Under the Adjustment of International Taxes Act, in international transactions, of which one of the parties is a foreign specially-related person, if the price of such transaction exceeds or falls short of a normal price, tax authorities may determine or correct the tax base or tax amount with respect to its resident based on the normal price.

In addition, in order to remove any potential causes of conflicts between tax payers and tax authorities and provide foreseeability of taxation, there is the Advance Pricing Agreement (APA) system in place.

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4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The corporate tax rate in Korea is currently 22%, but it will be changed to 20% from 2012.

4.2 When is that tax generally payable?

Companies should pay corporate tax on their income that they gain in a certain business year within 3 months from the closing date of the business year, but companies may pay the corporate tax in instalments with respect to: (i) any amount exceeding KRW 10,000,000 if the tax amount payable exceeds KRW 10,000,000 and the total amount of tax payable is no more than KRW 20,000,000: or (ii) 50% of the tax amount payable if the amount is KRW 20,000,000 or more, within 1 month (2 months for small companies) from the expiration of the period for payment, as mentioned above.

However, for companies of which the business year is 6 months or longer, the period of 6 months is prescribed as the period for interim payment. Such companies should pay, within 2 months after the expiration of such period for interim payment, the tax amount corresponding to 6 months among the total corporate tax paid in the previous business year or the tax amount calculated based on its income generated in the 6 months of the relevant business year (if the tax amount payable exceeds KRW 10,000,000, payment in instalments as mentioned above is available). The corporate tax paid as interim payment is deducted from the calculation of the final amount of corporate tax for the relevant business year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The corporate tax base is calculated by applying certain adjustments to the profits assessed pursuant to the corporate accounting rules.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The matters subject to adjustment include the difference in taxable period between the Corporate Tax Act and corporate accounting; the difference in evaluation method of assets and debts; and, the expense items, which are classified into expenses in business accounting but cannot be recognised as deductibles for policy purposes (i.e. any amount of entertainment expenses exceeding the statutory limit, penalties, etc.).

As Korea requires every listed company to adopt the international accounting standards until 2011, the country is preparing to amend the Corporate Tax Act in compliance with the international accounting standards so that the country is ready to deal with various problems that are expected to occur if the existing Corporate Tax Act remains in place.

4.5 Are there any tax grouping rules? Do these allow for relief in Korea for losses of overseas subsidiaries?

Korea enacted its first consolidated tax payment system on December 26, 2008 and implemented it on January 1, 2010. According to the system, a parent company and its wholly-owned subsidiary fall under a tax group for consolidated tax payment and constitute a single unit for imposition of corporate tax, and any deficits of the subsidiary can be deducted, in principle, from the amount of consolidated income.

However, since the companies eligible for such consolidated tax systems are limited to the companies which have their head offices or principal offices in Korea, such system is not applicable to overseas subsidiaries, and accordingly the deficits of overseas subsidiaries are not recognised as deductibles in the calculation of corporate tax.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

The Corporate Tax Act of Korea neither distinguishes the distributed profits and retained profits nor applies different tax rates to them.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There is education tax, which is reported and paid by financial and insurance companies at the rate of 0.5% of their profits; farming and fishing villages special tax, which is reported and paid by the companies receiving tax exemptions or deductions, at the rate of 20% of the deducted or exempted amount of tax; and, composite real property tax, which is levied on the companies which have excessive real properties.

Such education tax and composite real property tax are deducted from the taxable income for the calculation of corporate tax.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are such local taxes as follows: acquisition tax, which is reported and paid at the rate of 2% of the acquisition price at the time of acquisition of certain assets such as real properties and automobiles; registration tax, which is reported and paid at the time of registration of acquisition, transfer, change, or deletion of property right and other rights on public registry; local income tax, which is reported and paid at the rate of 10% of the levied amount of corporate tax; and property tax, which is paid by any person owning land, buildings, houses, ships, and aircrafts.

Among such local taxes, those relating to acquisition of assets (acquisition tax and registration tax, which is paid upon registration of acquisition of ownership of property right) constitute the acquisition cost for the assets, and other local taxes are deductible from the taxable income for corporate tax.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

In taxation, gains and losses from transfer of assets are included in the profits of the relevant business year like the gains and losses from the normal business.

However, as for the gains from transfer of properties, which are recognised as owned for a speculative purpose not in direct connection with the business such as houses and land for non-business purposes, companies are required to pay a certain amount of tax at a certain rate, separately from the corporate tax on the profits for the relevant business year as mentioned above.

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5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

As for the profits from transfer of general assets, they are included in business profits just like other kinds of business profits and are subject to 22% of the tax rate.

However, if the company transfers houses or land held for non-business purposes, any gains from such transfer, unlike the above business profits, are subject to the tax liability to pay an additional amount calculated by applying a 10% tax rate (30% after January 1, 2011) to the gains from the transfer.

5.3 Is there a participation exemption?

Regarding the dividends that a company satisfying the requirements as a holding company under applicable laws receives from its subsidiary, depending on its percentage of shareholding in the subsidiary, 100% [if the shareholding ratio is 80% (40% in the case of listed companies)] or 80% [if the shareholding rate is 40% - 80% (20% - 40% in the case of listed companies)] of dividends are excluded from taxable income. Regarding the dividends that a company other than a holding company receives from its subsidiary, depending on its shareholding percentage, 100% (if the shareholding rate is 100%), 50% [if the shareholding rate is no less than 50% (30% in the case of listed companies)], or 30% of dividends are excluded from taxable income. However, these provisions are applicable only to the dividends from Korean subsidiaries (which have their headquarters or principal offices in Korea), not to those from foreign subsidiaries.

However, regarding the dividends received from foreign subsidiaries, indirect foreign tax credits equivalent to foreign corporate tax paid by foreign subsidiaries are granted on the amount of dividends from foreign subsidiaries (which are limited to the companies, of which no less than 20% of shares have been held by the parent company for 6 months or longer as of the reference date for dividend allocation) in order to prevent double taxation. In such a case, if the indirect foreign tax credits are permitted under the tax treaty between the foreign subsidiary's resident country and Korea, the entire amount of foreign corporate tax, as calculated by statutory formula, is granted as tax credit, but even if indirect foreign tax credits are not allowed under the tax treaty, tax credits are granted under the Korean tax law on 50% of the foreign corporate tax.

5.4 Is there any special relief for reinvestment?

In the case of replacement investment of fixed assets for business purposes, the amount calculated by applying a certain rate to the value of the relevant fixed asset for business is deductible. However, stocks are not included in such fixed assets for business purposes.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

In establishing a corporation, 0.48% of the capital as registered at the time of incorporation should be reported and paid as the registration tax.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Subsidiaries, which fall under Korean companies, are liable to pay corporate tax to the Korean tax authority with respect to their worldwide income, but branches, which fall under foreign companies, are liable to pay corporate tax only on the income generated in Korea, among the entire income attributed to them.

6.3 How would the taxable profits of a local branch be determined?

If a foreign company has a fixed place of business in Korea, among the profits generated in Korea excluding capital gains, only the profits, which are deemed attributable to such fixed place of business, based on the actual relevance to it, constitute taxable income of such place of business.

In calculating the profits attributable to such fixed place of business, if the place of business is assumed as an entity conducting business independently from its head office, the profits expected to be earned by such place of business are deemed attributable to it.

Meanwhile, in determining the profits of the fixed place of business, overhead expenses including operation expense and general maintenance expense incurred for the purpose of such fixed place of business, wherever they are incurred, if reasonably allotted, are deductible from the taxable income.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

In the event there is a provision in the tax treaty between Korea and the foreign country where the foreign corporation is located (currently, there are explicit provisions for branch tax in the tax treaties between Korea and Canada, France, Australia, Indonesia, Philippines, Brazil, Kazakhstan, Morocco, and Thailand), a foreign company's fixed place of business in Korea should pay, in addition to the corporate tax, the tax calculated by applying the lower of 22% and the rate of the relevant tax treaty applicable to the profits of the relevant place of business in Korea after subtracting the corporate tax, etc. paid by the place of business and the recognised amount of replacement investment [shareholders' equity as of the end of the relevant business year (assets - liabilities) after subtracting shareholders' equity as of the commencement date of the same business year] and the amount not recognised as a deficit under the taxation system for thin capitalisation (in the case of the Philippines, the amount actually transferred).

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Since foreign companies' branches in Korea are not Korean companies or residents, tax benefits granted to Korean companies or residents under tax treaties are not applicable to them.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Please see question 6.4.

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7 Anti-avoidance

7.1 How does Korea address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The notes to the 2003 OECD Standard Model Treaty recommend its member nations to apply rigorous taxation to the abuse of tax treaties by strictly applying the principle of real taxation so that double taxation treaties executed between countries for the promotion of international investment and trade would not facilitate tax avoidance or tax evasion. In addition, the current position of courts is that even if tax treaties do not include such phrases, the principle of real taxation and other regulatory systems against tax avoidance and tax evasion under the nation's tax law are generally applicable to the interpretation and application of tax treaties. However, there is no disclosure rule.

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Yoon & Yang LLC is a leading law firm in Korea, which provides the best service across the entire areas of legal practice, including corporate law and international transactions and litigation based on its best expertise of more than 220 attorneys, accountants, tax accountants, and other professionals. In order to provide specialised legal services, Yoon & Yang LLC has organised specialised teams with specialised attorneys for each practice area, thereby systematically sorting out professional knowledge and know-how, and the firm also provides a comprehensive one-stop legal service, as optimised for customers through mutual cooperation between such specialised teams. Especially the tax team, which consists of Korean attorneys, certified public accountants specialised in international taxation, tax accountants, advisors who are former high ranking officials of the National Tax Service, and many other tax professionals, provide the best advice regarding general tax matters in Korea and to foreign companies, which wish to do business with Korean counterparts.

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Kosovo

Alketa Uruçi

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Kosovo?

Kosovo has concluded only one tax treaty. It was entered into with the Republic of Albania and has been in force since 2006.

1.2 Do they generally follow the OECD or another model?

The treaty follows the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties must be ratified by Parliament. A treaty ratified by Parliament becomes a part of the Kosovo legal system after publication in the Official Gazette and prevails over any law which differs from the treaty's provisions.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The treaty does not incorporate anti-treaty shopping rules.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

The treaty prevails over domestic law regardless of whether the domestic legislation existed previously or is introduced subsequently to it.

2 Transaction Taxes

2.1 Are there any documentary taxes in Kosovo?

No, there are no documentary taxes in Kosovo.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Kosovo has introduced VAT in 2001. Currently, the VAT rate is 16%; exports are zero-rated. A new Law "On VAT", which is in line with the EU Directive on VAT, entered into force on 1 July 2010. The turnover threshold for registration purposes is set to EUR 50,000.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The following activities are VAT-exempt:

- insurance and reinsurance transactions;
- financial services;
- the supply of postage stamps, fiscal stamps and other similar stamps;
- betting, lotteries and other forms of gambling;
- the supply of land or land on which a building or house stands;
- the supply of houses, apartments or other accommodation used for residential purpose; and
- the leasing or letting of immovable property.

Other exemptions are provided on importation, exportation and services related to international transport of goods and passengers.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Generally, taxpayers registered for VAT are entitled to recover the input VAT, provided that the VAT is charged in relation with taxable activity. When taxpayers make both taxable and exempted supplies, VAT may be reclaimed partially.

VAT can not be reclaimed on certain recreation expenses and representation costs and it is limited on car expenses not used only for business purposes.

2.5 Are there any other transaction taxes?

Excise tax apply to a limited number of goods such as coffee, tobacco, alcoholic drinks, soft drinks, derivatives of petroleum and motor vehicles, mainly for transport of passengers.

2.6 Are there any other indirect taxes of which we should be aware?

Except from excise and customs duties, there are no other indirect taxes.

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3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

No, there is no withholding tax on dividends distributed from a Kosovo resident company.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes. There is a 10% withholding tax on royalties paid by a Kosovo company to a non-resident.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes. There is a 10% withholding tax on interest paid by a Kosovo company to a non-resident.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

No, there are no "thin capitalisation" or similar rules.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

No, there is no any provision on this regard.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

As indicated in question 3.4, there are no "thin capitalisation" rules in place.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No, there are no restrictions.

3.8 Does Kosovo have transfer pricing rules?

Corporate Income Tax Law provides that the prices between related parties should be carried out at open market value. Such value should be determined under the uncontrolled price method, and when this is not possible, the resale price method or the cost-plus method.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Kosovo Corporate Income Tax Law provides for a flat rate of 10%.

4.2 When is that tax generally payable?

The tax is payable on quarterly advance payments and final settlement is made on or before 31 March of the following year upon submission of financial statements.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The taxable base is calculated starting from the profit shown in the financial statements, adjusted in accordance with the limitation provided in Corporate Income Law.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The Corporate Income Law provides a list of expenses that are non-deductible for tax purposes, consisting of:

- fines and penalties;
- income tax paid or accrued for the current or previous tax period and any interest or late penalty incurred for late payment of it;
- any loss from the sale or exchange of property between related persons;
- pension contributions above the maximum amount allowed by the Kosovo Pension Law;
- bad debts that do not meet the certain conditions;
- contributions made for humanitarian, health, education, religious, scientific, cultural, environmental protection and sports purposes, which exceed five per cent (5%) of taxable income (before the deduction of such expenses);
- representation costs (these include publicity, advertising, entertainment and representation), which exceed two per cent (2%) of total gross income; and
- accrued expense for which the withholding tax should be paid unless such expense is paid on or before 31 March of the subsequent tax period.

4.5 Are there any tax grouping rules? Do these allow for relief in Kosovo for losses of overseas subsidiaries?

No, there are no tax-grouping rules.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, there is no difference in this regard.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Yes, there are property taxes in Kosovo. All persons that own, use or occupy immovable property are subject to tax on real estate. The annual tax rates may vary between 0.05% and 1% of the market value of the real estate depending on the location.

4.8 Are there any local taxes not dealt with in answers to other questions?

No, there are not.

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5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes, Corporate Income Law indicates the rules applicable to capital gain. As a general rule, capital gains and losses are treated as ordinary income/losses from economic activity. Capital gains are not recognised for fixed assets which are depreciated in a pool and purchased prior to 1 January 2010.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Capital gains are taxed at the same rate as business profit.

5.3 Is there a participation exemption?

No, there is no any exemption.

5.4 Is there any special relief for reinvestment?

No, there is no relief for reinvestment.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes payable upon formation of subsidiaries.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no such taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

Branches are taxed only on the taxable income from a Kosovo source of income. The taxable income is determined in the same manner as for resident companies.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There are no such branch profit taxes. Taxable income of branches is subject to Corporate Income Tax at the same rate of 10%.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Branches have the same treatment under the local legislation.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No, there is no withholding tax or other tax in regard of remittance of profit by the branch.

7 Anti-avoidance

7.1 How does Kosovo address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Tax Procedure Law provides for the right of tax authorities to disregard and re-characterise a transaction or element of the transaction that does not have a substantial economic effect, where the form of the transaction does not reflect its economic substance and was entered into as part of a scheme to avoid a tax liability.

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Since 1999 Mrs. Uruçi focused her practice on tax and customs laws in all industries and sectors in Albania. With her double major studies background in Law and Economics, Alketa has acquired solid understanding and experience in tax legislation and its impact and interaction with other legal framework, such as labour and employment, commercial companies law, real estate and construction.
Her practice areas encompass corporate tax, VAT, national taxes, local taxes, personal income tax, excise tax and customs duties. Alketa advices and manages tax assignments in all industries and sectors such as aviation, banking and financial institutions, cement, consumer goods, construction and real estate, telecommunications, etc.
Alketa is active as tax litigator in all levels of Albanian courts, where she represents the clients during judiciary claims against the tax assessments and tax authorities.

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Mr. Andi Pacani has developed solid experience in accounting, tax and regulatory framework, with a very good experience in the application of accounting regulations (national and international standards), corporate tax law and other fiscal laws, by being involved in assignments providing any tax and accounting assistance to clients seeking to operate and engage in business activities in Albania and Kosovo.
Mr. Pacani graduated from the University of Tirana, Faculty of Economy in Business Administration, in 1999. In 2005, Mr. Pacani obtained a licence as an Approved Accountant.

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Boga & Associates, established in Tirana, Albania in 1994, has emerged as one of the premiere law firms in Albania, earning a reputation for providing the highest quality in legal, tax and accounting services to its clients. Boga & Associates has operated for many years in Kosovo (Pristina), offering a full range of services.

The firm maintains its commitment to quality through the skills and determination of a team of attorneys and other professionals with a wide range of skills and experience. The extensive foreign language capabilities of the team help to ensure that its international clientele have easy access to the expanding Albanian and Kosovo business environment.

Boga & Associates represents a broad spectrum of high-profile clients, including financial institutions, airlines, industrial complexes, mining and petroleum concerns, non-profit organisations, embassies, public utilities, international and governmental agencies. The firm has also an outstanding litigation practice, representing clients on all levels of Albanian courts.

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Latvia

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Latvia?

There are currently 48 effective tax treaties in force.

1.2 Do they generally follow the OECD or another model?

They generally follow the OECD model but in some cases the UN or US model is followed.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Treaties must be ratified by the Latvian parliament before they take effect.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

As a general rule most Latvian income tax treaties do not include express limitations of benefits articles. Exceptions include treaties with the US, Singapore, and Kazakhstan.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

According to Latvian law international treaties supersede domestic legislation.

2 Transaction Taxes

2.1 Are there any documentary taxes in Latvia?

There are state (stamp) duties in Latvia. The stamp duties are payable for a number of actions including, but not limited to, execution of notarial deeds if, for instance, an agreement executed in relation to the relevant transaction requires notarial certification, for registration filings with the Register of Enterprises and upon registration of corporate changes as well as upon registration of ownership title and security interest in respect to real estate with the Land Register.

Rates of state (stamp) duties are set by various laws and regulations.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Supply of goods and provision of services are subject to Value Added Tax in Latvia. The applicable rates are:

- general rate of 21% (applied on a majority of supply of goods and services);
- reduced rate of 10% (applied on supplies of medicines, specialised products intended for infants, heating and power supplies to consumers, periodicals and books, hotel lodging); and
- zero-rate of 0% (applied on export of goods and related services, tourism-related services which, according to VAT Law are not supplied domestically).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

VAT is generally applicable to goods and services supplied domestically. Business-to-business services, which are deemed to be supplied outside of Latvia are generally not subject to VAT. Certain supplies are exempt under the law such as medical services and goods, education services, and financial and insurance transactions. VAT also is not applicable to activities that fall outside the scope of VAT legislation such as contractual penalties, security deposits, down payments, membership fees, indemnities for insurance events paid by insurance companies, cost reimbursements that do not constitute payments for delivery of goods or provision of services, amounts received as a result of assignment of claims rights.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

In order to fully recover VAT, a business must be a registered VAT payer and supply VAT-taxable supplies. In cases when a business provides mainly exempt services only a proportion of VAT expenses incurred can be recovered based on the amount of VAT-taxable and non-taxable supplies made.

2.5 Are there any other transaction taxes?

No, however, in some cases state fees may be charged for specific actions such as requesting documents from state institutions, and registration of documents (e.g. company formation) obtaining certain state services necessary to complete a transaction. As a general rule the state duties are not material in amount. For more

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detailed information regarding state (stamp) duties, please see the answer to question 2.1 above.

2.6 Are there any other indirect taxes of which we should be aware?

Other indirect taxes in Latvia include excise tax, customs duty and natural resources tax.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid to a non-resident are subject to 10% withholding tax under domestic law. Dividends paid to an EU or EEA resident company are not subject to withholding tax provided the recipient is tax resident in its jurisdiction, subject to corporate or a similar tax in its jurisdiction and is a qualifying corporate legal form/entity.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Withholding tax is charged on royalty payments made to non-residents at a rate of 5% or 15%.

Withholding tax on royalties paid to EU resident associated companies is charged at 5% and from 1 July 2013 these payments will be exempt.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Withholding tax applies to interest payments from a Latvian source to related party non-residents at 10% (5% for banks).

For qualifying EU resident companies from 1 July 2009 the rate was reduced to 5% and from 1 July 2013 no withholding tax will apply. A qualifying EU resident company:

- is a tax resident in its jurisdiction;
- is subject to a similar corporate income tax in its jurisdiction; and
- has a 25% capital or voting interest in the borrower.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Latvia has thin capitalisation rules in place. Thin capitalisation rules limit the amount of interest and other economically-similar borrowing costs that can be deducted for corporate income tax purposes. Taxable income is adjusted by the amount that exceeds the larger amount as determined by one of the following two calculations:

(i) The amount of interest allowable is determined by multiplying the principal amount outstanding during the year by 1.2 times the average short-term interest rate for the last month of the taxation period, as determined by the Latvian Statistics Commission. This is then compared to the actual interest paid.

(ii) Taxable income is to be increased for interest paid by an amount that is proportional to the amount by which the average amount of the principal payable during the year exceeds a multiple of 4 times the company's equity as stated in its annual accounts at the beginning of the year, which is then reduced by any amounts that are long-term investment revaluation reserves or other reserves that are not reflected in the profit and loss statement.

The above restrictions are not applicable to credit institutions and insurance companies, or to interest payments for credits, leasing services and loans, issued by credit institutions registered in the Republic of Latvia or in another Member State of the European Union, the Latvian Treasury, the Nordic Investment Bank or from World Bank group, as well as from residents of Latvia. It is anticipated that the law will be amended soon to remove the discriminatory aspect of the rules exempting interest from debt to Latvian residents from the limitations.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There are no specific safe harbour rules applicable.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes, subject to the exemptions described in question 3.4.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No there are no additional restrictions.

3.8 Does Latvia have transfer pricing rules?

Latvian tax law requires transactions between related parties to be carried out at market rates. If market rates are not applied, taxpayers may be required to adjust their taxable income by the difference between the market value and the transaction value.

Latvian law provides that the certain methods should be used for determining transfer prices following the OECD guidelines. The three transactional transfer pricing methods (comparable uncontrolled price, cost-plus and resale method) should be used primarily. Two profit-based methods (transactional net margin method and profit split method) are available, if the first three methods are not sufficient for determining an arm's length price.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Latvian tax law provides for a flat corporate tax rate which is currently 15%.

4.2 When is that tax generally payable?

Corporate tax is payable on a monthly or quarterly basis as advance payments based on the previous financial period's tax liability. Final calculated amounts are payable within 15 days of submitting the annual corporate income tax return due within 4 months after the close of the financial year.

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4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base is the financial profit/loss as per the annual accounts subject to adjustments for tax purposes.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Adjustments that must be made for arriving at taxable income include exempt income, non-deductible expenses (non-business expenses) and statutorily prescribed capital allowances.

4.5 Are there any tax grouping rules? Do these allow for relief in Latvia for losses of overseas subsidiaries?

Latvian law does not allow for group taxation or fiscal unity. However there are grouping rules which allow for the transfer of losses within a group subject to certain preconditions. Under the group relief rules a subsidiary resident in the EEA or in a country with which Latvia has an effective double tax treaty can in limited circumstances transfer losses to the Latvian company which qualifies as a member of the group.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Retained profits and profits for distribution are taxed at the same rate.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Real estate tax is payable by the owners. The current rate is 1.5% of the cadastral value of land and buildings. Residential buildings are subject to rates between 0.1% and 0.3% depending on the cadastral value of the property. Unused agricultural land is subject to a rate of 3%. It is anticipated that material changes to the real estate tax base will be made in 2011.

Excise tax is payable on excised goods such as petroleum products, alcohol and tobacco, and soft drinks and coffee. Rates vary with respect to a particular product.

Natural resource tax is payable by entities that acquire natural resources, carry on with their polluting activity, and distribute polluting goods, including packaging.

4.8 Are there any local taxes not dealt with in answers to other questions?

Generally local taxes do not exist but in limited circumstances municipalities have limited rights to impose specific taxes or state fees for specific services.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Current law does not differentiate between capital gains and ordinary income earned by companies. A capital gains tax on individuals was introduced in 2010. Personal income tax is payable at a rate of 15% on capital gains realised by individuals.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Capital gains realised by companies are taxed the same as ordinary income at the flat corporate income tax rate of 15%.

5.3 Is there a participation exemption?

Participation exemptions are available with respect to dividends only. To qualify for the participation exemption, a company must hold at least 25% of voting shares in the non-resident subsidiary, which must not be incorporated in any of the statutorily-designated low tax zones. Dividends received from an EEA resident company qualify for the exemption regardless of the percentage of ownership.

5.4 Is there any special relief for reinvestment?

Current law does not provide for relief for reinvestment with the exception relating to the updating of fixed assets. Income gained from the sale of fixed assets is not taxed provided within a 12-month period before or after the sale of the fixed assets new fixed assets of a functionally-similar type are acquired.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no capital duties payable upon the formation of a company.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

As a general rule, a branch of a non-resident company is taxed the same as a subsidiary. A branch for tax purposes is treated as an independently operating entity subject to certain adjustment for transactions carried out with the head office.

6.3 How would the taxable profits of a local branch be determined?

Absent a double tax treaty, a branch calculates taxable income the same as a company. A branch would be required to prepare an income/loss statement as if it were a separate entity from its head office, which would be the basis for calculating taxable income.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Latvian law does not provide for a separate branch profits tax. If the first financial period of a branch is less than 12 months then the branch can apply a simplified tax calculated as 20% of the branches' revenues.

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6.5 Would a branch benefit from tax treaty provisions, or some of them?

Branches benefit from tax treaty provisions with respect to articles on business profits and allocation of income and expenses to permanent establishments as tax treaties generally have more beneficial terms.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Withholding tax is not charged on payments made by a branch to its head office.

7 Anti-avoidance

7.1 How does Latvia address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Avoidance is addressed through several provisions. Most importantly, payments made to statutorily-designated low tax zones are subject to 15% withholding tax unless approval has been obtained from the tax authorities in advance to not withhold the tax. Other anti-avoidance provisions include requirements to regularly report cash transactions and payments to non-residents.

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Experience: Zinta Jansons is a senior associate at the LAWIN Riga office and head of the Tax practice in Latvia, specialising in tax and corporate law. Qualified in New York (1999) and New Jersey (1999), USA, she is a member of the International and American Bar Associations and Latvian Tax Consultants Association. Zinta Jansons advises on tax matters relating to M&A deals, real estate transactions, banking and securities transactions, and other complex business transactions involving international and domestic companies. She also represents and advocates tax payers' interests with the tax authorities. She has more than 10 years' experience consulting in the Baltic region.
Education: Zinta has a J.D. degree from the Seton Hall School of Law, Newark, NJ, USA (1998) and B.Sc. from the School of Business at the Rutgers University, New Brunswick, NJ, USA (1993).
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Experience: Elina Girne is a senior associate at the LAWIN Riga office. She was admitted to practice in Latvia as an attorney at law in 2003 and is a member of the Latvian Association of Tax Consultants. Elina is a member of the LAWIN Tax practice, specialising mainly in tax law, general corporate issues and employment law. Elina consults clients in relation to tax payments in commercial transactions and commercial activity, VAT matters, contracts law and employment related issues.
Education: 2003 University of Latvia, Faculty of Law, Professional law degree (dipl.iur.).
Professional activities: Elina is a member of the Council (since 2008) and a vice president of the Labour Law Commission (since 2010) of the International Association of Young Lawyers AIJA (*Association Internationale des Jeunes Avocats*). Since 2003, she has also acted as a legal counsel at the Centre of Legal Practice and Assistance at the University of Latvia Faculty of Law.

LAWIN - internationally highest ranked business law firm in the Baltics - was launched in 2004 by Lepik & Luhaaar (Estonia), Klavins & Slaidins (Latvia) and Lideika, Petrauskas, Valiunas ir partneriai (Lithuania) - leading law firms in each jurisdiction since their very foundation in the beginning of 1990s.

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Liechtenstein

Christian Presoly

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Benedikt König

1 General: Treaties

1.1 How many income tax treaties are currently in force in Liechtenstein?

Liechtenstein has agreed to income tax treaties with its neighbouring countries Austria and Switzerland. As Liechtenstein currently undergoes an in-depth reform of the entire tax regime and there are ongoing negotiations with different (mostly European) countries, it is likely that additional tax treaties will be concluded in the upcoming years. Tax treaties have been signed with Luxembourg, San Marino, Hong Kong and Uruguay. However, they are not in force yet.

1.2 Do they generally follow the OECD or another model?

The tax treaties with Austria were concluded in 1955 and 1969 and do not follow the OECD model. The tax treaty with Switzerland was agreed on in 1995 and also applies its own rules. The new treaties shall follow the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

The Liechtenstein Parliament approves international treaties by majority vote to incorporate them into Liechtenstein law. After the approval of the parliament the confirmation of the Prince is required. Subsequently, the treaty is published in the legal gazette. The effective date usually follows the day of publication unless otherwise provided.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Both existing treaties in force do not contain anti-treaty shopping rules.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Both existing treaties are in force to full extent. Currently, there are no overriding rules.

2 Transaction Taxes

2.1 Are there any documentary taxes in Liechtenstein?

Since 1923 Liechtenstein has been in a tariff union with Switzerland. The tariff treaty basically provides for the applicability of the Swiss documentary taxes and the applicability of the corresponding Swiss legislation. Documentary tax comprises of taxation of certain documents for the raising of capital and the turnover of certificates such as securities.

There are three kinds of fiscal charges:

- tax on the issue of domestic participation rights, obligations and money market papers;
- a turnover tax on the turnover of certain domestic and foreign documents such as participation rights, fund units, obligations and comparable certificates; and
- a charge on insurance premiums.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Liechtenstein implemented the Swiss value-added tax system in its legislation by law in October 2009 ("*Mehrwertsteuergesetz* - MwStG"). The VAT rate is at 7.6%, the reduced rate of 2.4% mainly applies on convenience goods.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Basically VAT is charged on all supplies of goods and services carried out (or deemed carried out) in Liechtenstein:

- according to Article 10 of the Law on VAT, the VAT is less than CHF 100,000, as far as the exclusion from taxation is not waived;
- if enterprises have their seat abroad which perform only on the basis of a special taxation (*Bezugsteuer*); this exclusion does not apply for telecommunication businesses or electronic businesses and their services to subjects not liable to taxation; and
- if non-profit voluntary-based sports or cultural clubs or charitable institutions have a total turnover of less than CHF 150,000, as far as the exclusion from taxation is not waived.

Article 21 of the Law on VAT individualises a range of exceptions from the full VAT, applying the reduced rate at 2.4%, for example:

- certain medical and social services;
- charitable initiatives;

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- certain educational services;
- certain (re)insurance services;
- certain defined banking services;
- real estate transactions (including renting of real estate); and
- arbitration.

Article 23 of the Law on VAT defines certain general dispensations from the VAT duty:

- export of goods;
- export renting and chartering of goods;
- transit of goods;
- overseas placement services; and
- overseas services of travel agencies.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Generally, VAT is recoverable by all businesses. Restrictions comprise of the import of services and goods intended for rendering services excluded or dispensed from VAT. Acquisition, keeping and selling of equity interest (at least 10% of the capital) as well as reorganisation is fully recoverable. With holding companies the recoverability can be dependent on the business of the underlying companies.

2.5 Are there any other transaction taxes?

The present law on taxes provides for a coupon tax at a rate of 4%. However, the abolition of coupon tax is one of the characteristic features of the draft tax law coming into force in 2011. Therefore, income retained before 2011 will be taxed at 1% if disbursements are made in the first year of the reform, at 2% for disbursements in the second year, 3% in the third year and 4% for disbursements in the following years. No coupon tax is imposed on new income retained after the reform comes into force.

The Liechtenstein tax law provides for a real estate tax on the exchange of ownership. According to the draft law a progressive scale applying to the amount gained from the sale of real estate is introduced.

Further, the draft law provides for a tax on the dedication of assets to a legal entity imposed at the rate of 2.5% of the proprietary value of the asset dedicated.

2.6 Are there any other indirect taxes of which we should be aware?

Currently an inheritance tax and a gift tax are imposed; these taxes are abolished according to the draft tax law. This is intended to come into force by 2011.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

The current coupon tax is abolished with the new tax law (see question 2.5). The draft tax law does not foresee any withholding tax on disbursements of dividends and capital gains.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

The draft tax law does not foresee any withholding tax on royalties. Liechtenstein will introduce a special tax regime for intellectual industrial property rights providing for tax exemption of 80% of the income from certain intellectual property rights.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Liechtenstein is party to a treaty with the European Union on saving taxes according to EU directive 2003/48/EG. Accordingly, Liechtenstein imposes a 35% savings tax on interest accrued for the benefit of EU residents. As otherwise being protected by the banking secret, such beneficial owner may opt for an exchange of information, in which case no withholding tax is imposed.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

This does not apply in Liechtenstein.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

This does not apply in Liechtenstein.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

This does not apply in Liechtenstein.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

This does not apply in Liechtenstein.

3.8 Does Liechtenstein have transfer pricing rules?

The draft tax law now explicitly introduces the "arm's length principle". Consequently, for the calculation of the taxable net revenues, profits and expenditures are considered as if they had occurred between independent parties.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The draft tax law provides for a fixed flat rate at 12.5% p.a. for enterprises doing business within the country. The previous tax on capital is abolished. Instead of the previous domicile companies (for example foundations, establishments and trusts) on which a flat rate of CHF 1,000 applied, a new category, the personal asset structures, is introduced. According to the latest draft of the new law now an annual flat rate of CHF 1,200 (USD 1,220) is imposed on personal asset structures.

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4.2 When is that tax generally payable?

Recently, the filing date for the tax return is defined by the Liechtenstein revenue authorities on an annual basis (the previous law requested filing six months after the end of the business year). Upon request an extension for filing may be obtained. The payment of the taxes has to be effected within 30 days after the maturity of the fiscal claim. In most cases of the new tax law this deadline is activated by the delivery of the tax bill. For personal asset structures the anniversary of the formation applies as the due date. Generally, payment facilities can be agreed on.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base is always a 12.5% flat tax, which is accounted for the calculation of the tax on profits. Apart from personal asset structures all companies are liable to profit tax on their worldwide profits. Tax is payable on profits realised minus tax deductible expenses and losses which may be carried forward indefinitely. For the determination of the taxable profit, basically, the annual accounts are to be consulted.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

As stated above (question 4.1), according to the latest draft of the new law, a flat rate of CHF 1,200 (USD 1,220) is imposed on personal asset structures which do not necessarily have commercial accounts.

4.5 Are there any tax grouping rules? Do these allow for relief in Liechtenstein for losses of overseas subsidiaries?

Generally, the new Liechtenstein tax law provides for group taxation. Upon application companies may form a group and balance losses and profits achieved within one year amongst the group. The transfer of losses may be performed from the group members to the holding company or downwards to a company being fully taxable in Liechtenstein. Generally, profits are not added. There is no tax consolidation of the group. The attribution is effected on the basis of the amount of holding.

Companies are considered to be connected as far as the holding company has its statutory seat or its administration in Liechtenstein for the whole business year and directly or indirectly holds more than 50% of the voting rights or more than 50% of the registered capital of one or more domestic or foreign companies (members of the group). However, it is not required that all companies connected become members of the group. For the transfer of losses a Liechtenstein subsidiary is sufficient. It is required that no group member has essentially ceased to operate.

As the new law allows for the participation of a group member in another group, consolidated companies profit from multi-level domestic holding structures.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, it is not.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Liechtenstein continues to have a "property tax"; however, the term "property tax" only provides for the definition of "property" - income from property generally is taxed as a part of the profit tax.

4.8 Are there any local taxes not dealt with in answers to other questions?

The new tax law provides for a formation tax on the formation of new companies at the rate of 1% of the companies' capital (tax-free allowance of CHF 1 Mil), with reduced rates of 0.5% for formations with capital exceeding CHF 5 Mil and 0.3% exceeding CHF 10 Mil. For foundations and trusts a formation tax of 2% of formation capital (at least CHF 200) is imposed.

Further, a tax on certain insurance premiums at a rate of 5% of the premium payable and 2.5% for life insurances is imposed.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

According to the new tax law, capital gains are not comprised of taxation. Enduring losses may be written off. The law does not differentiate between domestic or overseas capital gains and losses.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

This does not apply in Liechtenstein.

5.3 Is there a participation exemption?

The draft tax law provides for an exemption of participations as it does for capital gains.

5.4 Is there any special relief for reinvestment?

Replacement purchases are exempt from taxation via amortisation of undisclosed reserves if the replaced item is necessary for running the business. Further, the replacement has to be necessary due to economic, legal, technical or factual reasons. Relief is not granted for the replacement of mere investment of assets, participations with the purpose of achieving capital gains and real estate, as far as real estate tax on the exchange of ownership is imposed. The reinvestment does not necessarily need to be done in the same accounting year.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

See question 4.8. Formation of a subsidiary due to reconstruction measures is not taxed if undisclosed reserves are dissolved.

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6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are not.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch of foreign corporations are taxed in the same way as domestic companies. Taxable profits are generally calculated by reference to the income and deductions attributable to the local branch's business activities, determined under the assumption that the branch acts like an enterprise independent from its head office. However, transactions between the head office and branches are generally disregarded (except for banking activities). All Liechtenstein income so allocated to and derived by a branch in Liechtenstein, is taxable in Liechtenstein (but also see question 4.5).

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No, it would not.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

The current double tax agreements with Austria recognise a separate taxation of branches in the particular country which also applies to sleeping partner's interests but not to share participations or private limited companies.

In the double tax agreements with Switzerland there is no comparable provision.

However, the draft of the new law generally provides for the prevention of double taxation if reciprocal treatment is granted.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

For the draft tax law, it would not. For the current law see question 2.5.

7 Anti-avoidance

7.1 How does Liechtenstein address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The draft of the tax law addresses tax avoidance on a general basis. Legal or factual constructions deemed inappropriate which have as their only purpose to achieve tax advances are abusive if:

- granting the tax advance is contrary to the spirit and purpose of the law; and
- the taxable person has no economic or other substantial reasons for the choice of the construction and such construction has no own economic consequences.

The consequence of an ascertained avoidance is the taxation on appropriate economic conduct, facts and relations. There is no requirement to disclose avoidance schemes in advance.

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Lithuania

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Lithuania?

Lithuania currently has 47 treaties on the avoidance of double taxation of income and capital in force.

1.2 Do they generally follow the OECD or another model?

The treaties follow the Lithuanian Model Tax Treaty that is based both on OECD and United Nations Model Tax Conventions, taking into consideration the remarks of OECD experts.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

These treaties are applied directly and do not have to be incorporated into domestic laws. The treaties come into force after they have been signed and ratified by the Lithuanian Parliament. The treaties themselves may also indicate a later moment of coming into force.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Lithuanian treaties on avoidance of double taxation usually do not incorporate special anti-treaty shopping rules, with minor exceptions (e.g. the treaties with the USA, UK, etc.). Nevertheless, most of them contain beneficial ownership requirements in the articles regulating taxation of dividends, interest and royalties and an arm's length requirement applicable to the transactions between related parties.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

International treaties have supremacy over domestic laws in Lithuania. As the treaty comes into force, it overrides the domestic laws of the same field, unless it is stated otherwise in the treaty itself or if the national law provides a more favourable regime.

2 Transaction Taxes

2.1 Are there any documentary taxes in Lithuania?

Stamp duties and State fees of exactly established amounts are applied only for the precisely defined formal services of State institutions, e.g. review of the application, issue of the document, etc.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Lithuania has value added tax which is harmonised with the EU acquis. The standard VAT rate is currently equal to 21%.

Some transitional periods, during which reduced VAT rates shall be applied, have been established for 2010-2011:

- partly or wholly compensated pharmaceuticals shall be taxed with 5% VAT until 31 December 2010;
- books and non-periodic publications shall be taxed with 9% VAT until 31 December 2010; and
- heat energy for heating of the residential premises and hot water supplied to these premises shall be taxed with 9% VAT until 31 August 2011 (prolonged for one additional year).

The 0% rate VAT is charged mainly on goods exported from the EU and certain related services of transportation and insurance, as well as on the certain supply of goods to another EU Member State; 0% VAT is also charged on a few other occasions prescribed by law.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

In general, VAT is charged on every supply of goods or services, when the supply is effected by a taxable person in the performance of his economic activities, if the supply is for consideration and effected within the territory of Lithuania. Still, certain supplies of goods and services (such as of a healthcare, social, education, culture and sport nature, certain mail services, radio, television, insurance, financial services, rent or sale of some real property, betting, gambling and lottery services, special marks, etc.), as well as some intra-community acquisitions, stay exempt from VAT.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Under the Law on VAT of the Republic of Lithuania (**the Law on VAT**), input/import VAT may be entered for deduction if the goods

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or services purchased are used for the taxable supply. With some exceptions, input/import VAT that is directly or proportionally attributed to the supply exempted from VAT cannot accordingly (in whole or proportionally) be deducted. Under the Law on VAT, in some cases input/import VAT on the acquisition of entertainment and representation goods and services, motor vehicles, passenger transport services and also VAT paid on behalf of another person cannot be deducted, or its deduction is limited.

In general, VAT paid in Lithuania is recoverable; still, a few circumstances exist which should be noted. According to the laws, the difference between input and output VAT will firstly be included to cover the tax arrears of the same taxpayer, the overdue state loans to the taxpayer or the overdue loans, warranted by the State. The remaining part of excess of VAT may be returned only to the taxpayer who has paid into the budget and funds all the taxes, default interest, penalties and interest for overdue tax. Moreover, the VAT will be refunded only if there are no open investigations regarding criminal activities of the taxpayer in respect of fulfilment of his VAT obligations.

The Law restricts the maximum recoverable VAT sum to the sum of conditional or calculated VAT on taxable amounts of particular categories goods and services prescribed by the Law on VAT, such as goods and services in respect of which the 0% VAT rate was applied, acquired capital assets, etc.

As regards a foreign person's right to recover VAT, under the Law on VAT, a taxable foreign person that: (i) is established in another EU Member State; (ii) is established in a third country and registered as a VAT-payer in an EU Member State for the electronic supply of services; or (iii) is established in a third country where the VAT paid (or any equivalent tax) is refundable to taxable persons of Lithuania, has a right to recover the VAT paid in Lithuania. With some exceptions, the foreign taxable person may apply for recovery of VAT only when he had no subdivision or place of residence and did not engage in commercial activity in Lithuania, which is subject to VAT, during the period in which he paid the VAT he is asking to be refunded.

With respect to the foreign taxable persons, the laws also establish the shortest period for which the VAT may be recovered, the minimal recoverable sum and the term (quite short) during which the request for VAT recovery may be submitted.

From 1 January 2010 a taxable person registered in another EU Member State and seeking to recover the Lithuanian VAT must submit the request to the Tax Administrator of the country of his establishment.

2.5 Are there any other transaction taxes?

No, there are no other transaction taxes.

2.6 Are there any other indirect taxes of which we should be aware?

According to the EU Customs Code and related legal acts, custom duties on particular goods imported into the EU within the territory of Lithuania are levied.

Excise duties are charged on ethyl alcohol and alcoholic beverages, manufactured tobacco, energy products (fuel, oil, gas, coal, etc.) and electricity.

Environment pollution tax is levied on subjects that in the course of their economic activity emit pollution, or manufacture or import into the Lithuanian market goods and/or packing that are potential sources of pollution (tyres, accumulators, batteries, oil and air filters, oil buffers, glass, plastic, metallic and other packing). Taxpayers that implement anti-pollution or treatment of waste standards may be exempted from corresponding taxation.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

According to the Law of the Republic of Lithuania on Corporate Income Tax (**the Law on Corporate Income Tax**), dividends paid by the Lithuanian entity to the non-resident entity in general are subject to 15% withholding tax on corporate income.

Still dividends paid by the Lithuanian entity to a foreign entity, that incessantly for at least 12 months controls not less than 10% of voting shares/member shares in the Lithuanian entity, shall not be subject to taxation, except for cases where the foreign entity receiving the dividends is registered or otherwise organised in target ("tax haven") territories.

These provisions shall also be applicable when the treaty on avoidance of double taxation provides a less favourable regime. In case the treaty on avoidance of double taxation provides a more favourable regime, provisions of this treaty should be followed.

Dividends paid to the natural person, who is treated as a non-resident in Lithuania for taxation purposes, are taxable by tax on personal income at the rate of 20%.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In general, under the Law on Corporate Income Tax, the royalties (for use or transfer of copyright and related rights, rights to use franchise, industrial ownership – patents, trade marks, models, know-how) paid by a Lithuanian company to a non-resident company having no permanent establishment in Lithuania – are subject to 10% withholding tax (without any deductions).

Since 1 July 2011, the royalties, paid by a Lithuanian company to a related EU company (the beneficial owner of royalties), both corresponding to the criteria established by the Law on Corporate Income Tax, shall be exempt from withholding tax in Lithuania.

The Lithuanian company, while paying a royalty to a foreign natural person that is not engaging in any related commercial activity in Lithuania, must deduct **15%** tax on personal income.

However, the applicability of the Lithuanian tax rate on royalties may be mitigated by the Lithuanian treaties on the avoidance of double taxation in force.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In general, interest paid by a Lithuanian company to non-residents (both natural and legal persons) is taxable at the same general rates as indicated in question 3.2.

However, the following interest paid by a local company to a non-resident is tax-exempt in Lithuania:

- interest paid to a foreign legal person that is registered or otherwise organised within a Member State of the European Economic Area or within a State which has and applies a treaty on the avoidance of double taxation with Lithuania, and received not through the foreign person's permanent establishment in Lithuania;

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- interest on securities issued by the Government, interest accrued and paid on deposits and interest on subordinated loans which meet the criteria set down by the legal acts of the Bank of Lithuania, under condition that these interests are received not through the foreign person's permanent establishment in Lithuania;
- with minor exceptions – interest received by a natural person on the loans granted, if the repayment of the loans commences no earlier than 366 days after the date of the granting of the loan, and interest received by the natural person on securities, if the redemption of those securities commences no earlier than 366 days after the date of the issue of those securities; and
- interest received by a natural person on securities of the Governments and political or geographic administrative subdivisions of the Member States of the European Economic Area, as well as interest on deposits held in banking and other credit institutions, established in the Member States of the European Economic Area.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Firstly, Lithuanian thin capitalisation rules apply only to the extent to which the ratio between the capital borrowed from the controlling creditor and the fixed capital of the Lithuanian entity-debtor exceeds 4:1. The interest for the part of the loan exceeding the above-mentioned ratio cannot be deducted from the taxable income of the entity-debtor, unless the debtor proves that the same loan could be provided/received on the same conditions between unrelated persons.

For the purposes of the application of thin capitalisation rules, the controlling creditor shall be held to be any Lithuanian or foreign legal or natural person: (i) directly or indirectly possessing more than 50% of the Lithuanian debtor's capital; or (ii) possessing at least 10% of the debtor's capital and at the same time together with related persons possessing more than 50% of the debtor's capital. Any member of a group of entities (a group consisting of a parent entity and one or more taxable subsidiaries, in each of which the parent entity holds more than 25% capital) as well as the creditor's spouse, fiancé, cohabitating partner and relatives up to first grade, shall also be held to be controlling creditors.

While applying thin capitalisation rules, the borrowed capital covers loans granted and convertible bonds issued by the controlling creditor, loans granted by third persons but guaranteed by the controlling creditor, and even loans guaranteed by third persons to whom at the same time the controlling creditor issued the guarantee.

The fixed capital for thin capitalisation purposes means the equity capital of the debtor, excluding the debtor's financial result (profit/loss) of the current financial year.

The above-mentioned rules are not applicable against the financial institutions providing financial rent or financial leasing services.

Secondly, the interest or rent fee that depends on debtor's turnover, income, profit and so on, and interest that may be converted into the creditor's right to the debtor's capital, cannot be deducted from the taxable income of the debtor.

As regards interest paid by a Lithuanian entity or permanent establishment to foreign entities registered or otherwise organised in target ("tax haven") territories, see also question 4.3.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

As indicated in question 3.4, thin capitalisation rules shall not be applied to the borrowed capital if the debt and fixed capital ratio of 4:1 is not exceeded; and even when exceeded, if the arm's length principle in respect to the amount and interest of the borrowed capital is followed.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

See question 3.4.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

In case a natural person provided a loan to a local company, of which he is the owner/member or to a local company in which he works, and the interest paid out by this company exceeds the real market price, the relief from the tax on personal income on this interest (see question 3.3) shall not be applied even in case the other conditions are met.

3.8 Does Lithuania have transfer pricing rules?

Where the conditions created or prescribed by mutual transactions or economic operations between associated persons (both resident and non-resident) are different from the similar ones created or prescribed between non-associated persons, the tax administrator may: re-evaluate the transactions according to their market value in similar conditions; reassess the taxable income and consequently the payable tax on income; and impose fines and penalties for the delayed payments, if any.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Currently profits of Lithuanian entities and permanent establishments of foreign entities in general are taxed at the 15% rate. Profits of small entities satisfying the requirements prescribed by the law are taxable by 5% tax on corporate profits.

With some exceptions (see questions 3.1-3.3 above), profits sourced in Lithuania and received by foreign entities other than through their permanent establishments in Lithuania are currently levied by a 10% (e.g., for interest, royalties, compensations for violation of copyrights or related rights) or 15% (e.g., for transfer or lease of immovable property located in Lithuania, distributable profits, including dividends, annual bonuses for the members of supervisory or management board) tax on corporate profits.

4.2 When is that tax generally payable?

The taxation period is usually the calendar year or another twelve-month period requested by the entity. If the income during the previous year exceeds LTL 1,000,000, the tax on corporate profit for the next year must be payable in advance in quarterly instalments, the first three of which must be paid before the end of

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the current quarter, and the fourth instalment before the 25th day of the last month of the quarter.

The newly-incorporated entities are released from the obligation to pay tax on corporate profit in advance for the first year after incorporation.

The annual declaration must be submitted and the tax must completely be paid (if it does not need to be paid in quarterly advance payments) before the first day of the tenth month of the next tax year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base of a Lithuanian entity is all income earned in Lithuania and foreign countries, and, according to the provisions of the Law on Corporate Income Tax, the positive income of its controlled foreign entity or part of such income, as well as the income or a part of such income of the relevant European Economic Interest Grouping.

The tax base of a foreign entity covers: (i) income received from activities carried on through a permanent establishment situated in Lithuania as well as income earned in foreign countries and attributed to the said permanent establishment if such income relates to the activities of a foreign entity in Lithuania; and (ii) income sourced in Lithuania and received in Lithuania other than through a permanent establishment here (most kinds of interest, distributed profits, royalties, payments for use of related rights, industrial property, know-how, franchise, compensations for violation of copyright and related rights, income from performer or sport activities, income from transfer or lease of immovable property in Lithuania and annual bonuses for the members of supervisory or management board).

Sponsorship received that was used for purposes other than specified in the Law of the Republic of Lithuania on Charity and Sponsorship, as well as sponsorship received in cash from a single provider during the tax period exceeding the amount of 250 minimum living standards (currently LTL 32,500), will also constitute the tax base both of national or foreign entities and shall be taxed at the 15% rate.

When calculating the taxable profits of a Lithuanian entity, non-taxable income, allowable deductions and deductions of limited amounts shall be deducted from income. The taxable income of permanent establishment shall be calculated by deducting from the income earned the non-taxable income, deductions of limited amounts and deductions relating to the income earned by a foreign entity through a permanent establishment. The taxable profits, earned by a foreign entity other than through a permanent establishment, shall include all of its income sourced in Lithuania without any deductions.

Sums for deduction must be supported by legally valid documents containing all the mandatory requisites of accounting documents or - if executed by the foreign persons - such documents must allow the identification of the content of the economic operation.

In addition, payments made by a Lithuanian entity or permanent establishment to foreign entities registered or otherwise organised in target (“tax haven”) territories shall be treated as non-allowable deductions, unless the Lithuanian entity or permanent establishment supplies evidence to the tax administrator that such payments are related to the usual activities of both parties, that the receiving foreign entity controls the assets needed to perform such usual activities, and that there exists a link between the payments and the economically-grounded operation.

It should also be noted that from 1 January 2009 the taxable profit of the entity may be reduced by deducting expenses, incurred during 2009 – 2013 for acquisition of long-term property, used by the entity in the investment project. The taxable profit of the entity may be reduced by 50% at the maximum per one taxation year. The part of expenses, not deducted during the first year, may be used to reduce the taxable profit of the entity during four succeeding taxation years.

Financial accountability of Lithuanian entities must be conducted following the Business Accounting Standards, approved by the Institute of Accounting of the Republic of Lithuania, or the International Accounting Standards as defined in Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards. The taxable income of the entities must be calculated according to the Law on Corporate Income Tax. As the provisions of these legal Acts differ in various aspects (e.g. different principles for the establishment of property acquisition price, etc.), the profit calculated for financial accountability purposes may differ from the one calculated for the corporate income tax purposes.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

See question 4.3.

4.5 Are there any tax grouping rules? Do these allow for relief in Lithuania for losses of overseas subsidiaries?

In general, each Lithuanian entity or permanent establishment of a foreign entity in Lithuania is treated as a separate taxpayer. However, income and losses of foreign permanent establishments of a Lithuanian entity must be included while calculating taxable corporate income of the Lithuanian entity. Depending on the treaties on the avoidance of double taxation, the income earned through the permanent establishments abroad and taxed there may be either released from the Lithuanian tax on corporate income, or there may be a possibility to deduct proportionally the tax paid abroad from the one payable in Lithuania.

Secondly, as indicated in question 4.3, the positive income of the controlled foreign entity shall, proportionally to its shares which are owned by the Lithuanian entity, be included in the taxable profits of the Lithuanian entity if:

- on the last day of the tax period, the Lithuanian entity holds directly or indirectly over 50% of the shares (interests, member shares) or other rights/pre-emptive rights to a part of distributable profits in the controlled entity; or
- on the last day of the tax period the controlling person, together with related persons, holds over 50% of the shares (interests, member shares) or other rights/pre-emptive rights to a part of distributable profits in the controlled entity, and at the same time holds himself at least 10% of the shares (interests, member shares) or other rights to distributable profits or pre-emptive rights to the acquisition thereof; and
- the controlled foreign entity: (i) is organised in a country which is listed in the special list (“white list”) approved by the Ministry of Finance of Lithuania, but acquires special tax exemptions according to the laws of the country of registration (e.g., the holding company registered in the Grand Duchy of Luxembourg, the Trieste Free Zone Financial and Insurance Centre in Italy, Limited Liability Company in the USA, etc.); (ii) is not registered or otherwise organised both in the “white list” and in the “black list” (“tax haven”) countries but is the payer of corporate income tax which amounts to less than 75% of the Lithuanian one; or

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(iii) is registered or otherwise organised in target ("tax haven") territory.

The above-indicated rule shall not be applicable in cases where the income of a controlled foreign entity comprises only those payments made by the controlled entity which are treated as non-allowable deductions, or when the income of a controlled foreign entity comprises less than 5% of the income of the controlling entity.

Thirdly, the income of a European Economic Interest Grouping shall, according to the requirements of the laws and in the proportions laid down in the memorandum of association of the grouping (in the absence of any such provision - in equal shares), also constitute a part of the Lithuanian entity's taxable profits.

Finally, from 1 January 2010, Lithuanian tax laws under specific conditions allow transfer of all or a part of losses within the group of legal entities, including the cross-border transfers.

According to the Law on Corporate Income, only the losses of one entity calculated for 2010 or subsequent taxation periods may be transferred in order to decrease the taxable profits earned by the other entity during corresponding taxation periods.

Additionally, the cross-border transfer of losses is possible only when the following conditions are met:

- the losses are transferred between the members of a group of entities, consisting of a parent entity and one or more taxable subsidiaries;
- the parent entity directly or indirectly holds not less than 2/3 of shares (interests, member shares) or other rights to the distributable profit of every subsidiary participating in the transfer of losses;
- the entities are the members of the same group incessantly for a period not shorter than two years; or they are the members of the said group for the shorter term from their registration, and shall incessantly stay in the group for the period not shorter than two years from their registration; and
- in case the foreign entity is transferring the losses to the Lithuanian entity, that foreign entity:
  - i) is the resident of the EU Member State for taxation purposes, has the organisation indicated in the Annex to the Directive 90/434/EB, and is the payer of the tax indicated in Point c Article 3 of the said Directive;
  - ii) the foreign entity cannot transfer his losses to his subsequent taxation year according to the tax laws of the country of his registration; or
  - iii) the losses of the foreign entity being transferred are calculated (recalculated) according to the provisions of the Law on Corporate Income of Lithuania.

It should also be noted that the entity cannot transfer its losses in case it has tax arrears or in case that, because of the tax exemptions, it is released from the tax on corporate income during that particular taxation year.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

In general, both distributed and retained profits are taxed at the same rate with the exemption of special relief for reinvestment executed during 2009-2013 (see question 5.4 below).

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Tax on immovable property is levied on immovable property owned by legal persons; and on immovable property owned by the natural persons with a commercial purpose or other purpose, but used for economic activities. The tax amounts to 0.3 – 1% (depending on the decision of the municipality where the property is located) of the taxing value of the property per year.

Private land (excluding public road and forest land, land owned by diplomatic or consular representatives) owners are charged 1.5% tax on the land per year, calculated from the cost of the land.

According to the Law of the Republic of Lithuania on Lottery and Gaming Tax, persons operating lotteries and gaming must pay lottery and gaming tax in the following amounts: 5% of the total face value of the tickets distributed in a lottery; in respect of bingo, totalisator and betting - 15% of the total amount of gamers' stakes after deduction of the amount of gainings actually paid out; and in the case of machine gaming and table games, a fixed amount for each gaming device per calendar month, amounting to LTL 300 – 6,000.

4.8 Are there any local taxes not dealt with in answers to other questions?

In addition to the above-mentioned taxes, Lithuanian laws prescribes State natural resources tax, petroleum and gas resources tax, overstock and production tax in the sector of sugar production, tax on additional quota for white sugar production, deductions from income under the Law of the Republic of Lithuania on Forestry, tax on use of the State property by trust, inheritance tax, contributions to the Guarantee Fund, State social insurance contributions, compulsory health insurance contributions, fees for the registration of industrial property objects, stamp duties, State-imposed fees and charges, and consular fees.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains constitute a part of the taxable income of a taxable entity and in general are taxed at the ordinary tax rate. Expenses incurred for the acquisition of the property transferred are in general deductible.

The participation exemption on capital gains tax still exists. The income from the increase in the value of assets, resulting from transfer of shares, received by a Lithuanian or foreign entity through its permanent establishment, is exempt from tax on profit in Lithuania, in case:

- the shares of an entity, registered or otherwise organised in a Member State of the European Economic Area or in a State with which a treaty for the avoidance of double taxation has been concluded and brought into effect and which is a payer of corporate income tax or an equivalent tax, are sold;
- the entity that transfers the shares held more than 25% of voting shares in the entity being transferred for an uninterrupted period of at least two years; or the entity that transfers the shares held more than 25% of voting shares in the entity being transferred for an uninterrupted period of at least three years in case the shares were previously transferred during special tax exempt reorganisation or transfer indicated in Law on Corporate Income; or
- the shares are not being acquired by the issuer of the shares itself.

The Law on Corporate Income Tax establishes special rules for the recognition and taxation of income from the increase in the value of assets in certain cases where entities are reorganised, liquidated or transferred, where a European company or a European cooperative

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society with a registered office in Lithuania transfers its registered office to another EU Member State.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

See question 5.1.

5.3 Is there a participation exemption?

For participation exemption regarding corporate income tax on received dividends, see question 3.1; on exemption regarding capital gains, see question 5.1.

5.4 Is there any special relief for reinvestment?

From 1 January 2009 the taxable profit of the entity may be reduced by deducting expenses, incurred during 2009 – 2013 for acquisition of long-term property, used by the entity in the investment project. The conditions, under which the project shall be held as investment project, are determined by the Law on Corporate Income Tax.

The taxable profit of the entity may be reduced by 50% at the maximum per one taxation year. The part of expenses not deducted during the first year may be used to reduce the taxable profit of the entity during four succeeding taxation years.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No taxes are imposed, except for State and notary fees.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no other such significant taxes.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch cover all the income attributable to the activities of the branch and have sourced both in Lithuania and in foreign countries, after allowable deduction of the expenses incurred for the purposes of the branch.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Income earned by the foreign company through the branch registered in Lithuania shall be subject to Lithuanian corporate income tax at the standard rate of 15%.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No, usually a branch would not benefit from tax treaty provisions.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Remittance of profits by the branch is not subject to any withholding or other tax (except bank fees).

7 Anti-avoidance

7.1 How does Lithuania address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Starting from 2002, the issue of preventing tax avoidance is resolved by a combination of general and specific anti-avoidance rules established in Lithuanian tax laws.

The main principle and general rule established in the Law on Tax Administration indicates that in respect of taxes, the content of the activities carried on by the participants of legal relations shall take precedence over their form. It means that where a taxpayer's transaction, economic operation or any combination is concluded with a view to gaining a tax benefit (i.e. to defer the deadline for the payment of tax, to reduce or fully avoid the payable amount of tax, to increase the tax overpayment/difference to be refunded/credited or to shorten the time limit for refunding the tax overpayment/difference), the tax administrator shall apply the **content-over-form principle** for the purpose of calculating the tax. In this case the tax administrator shall not take into account the formal expression of the taxpayer's activity and shall recreate the distorted or hidden circumstances associated with taxation, as provided for in tax laws, and calculate the tax pursuant to the relevant provisions of the said tax laws.

Complementing the above said principle, particular tax laws establish the specific anti-avoidance rules, such as the right of the tax administrator to **re-evaluate the transactions between associated persons** (see question 3.8), "thin capitalisation" rules relating to the interest paid to controlling persons (see question 3.4), treating payments made to foreign entities in target ("tax haven") territories as non-allowable deductions (see question 4.3), allowing the cross-border use of losses on strict conditions (see question 4.5), obligation to include into the taxable profits the positive income of the controlled foreign entity (see questions 4.3 and 4.5), not allowing to decrease the taxable profits by losses of financial activities, etc.

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Luxembourg

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Luxembourg?

Luxembourg has agreed to 71 income tax treaties. Currently, 60 of these income tax treaties are in force. In total 33 treaties apply to Luxembourg corporate undertakings of collective investment (SICAV/SICAF).

1.2 Do they generally follow the OECD or another model?

Almost all income tax treaties entered into by Luxembourg follow the OECD Model Convention on Income and Capital, except the income tax treaties with Germany and France that had come into force before the first OECD Model Convention (and despite further renegotiations with both treaty partners). Deviations from the OECD model treaty often relate to a few particulars but seldom to the entire treaty, e.g. the taxation of capital gains under the income tax treaty with South Korea or more typically the limitation-on-benefits provisions in the Luxembourg-US income tax treaty. 24 income tax treaties agreed by Luxembourg contain a provision compliant with article 26, paragraph 5 of the OECD model relating to the exchange of information upon request in matters that previously had been covered by banking secrecy. Luxembourg is not grey or black-listed by the OECD in this respect. Similarly, some tax treaties include some of the provisions proposed by the UN Model Convention. See also question 1.4.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties are to be incorporated into domestic law. The following procedure applies:

The legislator gives its consent by adopting a consenting law (*loi d'adaptation*) that authorises the Grand Duke to ratify the tax treaty. The tax treaty enters into force once the ratification instruments have been exchanged and after publication of such ratification in the official gazette, following which the tax treaty is incorporated into domestic law. Typically, a tax treaty contains specific language as to its entry into force, which thus, given the above ratification and publication process, may be retroactive. Such retroactivity is valid when provided for by the consenting law and provided that it improves the position of the tax payer ("*in meius*").

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The income tax treaties concluded by Luxembourg do not systematically contain anti-treaty shopping rules, except for the limitation-on-benefits provisions contained in the income tax treaty concluded with the USA, Hong Kong, Singapore and Trinidad and Tobago.

Also, more recently negotiated treaties make broader reference to the concept of "beneficial ownership" and in the context of dividend distributions that the distributing company must not only be "a Company of the other Contracting State" but "a Company who is a tax resident of the other Contracting State", which depending on the context may be considered as a more restrictive language.

Finally, a large number of treaties concluded by Luxembourg deny treaty protection to companies subject to the Law of July 31, 1929 (i.e. the Holding 29 companies, the relevant tax regime ending on December 31, 2010 pursuant to the law of December 22, 2006 as well as to companies subject to a similar tax regime like the Private Wealth Investments Companies (*Société de Gestion de Patrimoine Familial "SPF"*).

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Under general principle of Luxembourg public law, (tax) treaties are to be considered a "*lex specialis*" prevailing over domestic law. Thus, once a tax treaty is applicable and a conflict between domestic law and treaty law arises, the tax treaty provisions will apply.

2 Transaction Taxes

2.1 Are there any documentary taxes in Luxembourg?

Ad valorem registration duties are levied on a number of transactions in Luxembourg, which either must be registered (e.g. notary deeds and documents used in the framework of judicial proceedings in front of a court must be registered by law) or are voluntarily registered.

An *ad valorem* 6% registration duty, assessed on the highest of the purchase price or the fair market value, is levied on the transfer of land and buildings, even if such a transfer is not embodied in a written document. The registration duties may be increased by

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municipal transfer taxes. In addition, a transcription tax of 1% applies. As an example, transfers of land and buildings, other than residential property, located in the city of Luxembourg, are subject to 10% tax. Transfers of shares in Luxembourg tax-transparent entities holding Luxembourg situs real estate trigger tax in the same proportion as if the Luxembourg real estate was owned and sold directly by the investors in the transparent entity.

A 0.24% registration duty, assessed on the amount of the claim, is due on the registration of an obligation to pay evidenced by a document in writing, provided that the obligation to pay is not embodied in a security and provided that the obligation to pay does not represent the price of a transfer of movable or immovable goods which would not have been registered. The registration of such a document is therefore relatively exceptional, except if the claim is secured by a mortgage on Luxembourg real estate.

A 0.6% registration duty, assessed on the total amount of the lease payments, is due on the registration of lease agreements embodied in a written document. However, if the lease agreement is subject to VAT, no *ad valorem* registration duties will be due on the registration of the lease agreement.

All transactions relating to a securitisation operation involving a Luxembourg securitisation vehicle incorporated up under the Law of March 22, 2004 are exempt from registration, except if the transaction involves a transfer of rights on land and buildings located in Luxembourg or on planes and boats registered in Luxembourg.

Mortgages are subject to a special mortgage tax at 0.05% of the value of the property.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Luxembourg implemented the EU value added tax system in its legislation by a law of February 12, 1979.

The standard VAT rate applying to supplies of goods or services is 15%. However, specific transactions may be subject to reduced rates of 12%, 6% or 3%.

Three annexes to the Luxembourg VAT Code define the goods and services which are subject to the standard rate or the reduced rates. The annexes cover a defined area and must be interpreted in a strict sense.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

VAT is in principle charged on all supplies of goods and services carried out (or deemed carried out) in Luxembourg, for consideration and by a person carrying out an economic activity.

The rules governing the place of supply and the VAT exemptions generally follow the provisions of the Council Directive 2006/112/EC of November 28, 2006 and are refined by ECJ case law. Typical VAT exemptions relate to transactions relating to medical, social or educational care and cultural services, financial transactions, insurance and reinsurance and connected services, as well as management services rendered to regulated undertakings for collective investment and pension funds subject to the supervision of the CSSF or of the *Commissariat aux assurances*, SICARs and to Luxembourg securitisation vehicles subject to the law of March 22, 2004.

The supply and the renting of immovable assets are in principle exempt from VAT. However, VAT payers may opt for the application of the VAT to such transactions provided the immovable asset is entirely or mainly used for activities which allow the deduction of input VAT. Rental agreements which are subject to the VAT pursuant to an option for VAT are not subject to proportional registration duties and are registered at the fix rate of EUR 12. Supplies of buildings to which the VAT is applied pursuant to an option for VAT are however cumulatively subject to VAT and to proportional registration duties.

The transfer of a totality of assets or part thereof (provided it can be considered as a going concern), for example in the framework of a merger, falls outside the scope of the Luxembourg VAT.

Intracommunity supplies to taxable persons and exports are zero-rated.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Generally, all the VAT paid on goods and services by a Luxembourg taxable person in relation to his business is recoverable.

If a taxable person carries out transactions which are subject to VAT (i.e. subject to VAT or zero-rated) and transactions that are exempt from VAT, it will have a limited right to deduct upstream VAT. This right will, in principle, be calculated on the basis of a *pro rata* rule, unless a segregation of the business activities in a VAT-able and a VAT-exempt business sector is possible, in which case only the input VAT related to the VAT-able business sector will be recovered in full.

No recovery is available for VAT paid for goods or services used to deliver VAT exempt transactions, except for VAT on goods and services used to deliver banking, financial and insurance transactions, provided that the recipients of such transactions are established outside the EU or that these transactions are directly linked to goods which are to be exported outside the EU.

Certain persons that are not considered carrying out an economic activity, since they do not undertake transactions which fall within the scope of VAT (typically, passive holding companies), may also carry out certain transactions which are subject to VAT (e.g. re-invoicing of expenses or renting (part of) a building). These VAT payers, called partial VAT payers, might have a partial right to deduct input VAT.

2.5 Are there any other transaction taxes?

The 0.5% capital duty was abolished on January 1, 2009. From this date, a fixed registration fee of EUR 75 applies. The fee is due exclusively in the cases mentioned by law, i.e. upon incorporation or subsequent capital increase (or allocation to share premium) and migration of foreign entities to Luxembourg.

The abolition of the capital duty implies that the same registration duties apply in the case of a contribution of real estate to a company. In the case where real estate is contributed exclusively in consideration for shares of the company, a reduced rate of 0.6% transcription tax and 0.5% transfer tax applies. The transfer of real estate in the frame of business combinations is however tax exempt.

Mortgage Register: Changes in ownership of real property are subject to an additional 1% tax levied on the higher of the sales price or the market value.

2.6 Are there any other indirect taxes of which we should be aware?

There are Custom and Excise duties for certain goods, depending on the international commitments taken by Luxembourg.

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3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

A 15% (for hidden dividends the tax rate is 17.65%) withholding tax applies to dividends paid by a Luxembourg resident undertaking with a collective character, unless such rate can be reduced by applicable tax treaties or under the domestic dividend withholding tax exemption regime based on the EU Directive 90/435 of July 23, 1990, as amended.

Under the domestic dividend withholding tax exemption regime, dividends paid by a Luxembourg resident undertaking with a collective character to a shareholder who holds (or commits to hold) a shareholding for at least 12 months that represents at least 10% of the share capital of the dividend distributing entity (or shares with an acquisition price of at least EUR 1.2m), are exempt from Luxembourg withholding tax if the dividend recipient is: as from January 1, 2009, any foreign undertaking with a collective character that is a tax resident in a country that has concluded a tax treaty with Luxembourg and that is subject to taxation comparable to Luxembourg corporate income tax (at a rate of least 10.5%); or an undertaking with a collective character enumerated in the exhibit to article 2 of EU Directive 90/435 of July 23, 1990, as amended:

- a foreign (non-EU) corporation that has migrated to Luxembourg and that has become a fully taxable Luxembourg resident corporation;
- a corporation or a cooperative society, which is a resident in a Member State of the European Economic Area (i.e. Norway, Iceland, Liechtenstein) and that is subject to taxation comparable to Luxembourg corporate income tax;
- a corporation resident in Switzerland subject to corporate income tax without benefiting from an exemption; and
- a Luxembourg permanent establishment of one of the above mentioned categories.

Distribution of liquidation proceeds (or advance payments thereon) is not subject to dividend withholding tax. When properly structured, the same may hold true for distributions upon a partial liquidation of the Luxembourg company.

Distribution made by certain entities like Holding 29 companies (the relevant tax regime ending on December 31, 2010), Private Wealth Investments Companies (*Sociétés de Gestion de Patrimoine Familial* "SPF"), SICAV, SICAR and securitisation vehicles set up under the Law of March 22, 2004 are, in principle, not subject to withholding tax on payment of proceeds to an investor (but see EU Savings Directive 3.3).

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Regardless of the tax status of the recipient, Luxembourg does not levy any withholding tax on royalties since January 1, 2004.

Luxembourg has introduced a special tax regime for intellectual or industrial property rights acquired after December 31, 2007 or created by oneself, which provides for tax exemption of 80% of the income from IP rights, including the realised capital gain upon sale of the IP.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Arm's length, fixed or floating rate interest payments are not subject to Luxembourg withholding tax. Profit sharing interest paid on certain debt instruments may be subject, under certain conditions, to a 15% withholding tax, unless a lower tax treaty rate applies, or an exemption would be available.

With the introduction of the EU Savings Directive on taxation of savings income in the form of interest as of July 1, 2005, a withholding tax may be levied on interest paid by a Luxembourg paying agent, or secured for the benefit of, EU residents or residents of certain EU-dependent or associated territories individuals or "residual entities", unless such beneficial owner opts for an exchange of information procedure. The rate has been increased to 20% as of July 1, 2008, and will, in principle, be increased to 35% as of July 1, 2011 onwards.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Luxembourg tax law does not contain debt-to-equity ratio provisions. However, administrative practice requires compliance with an 85:15 debt-to-equity ratio when the debt financing is granted or guaranteed (see also question 3.5) by a shareholder. This, however, does not apply to back-to-back financing.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The Luxembourg authorities would generally consider 12 months' EURIBOR plus 200 basis points, as being an at arm's length interest rate for loans and within the limits of the 85:15 debt-to-equity ratio as referred to under question 3.4 above. In case the debt financing would exceed the above 85:15 debt-to-equity ratio, the interest on such debt would nevertheless not be regarded as excessive if through modification of the applicable interest rate total interest expense stays in line with the above ratio.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Debt advanced by a third party but guaranteed by a parent company (other than pledging the shares of the Luxembourg debtor to the creditor) is treated as a shareholder loan and consequently the 85:15 debt-to-equity ratio will be applied.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No there are not. However, regardless whether the recipient is a resident or a non-resident, Luxembourg tax law re-characterises profit-participating interest payments on certain debt instruments into non-deductible distributions that may trigger withholding tax in the same way as dividend payments (see under question 3.1).

3.8 Does Luxembourg have transfer pricing rules?

Inter-company pricing between affiliated companies must be on an arm's length basis to be accepted for Luxembourg tax purposes.

Luxembourg tax law does not contain specific rules or provisions for the determination of arm's length inter-company pricing between affiliated companies. In practice, the Luxembourg tax

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authorities accept all inter-company transfer pricing based on the transfer pricing methods referred to by the OECD transfer pricing guidelines.

Moreover, Luxembourg tax law does not contain specific rules or provisions with respect to transfer pricing documentation. It is, however, recommended to support transactions with affiliated companies by written transfer pricing agreements, which include comprehensive reference to current market conditions, and to hold adequate justifications for the transfer prices applied on each transaction with affiliated companies. In practice, the Luxembourg tax authorities accept all justification and documentation suggested by the OECD transfer pricing guidelines.

Documentation is to be prepared at the moment the transactions are passed. Transfer pricing documentation does not need to be filed with the tax returns. It only needs to be remitted to the tax authorities upon their request.

There are no specific limitations on transfer pricing adjustments either. General statutes of limitation apply.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The Luxembourg profit tax system consists of a national corporate income tax ("*impôt sur le revenu des collectivités*" or "IRC") at a rate of 21% and the municipal business tax ("*impôt commercial communal*" or "ICC") at a rate of 6.75% (for companies established in Luxembourg-city). In addition, there is a 4% surcharge for the employment fund calculated on the IRC. The total combined tax rate since January 1, 2009 is therefore 28.59%. Pursuant to the bill of law deposited on July 30, 2010, the surcharge would be increased to 5%, so that the total combined tax rate as from January 1, 2011 would be 28.80%.

4.2 When is that tax generally payable?

Corporate tax returns must be filed annually no later than May 31 of the year following the close of an accounting period. An extension for filing may be obtained. In principle, taxes become due upon the issuance of the assessment. However, upon receipt of a preliminary assessment, companies are required to make quarterly prepayments for both corporate income tax and municipal business tax (as well as net wealth tax; see question 4.7 below). The level of the preliminary assessment is based on the taxable income of the previous financial year. By exception, the tax administration is entitled to raise tax assessments immediately upon receipt of the tax return of a company and can issue a final assessment within a five year period.

The tax due according to the final assessment must be paid within one month after the date of assessment. On request, an extension for payment may be obtained. For late payment of the assessment, an interest rate of 0.6% per month on the assessed amount may become due.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Domestic companies and foreign companies resident in Luxembourg (including Luxembourg branches of foreign companies) are liable to corporation taxes on their worldwide profits, unless a tax treaty applies. Tax is payable on profits realised minus tax deductible expenses and losses which may be carried forward indefinitely.

For the determination of the taxable profit, in principle the commercial accounts are followed, subject to adjustments imposed by tax law (see question 4.4 below).

Pursuant to the bill of law deposited on July 30, 2010, fully taxable undertakings having financial assets for more than 90% of their balance sheet would be subject to a minimum flat corporate income tax of EUR 1,500 (unless corporate tax as determined under general taxation principles exceeds this amount).

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Differences between profits shown in commercial accounts and taxable profits are mainly due to:

- exempt commercially realised profits (e.g., dividend/capital gains exemption);
- add-back expenses (e.g., interest expenses on assets generating tax exempt income or directors' fees, which are not for day-to-day running of the company);
- corrections to the tax result from transactions not executed at-arm's-length; and/or
- the applications of different valuation rules in accounting and in tax (e.g. tax roll-over regimes) to different depreciation rules under tax and accounting rules.

Adjustments are generally made in the tax returns. In specific cases a separate tax balance sheet may be drawn.

4.5 Are there any tax grouping rules? Do these allow for relief in Luxembourg for losses of overseas subsidiaries?

Luxembourg tax law knows the concept of fiscal unity, i.e. consolidation, which applies if the following conditions are met:

- the parent company has held, directly or indirectly, a participation of 95% or more in the share capital of a subsidiary, as from the beginning of the accounting period during which the application for the consolidation regime has been made;
- the subsidiary is a capital company resident in Luxembourg and fully subject to corporate income tax;
- the consolidating parent company is a capital company resident in Luxembourg and fully subject to corporate income tax, or a branch of a non-resident company which is subject in its jurisdiction of establishment to an income tax which is comparable to Luxembourg income tax; and
- the consolidation is requested for a least five accounting years.

Subject to prior authorisation by the Minister of Finance, the tax consolidation regime may be granted to subsidiaries held for less than 95% but at least 75% provided that the relevant participation is of particular interest to the national economy of Luxembourg.

The consolidation for municipal business tax is granted upon election if the conditions of the income tax consolidation regime are met.

Each member of the fiscal group reports its own taxable result and files tax returns as if it were an independent tax payer. Thereafter, the parent company establishes the group tax return by adding up all individual results of the different group companies.

Under Luxembourg tax grouping rules no relief is granted for losses of overseas subsidiaries. The parent company may, however, book in its accounts depreciation on the participation.

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To some extent a tax consolidation also exists for net wealth tax (see question 4.7 below).

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained profits?

No, it is not.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Luxembourg companies are subject to annual net wealth tax, which is levied at a rate of 0.5% on the company's worldwide net worth on January 1. Non-residents unprotected under a tax treaty are subject to net wealth tax on their Luxembourg assets. Shareholdings eligible for the dividend exemption regime are excluded from the taxable base (see question 5.3). Liabilities financing tax-exempt assets are not deductible. For companies that solely invest in equity stakes for which they benefit from the parent-subsidiary exemption, the annual net wealth tax liability may be limited to the legal minimum of EUR 63 (S.A. or S.C.A.), or EUR 25 (S.à r.l.). The net wealth tax may be reduced within the limit of the Luxembourg corporate income tax due, provided certain conditions are met (among others an allocation to a non distributable reserve established for 5 years).

Holding 29 companies (the relevant tax regime ending on 31 December 2010), SPFs, undertakings of collective investment, SICAR and securitisation vehicles set up under the Law of March 22, 2004 are exempt from net wealth tax.

4.8 Are there any local taxes not dealt with in answers to other questions?

Real property tax levied by the municipalities on real estate located in their areas ranging from 0.7% – 1% multiplied by municipal factors, among others.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains and losses are included in the taxable basis for corporate income tax.

Capital gains exemption is available if a fully taxable Luxembourg resident undertaking with a collective character (or a Luxembourg branch of certain qualifying foreign entities), upon disposal of an interest in an undertaking with a collective character mentioned in the Exhibit to Art. 2 to the Parent/Subsidiary Directive (including Luxembourg) or of a capital company that is subject to an effective rate of taxation of at least 10.5% in its home country, has held (or commits to hold), for an uninterrupted period of at least 12 months, at least 10% of the paid up share capital (or shares with an acquisition price of at least EUR 6 million). Capital gains exemption, in principle, also applies to participations held through tax-transparent entities.

In case of a capital gain, expense recapture rules exist. This mechanism is globally tax neutral.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No, it is not.

5.3 Is there a participation exemption?

Dividend exemption is available if a fully taxable Luxembourg resident undertaking with a collective character (or a Luxembourg branch of certain qualifying foreign entities) has held (or commits to hold) for an uninterrupted period of at least 12 months at least 10% of the paid up share capital (or shares with an acquisition price of at least EUR 1.2 million) of an undertaking with a collective character mentioned in the Exhibit to Art. 2 to the Parent/Subsidiary Directive (including Luxembourg) or of a capital company that is subject to an effective rate of taxation of at least 10.5% in its home country. Dividend exemption, in principle, also applies to participations held through tax transparent entities.

If the above conditions are not met, dividends from a Luxembourg taxable capital company, from an EU resident company falling within the scope of the EU Parent/Subsidiary Directive, or from a capital company resident in a tax treaty country and that is subject to an effective rate of taxation of at least 10.5% in its home country, are exempt for 50%.

As a principle, expenses in relation with tax exempt dividend income are not tax deductible, up to the amount of such tax-exempt income.

5.4 Is there any special relief for reinvestment?

When a capital asset in the form of a building or an asset that cannot be depreciated, is disposed of, the taxpayer may elect to defer the tax liability generated by such disposal by means of roll over relief. To qualify for the relief, the alienated capital asset must have been entered into the balance sheet of the company for at least 5 years and the company must envisage the reinvestment of the sales price in certain qualifying assets. Further, the deferred gain must be booked into a non distributable reserve in the company's balance sheet for the year in which the alienation took place.

Tax roll-over relief under conditions may also exist for:

- conversion of debt into shares;
- conversion into another undertaking with a collective character;
- merger/de-merger of an undertaking with a collective character mentioned in the Exhibit to Art. 2 to the Parent / Subsidiary Directive (including Luxembourg) or of certain other foreign entities; and
- qualifying share for share exchange of an undertaking with a collective character mentioned in the Exhibit to Art. 2 to the Parent / Subsidiary Directive (including Luxembourg) or of certain other foreign entities.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

See under question 2.5.

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6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are not.

6.3 How would the taxable profits of a local branch be determined?

In principle, Luxembourg applies the direct method. This means, Luxembourg branches of foreign corporations are taxed in the same way as resident companies. Taxable profits are generally calculated by reference to the income and deductions attributable to the local branch's business activities, determined under the assumption that the branch acts like an enterprise independent of its head office. However, transactions between the head office and branch are generally disregarded (except for banking activities). All Luxembourg income so allocated to and derived by a branch in Luxembourg (including dividends, patents, royalties, and interest attributable to the branch), is taxable in Luxembourg.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No, it would not.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

As a general rule, branches are not considered to be a Luxembourg resident in the sense of domestic law or treaty law and can therefore not benefit from the provisions of the tax treaties entered into by Luxembourg.

However, under ECJ case law and, in certain cases, following non-discrimination provisions referred to in tax treaties concluded between Luxembourg and the residence country of the head office may require Luxembourg to extend benefits under a tax treaty with third countries when the Luxembourg branch derives income from such third countries. Relevant case law exists in Luxembourg in this respect.

In addition, Luxembourg branches of non-resident companies may, by virtue of domestic law, qualify for tax credits for foreign taxes, and for the exemption of capital gains or dividends (see under questions 5.1 and 5.3).

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No, it would not.

7 Anti-avoidance

7.1 How does Luxembourg address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The general tax law contains anti-avoidance provisions that permit the Luxembourg tax authorities to challenge sham transactions and tax-avoidance schemes (so-called "abuse of law"-doctrine) in the field of direct taxes. The "abuse of law"-doctrine does not apply in the field of capital duty and transfer taxes. It is unclear whether these anti-avoidance provisions also cover the field of VAT.

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Languages spoken:

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Malta

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Malta?

Malta has an extensive treaty network with over 50 income tax treaties in force and another 10 treaties or so that are in the pipeline awaiting signature, ratification or both. Malta's tax treaties are mainly with European countries although it also has treaties with countries in America, Africa, Middle East, the Gulf and Asia. Moreover, as a Member of the European Union, dividends, interest and royalties may also benefit from the EU Parent Subsidiary Directive or the Interest and Royalties Directive.

Apart from treaty relief, Malta also gives double taxation relief through legislative provisions in the form of unilateral relief or a Flat Rate Foreign Tax Credit (FRFTC) on foreign source income and capital gains. Unilateral relief provides relief from double taxation on a unilateral basis where the tax is charged in a country with which Malta does not have a double tax treaty. It may also be claimed in respect of underlying tax. The overseas tax is allowed as a credit against the Malta tax up to a level which does not exceed the total tax charge in Malta. The FRFTC is available to entities in receipt of income or capital gains from overseas and are therefore allocated, for income tax purposes, to the Foreign Income Account (FIA). A certificate from an auditor stating that the income stands to be allocated to the FIA is sufficient to claim FRFTC and no proof is necessary as to any foreign taxes suffered.

The FRFTC is calculated at 25% of the amount of the net overseas income or gain received by the Maltese company before any allowable expenses. The income plus the credit less allowable expenses is subject to income tax at the standard rate of 35%, with relief for the deemed credit up to a maximum of 85% of the Malta Tax payable. Upon a distribution of profits, the shareholders are entitled to tax credits and tax refunds and this results in an effective tax rate of up to 6.25%.

1.2 Do they generally follow the OECD or another model?

Malta's double tax treaties are mainly based on the OECD model convention. Many of the older treaties contain a tax-sparing provision which makes the treaty even more attractive. In all tax treaties, the dividends article caters for Malta's full imputation system.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

A treaty needs to be incorporated into domestic law. Treaties are given force of law by means of publication in the Government Gazette as a legal notice under the Income Tax Act. A treaty will enter into force from the date determined by the treaty and will have effect from the date determined by the treaty.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Very few treaties have an article on Limitation of Benefits, although protocols often exclude persons who are entitled to a special tax regime such as offshore companies, freeport companies and shipping companies registered under the Merchant Shipping Act. Most of these companies are now defunct. However, the tax treaty with the United States of America (which, at the time of writing, has been signed but is not yet in force) contains a detailed limitation of benefits clause.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

The Income Tax Act provides that once a tax treaty enters into force, this shall have effect in relation to income tax notwithstanding anything in the Act or any other enactment. Therefore, should there be a conflict between a treaty provision and domestic law it is the treaty which prevails. Needless to say, if the treaty provision is less attractive than the normal provisions contained in the Income Tax Act then the latter prevails. A classic example is withholding taxes since Malta does not impose any withholding tax on dividends, interest and royalties.

The only limitation is that treaties made after 1 October 1968 do not apply with respect to income tax upon the chargeable income of any person engaged in the production of petroleum produced in Malta.

2 Transaction Taxes

2.1 Are there any documentary taxes in Malta?

Malta levies a stamp duty which is known as a 'duty on documents and transfers'. This is payable on transfers of immovable property situated in Malta, certain marketable securities, insurance contracts and certain other transactions. Duty on the acquisition of immovable property is levied at 5% (with some exemptions in instances where the property is being bought as the individual's sole ordinary residence). Stamp duty on share transfers is 2%, but transfers of shares in Collective Investment Schemes (funds) and companies which have more than 50% of shares owned or

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controlled by non-resident persons are exempt from duty.

No duty is chargeable on the transfer of securities which are affected through a local bank or through a person holding a licence under the Investment Services Act. Hence transfers of listed securities, which have to be transferred through a licensed person, are consequently exempt from duty. Certain exemptions from stamp duty are also provided on certain share transfers made upon a restructuring of shareholding that occurs through mergers, demergers, amalgamation and reorganisation within a group of companies.

There is no succession duty or inheritance tax in Malta, except that duty is levied on transfers '*causa mortis*' of immovable property or securities in Maltese companies (provided they do not fall within the exemptions referred to above).

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

VAT was introduced in Malta in 1995 and is the principal form of indirect taxation in Malta. The VAT legislation incorporates most of the provisions contained in the EU Directives, although Malta has negotiated some special arrangements. The standard rate of VAT is 18% and applies to any supply of goods and services which is not exempt or subject to the reduced rate of 5%.

The reduced rate applies to certain types of accommodation, electricity, confectionery, printed matter and items for the use of the disabled.

Goods and services may also be exempt with credit or exempt without credit. Exempt with credit is similar to having a zero VAT rate and applies on exports, pharmaceutical goods and food. Exempt without credit applies to immovable property, insurance, banking, broadcasting and education.

Where supplies are either taxable or exempt with credit, input VAT is fully recoverable, but where supplies are exempt without credit, VAT is neither charged nor recoverable by the supplier.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Malta applied the EU Sixth Directive but also negotiated certain special arrangements. Exclusions from VAT are also provided for. A derogation obtained during accession negotiations (and subsequently confirmed by the EU) enables Malta to have exemption with credit status on food, pharmaceutical products, inland passenger transport, international passenger transport and domestic inter-island sea passenger transport. The supply of water by public authorities and the supply of buildings and building land are also exempt without credit.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is only recoverable by a taxable person (a person who is or is required to be registered for VAT). Input tax is attributed in accordance with the nature and the tax status of the supply intended to be made by the business. Input tax on supplies wholly used to make taxable supplies is deductible in full. Input tax wholly used to make exempt or non-business supplies is not deductible. Where a person makes both taxable and exempt without credit supplies and incurs expenditure that is not directly attributable to either, the VAT on the expenditure must be apportioned between the supplies. Schedule 10 to the VAT Act contains detailed provisions on the partial attribution.

Small undertakings with a turnover below the established threshold may opt for an exempt without credit status. Such entities or individuals will not recover input VAT.

Input tax on tobacco and tobacco products, alcoholic beverages, works of art, motor vehicles, entertainment and some other items is not recoverable.

2.5 Are there any other transaction taxes?

Customs duties are still levied on certain imports from non-EU countries. Excise duties are levied on particular classes of goods such as alcohol and tobacco.

Malta has an ecological tax known as 'Eco Tax' which levies tax on products and materials which are potentially harmful to the environment, such as batteries, refrigerators, air conditioners and plastic bottles. Applicable rates vary according to the particular product or material.

2.6 Are there any other indirect taxes of which we should be aware?

There are no further taxes applicable to businesses and corporate entities.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

There is no withholding tax on dividends irrespective of the shareholder's country of residence. Malta has a full imputation system of taxation on dividend distribution out of profits allocated to the Foreign Income Account, the Maltese taxed Account and the Immovable Property Account. Any tax paid by the company is credited in full to the shareholder upon a distribution of such profits.

The income tax rate applicable to companies is 35% and the highest personal tax rate is also 35%. If a shareholder is not subject to tax or qualifies for a lower rate of tax than the 35% already paid by the company, then he is entitled to a tax refund equivalent to the excess tax paid by the company. This system avoids any double taxation of distributed corporate profits.

Moreover, the income tax system utilises five different tax accounts, namely the Maltese Taxed Account (MTA), the Foreign Income Account (FIA), the Final Tax Account (FTA), the Immovable Property Account (IPA) and the Untaxed Account (UA). A distribution from the MTA or the FIA entitles shareholders to claim a tax refund equivalent to 6/7 or 5/7 of the tax paid by the distributing company (depending on the type of income). A distribution from the FIA entitles the shareholder to claim a tax refund equivalent to 100% of the tax paid by the company or else to 2/3 of the tax paid. As a result of these tax refunds, the overall effective tax rate may be reduced drastically and in some cases any tax leakage may also be eliminated completely.

Distributions to a non resident person from the FTA, IPA and UA are not subject to any withholding tax and no tax refunds may be claimed in respect of such dividend distributions.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties arising in Malta and accruing to a non-resident person are exempt from any tax in Malta, provided such royalties are not related to a permanent establishment which the said person may have in Malta.

Malta does not impose any withholding tax irrespective of the recipient's tax status and the country of residence.

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3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Interest arising in Malta and accruing to a non-resident person is exempt from any tax in Malta, provided such interest is not related to a permanent establishment which the said person may have in Malta.

Malta does not impose any withholding tax irrespective of the recipient's tax status and the country of residence.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Malta does not have any thin capitalisation rules but the Income Tax Act contains a general anti-avoidance provision. By virtue of this anti-avoidance provision, the tax authorities may disregard any scheme which reduces the tax payable.

However, a taxpayer may apply for an advance revenue ruling on the tax treatment of any transaction which concerns any financial instrument or other security and on any transaction which involves international business.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There are no statutory safe harbour rules.

The principle for related party transactions should be the arm's length principle. However, a taxpayer may apply for an advance revenue ruling and thus have certainty on the tax treatment of a transaction. Advance revenue rulings are valid for five years and renewable for a further five-year period and are still valid for a two-year period if there is a change in the legislation which affects the ruling.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

As already mentioned above, Malta does not have any thin capitalisation rules. However, a scheme which reduces the tax payable may fall foul of the anti-avoidance provision and thus be ignored for income tax purposes.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Malta does not impose any restrictions or limitations on the interest payments made by a local company to a non-resident. Article 12(1)(c) of the Income Tax Act of Malta exempts from tax interest received by non-residents, provided there is no permanent establishment in Malta.

3.8 Does Malta have transfer pricing rules?

Malta does not have any transfer pricing rules.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

All companies are subject to income tax at a standard rate of 35%. A company in receipt of foreign source income may claim the FRFTC (see question 1.1) so that the tax payable is reduced to 18.75%.

Companies engaged in petroleum produced in Malta are subject to a tax rate of 50%.

4.2 When is that tax generally payable?

Companies whose sources of income are Malta-sourced are subject to a system of provisional tax payments whereby income tax in respect of the current year is paid in three instalments, with the tax charge calculated on the chargeable income of the year preceding the previous year. Any shortfall of provisional tax payments which result in a tax liability for the year is to be paid by the tax return date. The tax return date for a company whose financial year end is a calendar year is 30th September of the following year. The provisional tax instalments of a company, whose financial year end is 31st December, become due on 30th April, 31st August and 21st December.

Companies which operate the FIA and whose sources of income are foreign source are not subject to any provisional tax payments. Payment of the company's income tax may be made within 18 months from the end of the financial year end and not by the tax return date.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In general terms, the tax base follows the commercial accounts subject to certain adjustments. Certain items of expenditure which reduce the accounting profits may not be allowable or deductible for tax purposes and are therefore added back in order to calculate the chargeable income. This applies to provisions and unrealised expenses.

On the other hand, tax legislation may provide for certain deductions which are not claimed as expenses in the commercial accounts. This may apply in cases of inflated allowances in excess of the actual expenditure incurred (for example R&D allowances).

The general rule is that expenses which are incurred in the production of the income are allowable for income tax purposes whilst expenses which are of a private nature, of a capital nature, recoverable from any insurance or of a voluntary nature are not allowed for income tax purposes.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Refer to question 4.3 above.

4.5 Are there any tax grouping rules? Do these allow for relief in Malta for losses of overseas subsidiaries?

Malta's tax laws do not require consolidated accounts for income tax purposes. However, groups of companies may still benefit from 'group relief' which enables a member company to surrender tax losses to another group member. The losses surrendered by a group company may be set off against the tax profits or chargeable income of the claimant company. The surrendered losses may be carried forward by the claimant company and these are available for set off against future profits. The surrendering and claimant company

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must have identical accounting periods, have satisfied the definition of a group during the last financial year, and must be tax resident in Malta. Hence relief for losses incurred by overseas subsidiaries is not possible under our law.

The 'group relief' provisions contain specific anti-abuse provisions to restrict the surrendering of losses made by companies performing work related to immovable property.

Companies are considered to be members of the same group if more than 50% of the capital is owned directly or indirectly by the same company. The 50% test applies to share capital, voting rights, profits available for distribution and distribution on a winding up.

A much wider definition of a group of companies applies for capital gains tax purposes. In this case companies of which more than 50% are owned and controlled by the same shareholders qualify as a group for capital gains tax purposes. Assets may be transferred within a group without any capital gains tax.

No group concept exists in the VAT legislation.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No. Subject to double taxation relief which reduces the Malta tax, chargeable income is subject to income tax at the rate of 35%, irrespective of whether it is distributed or not. Profits which are distributed are brought to charge in the shareholder's hands at the grossed up amount and full credit is given for the tax already paid by the company. Under Malta's full imputation system of taxation (which ensures a full credit of the income tax paid by the company), it may be said that profits which are distributed by a company are not subject to any income tax at all at the level of the distributing company.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There are no other national taxes payable by companies. Certain capital gains are brought to charge with trading income. Capital gains arising on transfers of immovable property or other specific assets such as securities, patents, trademarks, trade-names and business goodwill are brought to charge as part of the taxpayer's chargeable income.

Transfers of certain immovable property may be subject to a property transfer tax equivalent to 12% of the transfer value instead of taxing the actual capital gain (see question 5.2 below).

4.8 Are there any local taxes not dealt with in answers to other questions?

There are no other local taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Income tax is levied on all sources of income including trading profits, employment income or other sources of income of a revenue nature, as well as certain specific capital gains.

Capital gains which are chargeable to tax in Malta are those gains or profits realised from immovable property, securities (excluding preference shares having a fixed rate of return), business goodwill, copyright, patents, trademarks, trade-names and from the transfer of the beneficial interest in a trust.

There are specific rules on how to calculate or determine the capital gain on immovable property and securities, including securities in companies which own immovable property. The rules also contain formulae and inflation-linked adjustments, which mean that the effective tax rate can be less than the standard rate of 35%.

A capital gain is brought to charge as part of the chargeable income but a capital loss cannot be set off against other income for the year of assessment but shall be carried forward and set off against capital gains in respect of subsequent years of assessment until the full loss is absorbed.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Capital gains are taxed at the same rate applicable to other chargeable income, which is 35%. However, a special regime exists with respect to the transfer of immovable property situated in Malta. Transfers of immovable property (which had previously not been acquired through inheritance) are taxed at 12% of transfer value. The tax is collected by the notary upon the deed of transfer and the property tax is full and final. Under certain circumstances, the vendor has the option to opt out of this 12% final withholding tax, in which case 7% provisional tax (calculated on the transfer value) is payable upon the deed and the eventual capital gains calculated at the self assessment stage and subject to tax at 35%. The capital gain is arrived at by deducting the cost of acquisition from the selling price but there are various rules on how to calculate the cost of acquisition and the inflation element etc.

The capital gain arising upon the sale of immovable property which was derived through an inheritance is also paid on the transfer deed but at 12% upon the gain (selling price less the value which was declared upon the inheritance).

Individuals transferring their sole ordinary residence are exempt from tax upon capital gains, provided the property has been owned and occupied for at least three years and is transferred within one year from vacating the premises. There are other exemptions such as donations and group transfers.

5.3 Is there a participation exemption?

Yes, companies that derive dividend income or capital gains from a 'participating holding' may opt for the 'participation exemption'. Alternatively, the Maltese company may elect to be subject and pay income tax on dividend received and capital gains arising from a participation holding and upon a distribution of profits the shareholder is then entitled to claim a full refund of the company income tax.

A shareholding in a company qualifies as a 'participating holding' (and therefore for the participation exemption) if the Maltese company holds equity shares in a company or a qualifying body of persons and it:

- has at least 10% of the equity shares in another company;
- is an equity shareholder in a company and is entitled to purchase the balance of the equity shares of the other company, or it has the right of first refusal to purchase such shares;
- is an equity shareholder in a company and is entitled to either sit on the Board or appoint a person on the Board of that subsidiary as a director;
- is an equity shareholder which invests in a company a minimum of €1.17 million (or the equivalent in a foreign currency) and such investment is held for a minimum uninterrupted period of 183 days; or
- holds the shares in a company for the furtherance of its own business and the holding is not held as trading stock for the purpose of a trade.

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Furthermore, the other company in question must either satisfy any one of the following three conditions:

- it is resident or incorporated in the EU;
- it is subject to foreign tax of a minimum of 15%; or
- it does not derive more than 50% of its income from passive interest and royalties;

or else it must satisfy both of the following conditions:

- the shares in a body of persons not resident in Malta must not be held as a portfolio investment; and
- the body of persons not resident in Malta or its passive interest or royalties have been subject to tax at a rate which is not less than 5%.

5.4 Is there any special relief for reinvestment?

Where an asset, which is subject to capital gains and is used in a business for a period of at least three years, is transferred and replaced within one year by an asset used solely for a similar purpose in the business, any capital gains realised on the transfer is not subject to tax but the cost of acquisition of the new asset is reduced by the said gain. When eventually the asset is disposed of without replacement, the overall gain shall take into account the transfer price and the cost of acquisition, reduced as aforesaid.

Furthermore, where an asset is transferred from one company to another company and such companies are deemed to be a group of companies, it shall be deemed that no loss or gain has arisen from the transfer. This is also applicable where the two companies are controlled and beneficially owned directly or indirectly to the extent of more than 50% by the same shareholders.

The Income Tax Act contains anti-abuse measures in relation to the above two tax deferral provisions to ensure that companies benefiting from the above do not transfer the asset to third parties.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed on the formation of a subsidiary. Only a registration fee (ranging from €245 up to €2,250) is payable to the Registry of Companies.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

A Malta resident subsidiary is subject to tax on a worldwide basis subject to the tax credits and refunds which may apply upon a distribution of profits. However, a branch of a foreign company, known as an ‘overseas company’, is subject to tax on income attributable to the branch. The income computation follows that adopted for domestic companies. The branch is allowed to deduct a proportion of the expenses associated with the head office management. In practice there are minor differences between having a branch and a locally registered subsidiary.

6.3 How would the taxable profits of a local branch be determined?

A branch is subject to income tax in Malta as if it was a wholly independent entity. The tax authorities follow the OECD principles.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax in Malta.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A branch of a foreign company or an overseas company may benefit from Malta’s network of tax treaties, provided it is a tax resident in terms of the treaty provisions. The tax legislation does not contain specific provisions applicable to branches and these are treated as a permanent establishment subject to income tax on income attributable to the branch.

Apart from tax treaty provisions, an overseas company may also benefit from unilateral relief.

There are no big differences between the tax treatment of branches and subsidiary companies except that the determination of chargeable income of a Malta branch may be more subjective and therefore it may be advisable to seek advance revenue ruling or confirmations from the tax authorities.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No, Malta does not have withholding taxes. Profits may be remitted without any tax implications.

7 Anti-avoidance

7.1 How does Malta address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company’s tax return being submitted?

The income tax legislation contains a few general anti-avoidance provisions.

One provision provides that where any scheme which reduces the amount of tax payable by any person is artificial or fictitious or is in fact not given effect to, this shall be disregarded by the tax authorities and the person concerned is assessable accordingly.

Another provision provides that where ‘a series of transactions’ is effected with the sole or main purpose of reducing the amount of tax payable by a person under the ‘investment income provisions’, then such person would be assessable as if the said ‘investment income provisions’ did not apply. (The investment income provisions provide for a final tax of 15% on certain investment income.)

A similar anti-avoidance provision (applicable to the investment income provisions) applies to the Flat Rate Foreign Tax Credit.

Another anti-avoidance provision relates to group relief. If a company is a member of a group of companies and arrangements are in existence, the sole or main purpose of which is to reduce any company’s tax liability, then that company shall be treated as not being a member of that group of companies for any year preceding a year of assessment in which the said arrangements are in existence. There are also other specific anti-abuse provisions related to group relief.

Another provision provides that when an asset is transferred from one company to another company within a group and the transfer is exempted from tax as the two companies form part of a group, the transfer will be subject to property tax at the rate of 12% if the

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companies cease to be a group before the lapse of five years.

Under Maltese law there is no system for the advance disclosure of avoidance schemes.

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Walter currently advises a number of multi-national companies and also sits on the board of directors of a number of companies. Apart from his wealth of experience in international tax matters including tax planning, treaty interpretation and advice he also has a great deal of knowledge on corporate matters, company law, management and administration. He specialises in holding companies, treasury and finance operations and IP companies.

During his time as a Big 4 partner Walter was responsible for the firm's tax department and a regular participant in international tax conferences and events. He continues to give various lectures and presentations and is the author of various taxation articles.

Walter holds a first degree in Accounting and a post graduate in International Tax Law. He is a fellow member of the Malta Institute of Accountants, a member of the Institute of Financial Accountants in the UK, a member of the Malta Institute of Taxation, a member of the Institute of Financial Services Practitioners, a member of the International Fiscal Association and sits on various councils and committees in the fields of taxation and financial services. For a number of years, he also was an examiner in taxation with the Association of Chartered Certified Accountants of the UK.

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Mary Anne advises a number of multi-national companies, financial institutions and also high net worth individuals in her areas of expertise and was involved in cross border financing transactions and reorganisations.

Apart from her experience in local and international tax matters she assists clients in tax negotiations and obtaining advance revenue rulings from the tax authorities.

Avanzia Taxand has been awarded 'Malta Tax Firm of the Year' for 2009 by the International Tax Review.

Avanzia Taxand is the Maltese member firm of Taxand which is the first global network of independent tax advisors. We work closely with over 300 tax partners in nearly 50 countries and more than 2,000 tax advisors serving the global marketplace.

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New Zealand

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1 General: Treaties

1.1 How many income tax treaties are currently in force in New Zealand?

New Zealand has entered into double tax agreements (**DTAs**) with 36 trading partners: Australia, Austria, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, Germany, India, Indonesia, Ireland, Italy, Japan, Korea, Malaysia, Mexico, Netherlands, Norway, Philippines, Poland, Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey (not yet in force), the United Kingdom, the United Arab Emirates and the US. The New Zealand government has recently announced the commencement of DTA negotiations with Hong Kong.

Typically the source country maximum withholding tax rates in New Zealand's DTAs are 15% for dividends and 10% for interest and royalties. Substantially revised DTAs have, however, recently been completed with the Australia, Singapore and the US. As of [21] October 2010, the revised DTAs with Australia and Singapore are in force, but that with the US is not. The most significant feature of these revised DTAs are reduced source country maximum tax rates on:

- dividends derived by most companies resident in the other State (5% and in some cases 0%);
- royalties derived by residents of the other State (5%); and
- (in the case of the US and Australia DTAs only) interest derived by financial institutions resident in the other State (0%).

The more favourable rates in the revised US, Australia and Singapore DTAs trigger renegotiation obligations in a number of other of New Zealand's DTAs.

New Zealand has also entered into 18 Tax Information Exchange Agreements with Anguilla, Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, the Cook Islands, Dominica, Gibraltar, Guernsey, the Isle of Man, Jersey, the Marshall Islands, Netherlands Antilles, St Christopher and Nevis, St Vincent and the Grenadines, Samoa, the Turks and Caicos Islands and Vanuatu (although only the agreements with the Isle of Man and Netherlands Antilles are in force at present).

1.2 Do they generally follow the OECD or another model?

As a member of the OECD, New Zealand has adopted the OECD Model Convention as the basis of its DTAs, although it has made a number of reservations to the model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. New Zealand statute law provides for a DTA to be incorporated into New Zealand domestic law through an Order in Council made by the Governor General.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Most of New Zealand's DTAs do not have anti-treaty shopping rules or "limitation of benefits" articles which have a similar effect. Exceptions are the DTAs with Chile and the US (both the current and revised US DTA), which do contain specific "limitation of benefits" articles, albeit with significant carve-outs. Further, the dividend, interest, royalties and other income articles in the United Kingdom DTA contain anti-abuse provisions which withhold benefits if the main purpose of the creation or assignment of shares, a loan, a right to royalties or other income, was to take advantage of the relevant article. Also, the dividend article in the revised DTA with Australia contains an anti-treaty shopping rule comparable to the limitation of benefits article in the revised US DTA, insofar as it applies to dividends.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

A DTA that is incorporated into New Zealand law generally prevails over New Zealand's domestic income tax rules. Agreements for recovery of unpaid tax that New Zealand has entered into with some countries are subject to a specific set of domestic law rules.

2 Transaction Taxes

2.1 Are there any documentary taxes in New Zealand?

No, although cheque duty applies at 5 cents on every cheque printed, payable by the printers.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. New Zealand's Value Added Tax is called GST (goods and services tax). GST is imposed at one of two rates:

- 15% on supplies of goods and services that are not exempt or

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zero-rated; and

- 0% on zero-rated supplies (which are taxable supplies) of goods and services (eg supplies of going concerns and exported goods and services which meet administrative requirements for a zero-rating).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

GST is imposed on most supplies of goods and services made in New Zealand by a registered person, where the goods and services are consumed in New Zealand, with limited exemptions. Notable examples of supplies exempt from GST include:

- financial services (although some business-to-business supplies of financial services are zero-rated, rather than exempt);
- residential rental accommodation;
- new fine metals (e.g. refined gold, silver and platinum); and
- donated goods sold by non-profit organisations.

There are detailed rules for determining whether goods and services are treated as being supplied or consumed in New Zealand.

GST registration is compulsory where the total value of taxable supplies by a person in a 12-month period exceeds a set threshold (currently $60,000).

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

GST input tax credits can only be recovered on the cost of goods and services if they are acquired by a registered person for the principal purpose of making taxable (i.e. non-exempt) supplies. Businesses will generally meet this requirement, unless and to the extent that they make exempt supplies (e.g. suppliers of financial services, such as banks) or apply goods and services to non-business uses.

2.5 Are there any other transaction taxes?

Gift duty may apply where property is disposed of for inadequate consideration and either:

- the donor is domiciled, or is a company incorporated, in NZ; or
- the property is situated in NZ.

Gift duty applies, on a progressive scale (the maximum rate being 25%), on gifts in excess of a *de minimis* threshold (currently $27,000 total value of gifts per donor per 12-month period). Certain exemptions (including gifts to charities) apply.

The New Zealand Revenue has recently released a paper discussing the possibility of abolishing gift duty, provided associated revenue and other risks can be mitigated by alternative means. We expect the abolition to proceed during 2011.

2.6 Are there any other indirect taxes of which we should be aware?

There are customs duties (including "import GST") payable on some goods imported from outside of New Zealand, excise duties levied on certain types of goods such as fuel, liquor and tobacco, and gaming and casino duties.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

In some cases.

Under New Zealand's domestic tax rules, dividends paid to non-residents are subject to nil non-resident withholding tax ("**NRWT**") if they are "fully imputed" (reflecting New Zealand corporate tax paid by the dividend-paying company on its underlying income) and the non-resident recipient of the dividends has a 10% or greater direct voting interest in the dividend-paying company.

NRWT applies at the rate of 15% to fully imputed dividends paid to non-resident shareholders with a less than 10% direct voting interest in the dividend-paying company. However, in most cases the foreign investor tax credit ("**FITC**") regime effectively eliminates NRWT in these circumstances. The relief is provided via a credit available to the New Zealand dividend-paying company, which must be used to fund a "supplementary dividend" (equal to the credit) paid to the non-resident shareholder. The aggregate dividend amount (comprising the initial dividend and the supplementary dividend) is subject to 15% NRWT when paid. The supplementary dividend effectively funds the NRWT liability in respect of both the initial dividend and the supplementary dividend. Consequently, the foreign shareholder receives the full amount of the initial dividend in cash, even though NRWT has been paid.

In other cases (ie. where dividends are not fully imputed but are instead sourced from tax-sheltered or capital profits) dividends are subject to NRWT at 30%. However, most of New Zealand's DTAs limit NRWT on dividends to 15% (and in some cases less under the revised DTAs with Australia, the US and Singapore – see question 1.1).

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes. Royalty payments to non-residents are generally subject to 15% NRWT (this is subject to a cap, generally 10% or 15%, in any applicable DTA, and 5% under the revised DTAs with Australia, the US and Singapore – see question 1.1). This is a final New Zealand tax unless the recipient and payer are associated for New Zealand income tax purposes.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes. Interest payments to non-residents are generally subject to a 15% NRWT (capped at 10% or 15% by most DTAs and in certain instances 0% under the revised DTAs with Australia and the US – see question 1.1), unless the non-resident has a New Zealand branch (in which case different withholding tax rules apply). This is a final New Zealand tax unless the recipient and payer are associated for New Zealand income tax purposes.

However, where a local company (or other person) borrows from a non-resident non-associated lender (that does not have New Zealand branch), the local company may, by completing certain registrations, opt-in to the Approved Issuer Levy (**AIL**) regime. Under this regime, if the New Zealand resident borrower pays the 2% AIL in respect of the gross interest payment, NRWT is zero-rated. AIL is a duty payable by the New Zealand borrower and so is not likely to be creditable in a non-resident lender's home jurisdiction. It is a contractual (rather than statutory) matter

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whether the levy is deducted from each interest payment (as if it were a withholding tax) or accounted for separately by the borrower. The levy is deductible to the borrower for income tax purposes.

Note that under the revised DTAs with Australia and the US (see question 1.1), New Zealand retains the right to impose AIL, even where the DTA provides that the resident of the other State is exempt from New Zealand tax on interest derived from New Zealand.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Yes. Thin capitalisation rules apply (*inter alia*) to companies resident in New Zealand that are controlled directly or indirectly by a single non-resident and branches of certain overseas companies. The rules operate by limiting interest deductions to a level consistent with a 75% New Zealand group debt percentage or 110% of worldwide group debt, whichever is the greater (see our answer to question 3.5). For the 2011 – 2012 income year (beginning 1 April 2011 for most companies), the 75% New Zealand group "safe harbour" has been reduced to 60%, but the 110% worldwide group safe harbour remains. The thin capitalisation rules apply to interest on both associated and non-associated debt.

A similar set of thin capitalisation rules apply for the 2009-2010 tax year (beginning 1 April 2010 for most companies), to limit the interest deductions of New Zealand resident entities that directly or indirectly control non-resident companies (**CFCs**). These rules have been introduced in conjunction with the introduction of an exemption for active income derived by New Zealand residents from interests in CFCs, and are intended to limit the extent to which New Zealand groups can bias the allocation of their interest costs to New Zealand.

Note that there is a different set of thin capitalisation rules for foreign-owned registered banks.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Yes. The thin capitalisation rules provide a safe harbour in which interest deductions for a New Zealand group are allowed to the extent its New Zealand group debt percentage (broadly New Zealand group debt as a percentage of New Zealand group assets) does not exceed the greater of 75%, or 110% of the debt percentage of the worldwide group. As noted in question 3.4 (above), for the 2011 – 2012 income year (beginning 1 April 2011 for most companies), the 75% New Zealand group "safe harbour" has been reduced to 60%, but the 110% worldwide group safe harbour remains. The thin capitalisation rules also contain an on-lending concession in calculating the debt percentages.

The different thin capitalisation rules that apply for foreign-owned registered banks are triggered where New Zealand group equity is below 4% of risk-weighted assets.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes. There is no exception to the thin capitalisation rules for debt advanced by third parties. See our answer to question 3.4.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Yes. If the debt funding was provided by a non-resident associated person and was greater than an "arm's-length" amount, the transfer-pricing rules could limit the New Zealand borrower's interest deduction.

3.8 Does New Zealand have transfer pricing rules?

Yes. Transfer pricing rules apply (with a number of exceptions) where amounts paid by local entities to associated non-New Zealand residents exceed an arm's length consideration, and where amounts received by local entities from associated non-New Zealand residents are less than an arm's length consideration. It is possible to apply to the Inland Revenue Department for an "advance pricing agreement", which approves transfer prices in advance.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax on company profits is currently 30%. From the beginning of the 2011 – 2012 income year (from 1 April 2011 for most companies), this has been reduced to 28%.

4.2 When is that tax generally payable?

New Zealand companies are generally required to pay income tax in three equal "provisional tax" instalments. The instalment dates are based on the company's income year. For a standard income year, which ends on 31 March, the instalment dates are 28 August and 15 January of the relevant income year and 7 May of the following income year. The amount of provisional tax is generally calculated based on either an estimate of the company's income, or an uplift of 5% of tax payable for the previous income year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

New Zealand income tax is calculated on a gross/global basis, meaning that for tax purposes net income (or loss) is calculated as total "assessable income" less total "deductions" - these concepts are extensively defined in the income tax rules. Therefore, in principle, New Zealand does not impose tax based on commercial accounts (especially in relation to deductions). However, in many areas commercial accounting rules correspond to tax rules, so in practice a company's net income (or loss) is most commonly calculated by making adjustments to commercial accounts.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Significant differences between the profit in commercial accounts and taxable income are likely to arise from:

- depreciation deductions which are based on tax depreciation rates that do not follow commercial accounts;
- financial arrangements rules (applying to debt and debt

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substitutes), which may deny deductions for credit impairment adjustments, may include in assessable income amounts allocated to equity for accounting purposes, and in some cases may not follow commercial accounting rules at all;

- capital gains treated differently for commercial accounting and income tax; and
- impairments to goodwill or revaluations of assets.

4.5 Are there any tax grouping rules? Do these allow for relief in New Zealand for losses of overseas subsidiaries?

Yes, there are tax grouping rules. Broadly, loss offsets (and/or subvention payments, where a profit company makes a deductible payment to a loss company) are permitted between companies that satisfy a 66% common ownership threshold from the time at which the relevant losses were incurred by the loss company, to the time at which they are to be offset (or subvented) to the profit company.

The loss grouping rules do not allow relief in New Zealand for losses of overseas subsidiaries. The rules require that the loss company is either incorporated, or carries on business through a fixed establishment, in New Zealand. Further, if the loss company is a New Zealand resident company, its losses cannot be offset against the income of another New Zealand group company if the loss company is either treated under a DTA as being resident outside New Zealand, or is liable to income tax in another country through domicile, residence or place of incorporation.

A resident company may, however, be able to offset losses incurred through an overseas branch, to other companies in its New Zealand tax group.

Dividend payments and trading stock transfers between members of a 100% commonly-owned group are not taxed if certain requirements are met.

A 100% commonly-owned group may also elect to form a consolidated group that is treated as a single company for most income tax purposes. An overseas subsidiary is not eligible to be a member of a consolidated group.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, company income tax is imposed at the same rate whether profits of a company are distributed or retained.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Employers, employees and self-employed persons are subject to various "ACC levies" under New Zealand's universal, no-fault accident compensation regime. ACC levies are also payable by road users.

4.8 Are there any local taxes not dealt with in answers to other questions?

Local councils levy rates to fund their operations. Rates are broadly levied according to land values.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

New Zealand does not have a comprehensive capital gains tax.

However, there are situations where gains which would in other jurisdictions be characterised as capital in nature are included in a person's income, which is subject to income tax. New Zealand's financial arrangements rules, which apply to debt and debt substitutes, tax certain movements in the value of instruments that might otherwise be regarded as capital gains (including on an unrealised basis). "Capital" gains with respect to land transactions can also be treated as income. For example, if a person acquires land at a time when they, or someone that they are "associated" with, deals in or develops land, the proceeds from disposal of the land may be treated as income and subject to income tax, regardless of the purpose for which the particular land is acquired.

Untaxed capital gains of companies (other than certain qualifying companies) can generally not be distributed to shareholders as non-dividend, other than on a liquidation. Even on a liquidation, capital gains distributed to non-resident corporate shareholders with a 50% or greater interest in the dividend-paying company or otherwise commonly-owned or controlled with the dividend-paying company are still subject to NRWT (limited to 15% by most DTAs but in some cases lower under the revised DTAs with the US, Australia and Singapore (see question 1.1)).

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

There is no separate rate of taxation for capital gains.

5.3 Is there a participation exemption?

There is no participation exemption from capital gains tax.

5.4 Is there any special relief for reinvestment?

There is no special relief from capital gains tax for reinvestment.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

None. There are no taxes imposed on the formation of a subsidiary in New Zealand.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No. However, a New Zealand resident subsidiary would pay company tax on its worldwide income, whereas a foreign company with a New Zealand branch would be subject to company tax only on income that has a New Zealand source, as described in the answer to question 6.3.

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6.3 How would the taxable profits of a local branch be determined?

A New Zealand branch of a non-resident company will not be treated as a separate entity for tax purposes. The non-resident company will be subject to New Zealand income tax, only on income with a New Zealand source, with deductions allowed for expenses connected with earning that income (subject to thin capitalisation, transfer-pricing and other limitations).

A non-resident company's New Zealand tax obligations in respect of a New Zealand branch will be subject to any DTA between New Zealand and the non-resident's country of residence. Generally, any applicable DTA will permit New Zealand to impose company income tax on "business profits" attributable to the branch. "Business profits" will include New Zealand sourced dividends, interest and royalties effectively connected to the branch, so New Zealand will be permitted to tax these at the full company tax rate (30%, reducing to 28% from the beginning of the 2011 – 2012 tax year), rather than the concessionary rates provided in dividend, interest and royalty articles in the relevant DTA.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No. There is no branch profits tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

This is unlikely. New Zealand's DTAs are generally based on the OECD Model Tax Convention, which provides relief only to residents of the contracting States. Consequently, it is unlikely that a non-resident company with a New Zealand branch would benefit from a DTA between New Zealand and a third country. Having said that, if a New Zealand branch of a non-resident company derives income from a third country, the income will be taxable in New Zealand only to the extent that it has a New Zealand source under New Zealand domestic source rules (see question 6.3).

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No. No withholding tax or any other tax would be imposed as the result of a "remittance" of profits by the branch (which is not treated as a separate entity for New Zealand income tax purposes). The ability to remit capital gains of a branch without any withholding or other tax remains a relative advantage of investing in New Zealand through a branch, rather than a subsidiary. Extraction of capital gains from a subsidiary generally attracts NRWT (see question 5.1).

7 Anti-avoidance

7.1 How does New Zealand address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

New Zealand has a general anti-avoidance rule under which the Commissioner of Inland Revenue may treat a "tax avoidance arrangement" as void. A "tax avoidance arrangement" is an arrangement which has tax avoidance as its purpose or effect, or as one of its purposes or effects, not being a merely incidental purpose or effect. There is a significant body of case law relevant to the interpretation of the general anti-avoidance rule. The Commissioner may also reconstruct a tax avoidance arrangement to counteract any tax advantage obtained by a person from the arrangement. In addition to the general anti-avoidance rule, there are numerous specific anti-avoidance rules.

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Nicaragua

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Nicaragua?

There are no income tax treaties currently in force in Nicaragua.

1.2 Do they generally follow the OECD or another model?

Not applicable.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes, treaties must be incorporated into domestic law before they take effect. The applicable procedure is the following:

1. The treaty must be approved by the National Assembly (Congress).
2. The treaty must be ratified by the President of Nicaragua.
3. The treaty must be published in the government's Official Publication (*La Gaceta*).

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Not applicable.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Treaties may be overridden by the Nicaraguan Constitution or any law that has the status of a Constitutional law (i.e. the Electoral Law, the Emergencies Law and the Amparo Law).

2 Transaction Taxes

2.1 Are there any documentary taxes in Nicaragua?

Nicaragua has a documentary tax. The Tax Law establishes the value of the documentary tax in accordance to the type of document which requires the stamp.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes. Value Added Tax is of 15%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Generally, the VAT is applied to the transfer of goods, to services and to imports. Relevant exclusions are transfers of real estate property, transfers of second hand movable assets, health-related services, and others included in the Tax Law.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Generally, all businesses can recover VAT fully, with the exception of the VAT charged to exempt persons established in the Tax Law, such a diplomats, international organisations, churches, etc.

2.5 Are there any other transaction taxes?

No, the VAT is the only transaction tax applicable in Nicaragua.

2.6 Are there any other indirect taxes of which we should be aware?

There are several indirect taxes such as: Importation Tariffs ("*Derechos Arancelarios a la Importación*"); excise taxes (Selective Consumption Tax, Road Maintenance Tribute collected from Oil Derivatives' sales); the Real Estate Tax; and municipal taxes.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends to a non-resident are affected by a 10% Income Tax withholding.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

A withholding tax rate of 21% applies to royalty payments made by a local company to a non-resident.

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3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Interests to a non-resident are affected by a 10% withholding. There are, however, exceptions to interests paid to Foreign Banking Institutions authorised to be exempt by the Nicaraguan government in accordance to a duly published list.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There are no thin capitalisation rules in Nicaragua.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Not applicable.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Not applicable.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Not applicable.

3.8 Does Nicaragua have transfer pricing rules?

Currently, there are no generally applicable transfer pricing rules in Nicaragua. The issue is touched upon in a brief article contained in the Tax Law's Bylaws where it is stated that if there were to be an exceeding amount between the sale price of a good to Nicaraguan importers and the current wholesale price at the country of origin (plus insurance and freight), then it would be understood that there is an economic relation between the Nicaraguan importer and the foreign exporter with the difference between prices being subject to Income Tax withholdings. However, the disposition is rarely applied.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Corporate profits originated in Nicaragua are subject to the Nicaraguan income tax at a rate of 30%.

4.2 When is that tax generally payable?

Income Tax returns must be filed and paid in full within the three months that follow a company's fiscal year end (the general fiscal year is established from July 1st to June 30th but tax payers can request special periods).

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The Corporation's net income constitutes its taxable income. Net income is calculated by subtracting allowable deductions from gross income.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

There is no difference.

4.5 Are there any tax grouping rules? Do these allow for relief in Nicaragua for losses of overseas subsidiaries?

There are no tax grouping rules in Nicaragua.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, there are no different rates to distribute profits as opposed to retained profits. Retained profits are not taxable.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There are no other national taxes which have not been mentioned previously.

4.8 Are there any local taxes not dealt with in answers to other questions?

Aside from the Real Property (1% for goods under U$50,000, 2% on goods valued between U$50,000.01 and U$100,000 and 3% on goods over U$100,000.01), other municipal taxes include the municipal Income Tax (*Impuesto Municipal sobre Ingresos*) equal to 1% of net income every month; and the Registration Tax (*impuesto de matricula*) which taxes the value of goods' sales and services at 2% on a yearly basis.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

There are no special rules for taxing capital gains in Nicaragua.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

As there is no separate capital gains tax, the income accrued through a capital gain is taxed as the applicable income tax rate as an occasional gain. However, the taxable portion of the capital gain varies in dependence on what type of transaction produces the capital gain.

5.3 Is there a participation exemption?

There is no participation exemption.

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5.4 Is there any special relief for reinvestment?

No, there is no special relief.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No taxes would be imposed upon the formation of a subsidiary.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no other significant taxes or fees.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of any branch are determined by its net income.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There are no branch profits tax in Nicaragua. Branch offices are subject to the same taxation scheme as other business entities.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No, it would not.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Yes, a 10% withholding would apply. This is understood as a final withholding.

7 Anti-avoidance

7.1 How does Nicaragua address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is not a general disposition regulating anti-avoidance rule or any rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted.

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Ana Teresa has also been involved in drafting and reviewing the "*Ley de Garantías Mobiliarias*" and "*Ley de Leasing*" to be approved by the National Congress as well as in the discussions of the "*Ley de Promoción de la Competencia*".
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Arias & Muñoz is unique in Central America, for it operates as a single firm rather than as an alliance of firms and currently has eight, fully-integrated offices in five countries: Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica. It has become, today, not only a solid, but also an innovative legal firm that continues to spread its influence throughout the region.

For clients, choosing the right legal partner is key, and Arias & Muñoz, with its core experience over a broad range of practice areas and industries, as well as its dedicated lawyers, unlocks the region's intricacies and subtle differences in laws for them. The firm is truly a one-step, one-stop law firm offering clients the benefits and demonstrated advantages that come from having all their regional businesses served from one, fully integrated base.

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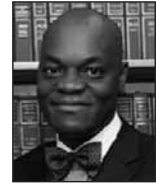
Nigeria

Afolabi Elebiju



TEMPLARS

Vivian Osayande

1 General: Treaties

1.1 How many income tax treaties are currently in force in Nigeria?

According to the Federal Inland Revenue Service (FIRS) website, Nigeria has tax treaties (TTs) with nine countries: Belgium, Canada, France, the Netherlands, Pakistan, Philippines, South Africa and the United Kingdom. Although the Companies Income Tax Act (CITA), 2004 LFN exhibits the Ministerial Orders for only 5 treaties pursuant to section 45 of the CITA, in practice the FIRS generally regard other TTs (in so far as agreement has been signed on behalf of Nigeria) as effective. Thus TTs with China and the Czech and Slovak Republics are given effect to. It is unclear at the moment whether the appropriate Orders have been made by the Minister in respect of a number recent TTs, but UNCTAD's Blue Book (July 2009) lists other countries such as Republic of Korea, Denmark, Norway, Poland and Sweden amongst those which have TTs with Nigeria.

1.2 Do they generally follow the OECD or another model?

Nigerian TTs follow both the OECD and the UN model, albeit the influence of the UN model is more pronounced. Also there are strains of 'domestic models' of Nigeria and her negotiating partners in the TTs.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

The constitution requires treaties to be domesticated before they can take effect. However, as noted in question 1.1 above, the FIRS gives effect to TTs once they have been signed on behalf of Nigeria, including for example the Nigeria-China TT (reportedly signed in 2002, but not on the FIRS website). This may also not be unconnected with historic FIRS practice (like many other agencies) of the commencing implementation of government policy initiatives/directives ahead of completion of the relevant formal framework. The issue of the constitutionality of section 45(1) of the CITA, pursuant to which certification by the minister that treaty arrangements have been made with the government of any country is sufficient to give the TT effect notwithstanding any provision of the CITA, has not been tested.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

No they do not incorporate strict anti-treaty shopping rules. Generally, a resident of a State that is not a party to the double taxation treaty may establish an entity within a State that is a party to such a treaty and obtain the benefits therefrom. Examples of some restrictions on the enjoyment of treaty benefits is the 'subject to tax' requirement (Nigeria-UK TT) or 'beneficial owner' concept (Nigeria-Netherlands TT), whereby recipient enjoys a treaty rate only if subject to tax in the country of residence and not a proxy for the beneficial owner, respectively.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Where a treaty has been ratified, it would take precedence over any domestic law (except the constitution, which is Nigeria's *grundnorm*) in case of any conflict.

2 Transaction Taxes

2.1 Are there any documentary taxes in Nigeria?

Yes. Stamp duties are payable under the Stamp Duties Act (SDA). The Schedule to the SDA sets out the classification of instruments and the applicable rates – whether *ad valorem* or nominal (flat) rates, depending on the particular instrument. The current rate on share capital is 0.75%. It is possible to structure transactions to optimise the related stamp duty exposure. Failure to stamp documents that are liable to stamp duties does not render the documents void, but incapable of being tendered in evidence (in such event the documents can be tendered upon payment of stamp duties and any applicable penalties for failure to stamp in time). Accordingly, in practice parties may not stamp agreements between related companies as the prospect of dispute would be minimal. Conversely, the share transfers of unlisted companies are stamped as a necessary incidence of the prudent practice (but not legal requirement) of filing share transfers at the Corporate Affairs Commission (CAC), since the CAC would not accept unstamped documentation for filing.

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2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes, Value Added Tax (VAT) is chargeable under the VAT Act at 5% of "the value of all taxable goods and services". Newly-incorporated companies register for VAT simultaneously upon registration for CIT. There is pending litigation, instituted by Lagos State, at the Supreme Court on the constitutionality of the VAT Act, on the basis that in Nigeria's federal system, State Governments, and not the Federal Government, should collect and administer sales taxes.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

VAT applies to the supply of goods (which includes any transaction where the whole or property in the goods is transferred or contemplated to be transferred) and the supply of services for a consideration. It has been argued that only exempt items listed in the 1st Schedule to the VAT Act (including zero rated items in Part III of the 1st Schedule, as amended by VAT Amendment Act No. 12 2007), will not be subject to general VAT treatment. The VAT-exempt items are necessaries (such as basic food items, medical and pharmaceutical products and medical services) listed as a matter of policy or law (agricultural equipment, gas-related equipment, plant machinery or goods imported for use in export processing or free trade zones), and exported services. The FIRS maintains that services provided by a Nigerian resident to a non-resident client are not "exported services" for the purpose of the VAT Act.

However, the argument has been made, equally convincingly, that choses in action (e.g. shares, licence interests) are not subject to VAT because they are neither "goods" nor "services". This view has force because tax can not be imposed by implication, but can only be express words of the tax statute, which in any event must be construed in favour of the taxpayer and against the Revenue. Differences of opinion on this issue of whether VAT applies to choses in action between the FIRS and taxpayers will hopefully soon be the subject of judicial pronouncement.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Under the VAT Act (section 17), input VAT paid by businesses on their purchases is recoverable from the output VAT charged on sales. However, only input VAT incurred on goods imported or purchased directly for the resale or goods, which form stock-in-trade for the production of other goods on which VAT is charged, may be recovered from the output VAT. Accordingly, the input VAT incurred on services, overheads and general administration expenses can only be recovered through the profit and loss account. Input VAT incurred on capital expenditure must be capitalised with the cost of the asset in the balance sheet.

2.5 Are there any other transaction taxes?

Other transaction taxes include principally the following:

(a) Capital gains, pursuant to the Capital Gains Tax Act (CGTA), which charges CGT on "…the gains accruing to any person on a disposal of assets"(section 1) at 10%. By section 6(1), there is a disposal of assets by a person "… where any capital sum is derived from a sale, lease, transfer, an assignment, a compulsory acquisition, or any other disposition of assets, notwithstanding that no asset is acquired by the person paying the capital sum". "Capital Sum" is defined as any money or money's worth which is not excluded from the consideration taken into account in the computation of the Capital Gain. The CGTA excludes "any money or money's worth charged to income tax as income of, or taken into account as, a receipt in computing income or profits or gains or losses of the person making the disposal" for the purpose of the CIT. In practice, CGT is computed at 10% of the net gain (i.e. transfer proceeds less acquisition, historical costs such as enhancement of asset and transfer-related costs). By virtue of section 41 of the CGTA, CGT is subject to the terms of any applicable TTs. For a Nigerian resident, it is irrelevant that such asset is not situated in Nigeria; for a non-resident, CGT will only be levied on the amount received or brought into Nigeria.

(b) Property taxes, especially consent fees charged on the transfer of any interest in property pursuant to the Land Use Act. The rates vary from State to State and in Lagos State it is an average of 15% of the asset value or consideration. Federal rates (in respect of transactions in Federal land) tend to be lower.

(c) Perfection costs such as CAC filing fees on mortgages, charges and registration fees at Lands Registry etc. Land Use Charge (or its equivalent) is not a transaction tax from a strict point of view because it is not triggered by any transaction – liability arises by virtue of the property being in existence and in a location subject to jurisdiction of the enabling Law.

2.6 Are there any other indirect taxes of which we should be aware?

Yes there are, and some of these are excise duties, import duties and export duties. Import duties are assessed using the ECOWAS Common External Tariff (CET) and the Comprehensive Import Supervision Scheme (CISS), with an administrative charge of 1% of F.O.B; the value of the imports. Other charges are: 7% surcharge calculated on the customs duty; 0.5% trade liberalisation scheme levy (on customs duty from non-ECOWAS countries); VAT at 5% on the CIF value of imports, customs duty and the allied charges mentioned above; and other applicable levies, for example port surcharges.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Yes. Withholding tax (WHT) applies at 10% or 7.5% if the shareholder is resident in a country which has TTs with Nigeria. In either case, the WHT is the final tax on such dividend for the non-resident. Pursuant to section 23 of the CITA, a dividend received from investments in wholly export-oriented businesses is tax exempt and therefore would not be subject to WHT.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes, at the rate of 10% (non-resident individuals 5%). Nigeria TTs also have beneficial provisions on royalties. WHT deducted on royalties and interest is the final tax on such income for non-residents.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

WHT is applicable at 10% or 7.5% if a non-resident lender is based in a TT country. However, foreign loans could qualify for full or

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partial WHT exemption based on tenor – including a moratorium and grace period, pursuant to the 3rd Schedule of the CITA; loans with a 7 year + tenor enjoy 100% exemption. The moratorium period (payment of only the interest but not the principal) could be zero, but there must be a grace period (during which neither interest nor principal is payable, although interest accrues). Accelerated repayment results in loss of the (full) exemption or triggers graduated exemption depending on timing.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

No, there are generally no thin capitalisation rules; interest is allowed as a deductible expense. However the FIRS would be interested in the competitiveness of the interest rates, and could adjust the transaction to impose a "realistic" or "arm's length" commercial interest rate and tax the borrower's profits accordingly, if they are of the view that the interest is excessive, especially in related parties' context. On the other hand, the FIRS does not query interest free loans or concessionary interest rates from foreign lenders to Nigerian companies, since this results in higher taxable profits for the Nigerian company, which is taxable at 30%, rather than the 10% WHT to be withheld on the interest income.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The only "safe harbour" is that the interest was incurred in order to generate income (i.e. it was an expenditure incurred "*wholly, exclusively, necessarily and reasonably*" for that purpose), and the same is deductible.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

See questions 3.4 and 3.5 above. Thin capitalisation is relevant for financial institutions (especially banks), which have strict capital adequacy requirements, but these are not tax-driven, but sector-regulated.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

None – if the expense meets the "*wholly, exclusively, necessarily and reasonably*" test of section 24 of the CITA and the interest rate is competitive.

3.8 Does Nigeria have transfer pricing rules?

Yes, the general anti-avoidance provision of section 22 of the CITA empowers the FIRS to adjust transactions (especially between related parties) that it considers artificial or fictious, being entered into for the primary purpose of reducing tax that would have been otherwise due, and tax the same accordingly. Pursuant to the National Office for Technology Acquisition and Promotion (NOTAP) Act, NOTAP regulates technology payments by Nigerian beneficiaries to non-resident service providers or licensors of intellectual property, with a view to checking transfer pricing abuses. On this basis, fees paid under registrable but unregistered service agreements with NOTAP may be disallowed by the FIRS as a deductible expense. However, it is generally possible to achieve reasonable transfer pricing objectives with appropriate structuring of contracts.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

CIT is charged on corporate profits accruing in, derived from, brought into or received in Nigeria at 30%. Nigerian companies are also liable to education tax at 2% of their assessable profits. The education tax is deductible for CIT purposes.

4.2 When is that tax generally payable?

Generally it is payable within 6 months from the end of the accounting year when self-assessment returns are filed, and accompanied at least by instalment payments of the tax due (unless the company is in a refund position, for example by reason of excess withholding tax credits).

Eligible companies may enjoy tax incentives, including tax holidays pursuant to the CITA (section 39 on downstream gas utilisation) or the Industrial Development (Income Tax Relief) Act (for "pioneer" companies), which includes the solid minerals sector.

Companies in export processing or free trade zones are exempt from all Federal, State, LG taxes, levies and rates, to the extent that 100% of their production is for export, otherwise tax accrues proportionately on the profits. This, however, does not relieve them of reporting requirements to regulatory agencies within the Zones.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Tax is assessed on total profits pursuant to audited accounts which are subject to adjustments. Provisions on the payment of minimum tax may be triggered, but this does not apply to Nigerian companies which have at least 25% foreign participation, carrying on agricultural trade or business within the first four years of the commencement of business (section 33 of the CITA). Sections 19 and 20 of the CITA provide for excess dividend tax, whereby if in any year the amount of dividends paid exceed the tax payable or the tax is not payable at all (for example, if dividend is being paid out of retained earnings), then the company paying the dividend shall pay CIT on the amount of the dividend "as if the dividend is the total profits of the company for the year of assessment to which the accounts, out of which the dividend is declared, relates". There are creative opportunities and sustainable arguments to manage this exposure. Also, section 21 of the CITA stipulates that undistributed profits of a closely-held company of less than five shareholders may be treated as distributed for the purpose of taxing the deemed distribution in the hands of the shareholders through WHT.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

None – save for observations above.

4.5 Are there any tax grouping rules? Do these allow for relief in Nigeria for losses of overseas subsidiaries?

Group tax relief is not allowed in any shape or form in Nigeria –

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each company is treated as a separate taxable entity. On the basis of the "*wholly, exclusively, necessarily and reasonably incurred*" expense deductibility test in section 24 of the CITA, losses of overseas subsidiaries should be allowed to reduce the taxable profits of the Nigerian parent, particularly as such investment income would have been taxable when brought into Nigeria, but for the specific exemption in, and upon compliance with, section 23(1)(k) of the CITA. However, the foregoing would also be subject to the qualification that the CITA precludes loss from one trade/business being offset against income from another trade or business.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Generally, no. However, by section 21 of the CITA, where small closely-held companies that have distributable profits (which could be declared as dividends) fail to do so, the FIRS could deem the dividends as distributed for the purpose of enforcing payment of WHT on the deemed distribution from the company. This provision does not apply to companies which have more than 5 shareholders.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There is the Education Tax which is charged at 2% of assessable profits and is imposed on all companies incorporated in Nigeria. Sectoral taxes, for example the NITDA Levy (1% of profit before tax), is payable to FIRS by operators in the telecoms/IT industry, and financial institutions including pension operators, etc., with an annual turnover of N100 million and above. The Industrial Training Fund (ITF) Act requires every employer, who has 25 or more employees, to contribute 1% of annual payroll costs to the ITF; however, the ITF may grant up to a 60% refund of an employer's contribution if such employer satisfies the ITF in respect of the adequacy of its employee training programme in any particular year.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are several other taxes, fees and levies which varies from State to State and local government (county) to local government. The Taxes & Levies (Approved List for Collection) Act sets out the list. It is to be noted that State Houses of Assembly, ostensibly relying on constitutional provisions they argue enable them in that behalf, have legislated for additional taxes collectible by their State or local governments. The wider constitutional issue of whether the Act (a federal legislation) could limit taxes collectible by State and local governments is yet to be decisively determined, although there have been decisions, such as *Eti-Osa Local Government v. Rufus Jegede & Anor.* (2007) 5 CLRN 67 (Court of Appeal), which held that particular levies were invalid as they were inconsistent with the Act.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Yes, these rules are contained in the CGTA. The basis of computation is that of net gain - by deducting from the sum received or the receivable person realising the chargeable gain, the cost of acquisition to the plus expenditure incurred on the improvement or expenses incidental to the realisation of the asset.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Yes it is. The rate for capital gains is 10%, while that of business profits is 30%.

5.3 Is there a participation exemption?

Sections 30 and 32 of the CGTA exempts gains from the transfer of shares arising from mergers, acquisitions or other forms of business combinations from the CGT. Gains accruing to holders of unit trusts are also exempt provided the proceeds are re-invested (section 33). Ecclesiastical, charitable or educational institutions and statutory and diplomatic bodies are exempt. Also the transfer of assets from trustees to beneficiaries will not attract CGT. Other exemptions include: gains made upon a disposal of business assets where the proceeds are spent in acquiring new business assets; and gains made upon the disposal of an interest in the rights under any policy of an assurance or contract for a differed annuity on the life of any person.

5.4 Is there any special relief for reinvestment?

Yes. In addition to section 33 on the exemption of proceeds of unit trust in question 5.3 above, under section 32(1) of the CGTA, where businessmen or traders sell assets of old businesses and use the proceeds to procure new and similar business assets, then no gain will be said to have occurred.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

During incorporation, stamp duty is charged at 0.75% of the companies share capital. Stamp duty will also apply if the share capital of the subsidiary is to be increased post-incorporation.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

None; in any event branch registration is not permitted in Nigeria, as section 54 of the Companies and Allied Matters Act (CAMA) requires foreign companies to incorporate Nigerian subsidiaries in order to do business in Nigeria. Although there is provision for exemption from incorporation pursuant to section 56 of the CAMA, that procedure, given its cumbersome nature, is rarely invoked.

6.3 How would the taxable profits of a local branch be determined?

Not applicable. Nigerian tax rules do not distinguish between local branches and Nigerian subsidiaries – the rules are applied to taxable income in the same manner. As a matter of practice, historically (to overcome associated logistical challenges, etc.) the FIRS assesses non-resident companies to tax, using a deemed profit rate of 20%, which, given the 30% CIT rate, effectively translates into 6% of turnover. Such non-residents would prefer high margin projects to be

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taxed on a deemed basis, but low margin ones on actual figures. This is in contrast to residents which are only taxed on the basis of their audited accounts. The FIRS is however moving away from using deemed profit and instead insisting on taxation based on actual figures.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No it would not.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Every Nigerian or non-resident company will benefit from applicable treaty provisions.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Any profits to be remitted to the non-resident would be regarded as dividends and subject to WHT at 10% or 7.5%, if based in a treaty country.

7 Anti-avoidance

7.1 How does Nigeria address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The general anti-avoidance provision is to be found in section 22 of the CITA (and also section 20 of the CGTA), giving FIRS the power to adjust transactions that it considers artificial or fictitious. Specific anti-avoidance provisions include sections 19, 20 and 21 of the CITA on excess dividend tax and deemed distribution respectively (see question 4.3 above). In respect of CGT, anti-avoidance provisions target bargains comprising two or more transactions and transactions between "connected persons" (sections 19 and 22). There is no general anti-avoidance rule or disclosure rules' imposing a requirement to disclose avoidance schemes. The FIRS uses its audit powers to review transactions and may issue additional assessments or take other necessary action as it deems fit.

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TEMPLARS

TEMPLARS is a leading full service commercial law firm in Nigeria, with the know-how to provide innovative commercial solutions for clients with diverse needs. With over 40 lawyers and 12 partners working out of offices in Lagos, Abuja, Port Harcourt and Uyo, Templars is strategically placed to offer quality legal services to clients in Nigeria's major economic hubs. We are organised into Corporate Commercial, Energy & Projects, Finance and Dispute Resolution Practice Groups. The Tax practice straddles all the Groups and has been involved with transaction advisory, structuring, compliance, tax litigation and investment arbitration.

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Poland

Ewa Opalińska

Gide Loyrette Nouel

Maciej Grela

1 General: Treaties

1.1 How many income tax treaties are currently in force in Poland?

Poland has entered into income tax treaties with over 80 countries including the Member States of the European Union, most other European countries and with several American, Asian, Australian and African countries.

1.2 Do they generally follow the OECD or another model?

Polish income tax treaties generally follow the OECD Model Convention.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

According to the Polish constitution, tax treaties are incorporated into Polish law once accepted by Parliament in an enactment of legislation, and then ratified by the President of Poland.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, Polish tax treaties do not contain 'limitation of benefits' clauses. However, in line with the OECD Model Convention, some treaties rely on the concept of 'beneficial ownership' to eliminate treaty shopping with regard to income from dividends, interest and royalties. However, in practice, the issue of 'beneficial ownership' is not subject to special attention by the Polish tax authorities.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

According to the hierarchy of sources of law included in the Polish constitution (being the supreme legal act), Polish tax treaties (as international agreements ratified by an enactment of legislation) override domestic tax legislation (apart from the general provisions of the Polish constitution applicable to tax matters).

2 Transaction Taxes

2.1 Are there any documentary taxes in Poland?

Polish regulations provide for stamp duty imposed on certain administrative procedures and documents.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The Polish tax system provides for VAT. The Polish VAT Act provides the following rates of VAT:

- a standard rate of 22% (starting from 2011, increased to 23%);
- a reduced rate of 7% (starting from 2011, increased to 8%);
- a "zero" rate;
- a reduced rate of 5% (starting from 2011, applicable mainly to certain food products and books); and
- a transitional reduced rate of 3% (valid until the end of 2010, applies mainly to food products).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

In general, VAT must be charged by all individuals, legal entities or other units that supply goods or services on a regular or permanent basis in Poland. Certain transactions, however, are not covered by VAT (i.e. supply of an enterprise or an organised part of an enterprise). Certain transactions are exempt from VAT with the right to a deduction ("zero" rate with the right to deduct input VAT), i.e. exports, intra-Community supplies or services and sales relating to international transportation. Certain transactions are exempt from VAT without the right to a deduction, for example the sale of real estate (excluding, for example, new buildings and building plots) unless the taxpayer opts for taxation, financial and insurance services and healthcare services. Under certain conditions, small businesses can elect to be VAT-exempt.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

As a rule, VAT payers registered for VAT purposes in Poland can deduct input VAT from the amount of output tax. Foreign entities without a business presence in Poland may reclaim the tax charged to them in a refund of VAT for foreign entities.

As a general rule, input VAT deriving from a business activity is

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fully-deductible, though input VAT on the supply of goods and services used for exempt or non-business activities are not deductible to the extent that they serve these activities.

Moreover, the Polish VAT Act defines certain cases when input VAT is not recoverable in principle (e.g. purchase of a passenger car or fuel for such cars, purchase of hotel and gastronomic services etc.).

2.5 Are there any other transaction taxes?

Apart from VAT, Polish regulations provide for other transactional tax – a transfer tax (*podatek od czynności cywilnoprawnych*). Transfer tax is levied on a closed catalogue of civil law activities and transactions (including sale, exchange and loan contracts) and on certain operations resulting in the establishment or increase of share capital of companies and partnerships.

The rate of transfer tax differs according to the type of transaction:

- the sale (exchange) of goods and property rights connected with real estate (i.e. perpetual usufruct or ownership), loan agreements – 2%;
- increase of share capital – 0.5%; and
- sale (exchange) of other property rights – 1%.

If at least one of the transactional parties is considered to be a VAT payer with respect to this transaction, the transaction will be out of the scope of the transfer tax (this rule does not concern the transactions regarding real properties that are subject to VAT exemption).

As a rule, most restructuring transaction such as: the in-kind contribution of part of an enterprise or a qualified number of shares, as well as loans granted by shareholders to its subsidiaries, are exempt from transfer tax.

2.6 Are there any other indirect taxes of which we should be aware?

Polish tax law provides for an excise tax settled by companies selling or importing certain goods, i.e. alcoholic beverages, tobacco, mineral oil (petrol, gasoline, and other oil derivatives) and energy distributors. The tax payable is calculated on an amount per unit sold basis, or as a percentage of the price.

There is also a gambling tax, impose on certain gambling activities lotteries and random games. The activities subject to this tax are VAT-exempt.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid to foreign shareholders are subject to a 19% withholding tax, unless the provisions of a relevant tax treaty state otherwise, or unless the qualified shareholder from the EU (or Switzerland, Norway, Iceland or Lichtenstein) applies for exemption, as provided by the Polish CIT Act. In order to benefit from exemption or a reduced rate of withholding tax, the foreign shareholder must provide the Polish company with an eligible certificate confirming his tax residence.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid abroad are subject to 20% withholding tax, unless the relevant tax treaty states otherwise, or unless the beneficiary (being a shareholder from the EU meeting certain additional criteria) applies for a preferential rate (from July 2013 – exemption from withholding tax), as provided by the Polish CIT Act. In order to benefit from a reduced rate of withholding tax, the foreign beneficiary must provide the Polish company with an eligible certificate confirming his tax residence.

Royalties paid by Polish companies or Polish PE's to non-resident shareholders who are companies from the EU may benefit from a preferential 5% withholding tax rate if the company being the beneficiary of the royalties holds directly at least 25% of the shares in the paying company for an uninterrupted period of at least two years (this condition does not have to be met at the date of the transaction).

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Interest paid abroad is subject to a 20% withholding tax, unless the relevant tax treaty states otherwise, or unless the beneficiary (being a shareholder from the EU requires certain additional criteria) applies for a preferential rate (from July 2013 – exemption from withholding tax), as provided by the Polish CIT Act. In order to benefit from a reduced rate of withholding tax, the foreign beneficiary must provide the Polish company with an eligible certificate confirming his tax residence.

Interest paid by Polish companies or Polish PE's to non-residents shareholders who are companies from the EU may benefit from a preferential 5% withholding tax rate if the company being the beneficiary of the interest holds directly at least 25% of the shares in the paying company for an uninterrupted period of at least two years (this condition does not have to be met at the date of the transaction).

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Where debt finance is three times greater than the value of the company's share capital (i.e. debt / share capital ratio is greater than 3:1), thin capitalisation rules apply to interest paid to shareholders holding at least 25% of shares in capital of the company or a sister company held by the same parent company ("qualified shareholders"). As a result, interest on such loans is not recognised as a tax deductible cost in the portion in which the loan exceeds the debt / share capital ratio referred to above.

The regulations refer to both domestic and foreign loans.

Any amounts uncovered, or covered only by shareholders' debt claims on the company, are excluded when calculating the value of share capital for the purposes of a 3:1 ratio.

For thin capitalisation purposes, a "loan" is deemed to be any kind of debt claim, including debt securities and certain deposits.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Thin capitalisation rules do not interfere with the tax relief concerning interest payments abroad, as they concern only the issue of tax deductibility of the interest paid by the Polish company.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

No, such a situation will not be subject to Polish thin capitalisation restrictions.

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3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in answers 3.4-3.6 above?

Thin capitalisation rules do not interfere with the tax relief concerning interest payments abroad, as they concern only the issue of tax deductibility of the amounts paid as interest by the Polish company.

3.8 Does Poland have transfer pricing rules?

The Polish CIT Act provides that open market terms should be used to assess transactions ("Arm's Length Principle"), particularly transactions between associated entities and between companies and their permanent establishments in Poland.

Under CIT regulations, where the terms of a transaction between related parties differ substantially from the terms of a comparable transaction between independent entities, and where those related parties do not report any income, or report income less than could be expected in a transaction between independent entities, the tax authorities are entitled to assess the income arising from the transaction without regard to the conditions under which it was carried out.

In such cases, the tax authorities may assess the taxable transaction price using one of the following methods: (i) comparable uncontrolled price; (ii) re-sale price; (iii) reasonable margin (i.e. cost-plus); or (iv) transaction profit.

If the total value of a transaction carried out between related parties exceeds the PLN equivalent of EUR 30,000 (this concerns the performance of services or transfer of intangible assets or legal rights), the taxpayers involved should prepare relevant transfer pricing documentation. Such documentation must specify the obligations of the parties to the transaction (taking into account the assets and the risk involved), anticipated costs connected with the transaction, and the form and time of payment involved.

Transfer pricing documentation is also required for the payments made by Polish taxpayers to "tax havens" if their total transactional value exceeds annually the level of PLN equivalent of EUR 20,000.

If the documentation is not presented within seven days from a request from the tax authorities, a 50% penalty income tax rate may be applied to the underestimation of tax reassessed by the tax authority.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax is 19%.

4.2 When is that tax generally payable?

In general, advance corporate income tax payments are made monthly, before the 20th day of the following month (in certain cases it is possible to make advances quarterly). Annual income tax settlement should be made within three months from the end of the fiscal year (the entities subject to CIT may elect a fiscal year different to the calendar year).

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In general, a company's taxable base for the purpose of CIT is its net income (or, exceptionally, its gross income for example in case of dividends). Taxable net income is calculated as the difference between revenue (gross income) and tax deductible costs. A company's taxable income is calculated using data from the taxpayer's account books (adjusted in accordance with the tax law).

Tax deductible costs are defined as expenses incurred for the purpose of earning revenue or preserving/securing the source of the revenue. There is a prescribed list of expenditures and costs that are excluded from deduction by the CIT Act.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Commercial accountancy and income tax regulations determine separately the methods of calculation of the final accountancy and tax financial results. For example, tax regulations provide for different methods of depreciation of fixed and intangible assets and the settlement of foreign exchange differences, and they exclude the deductibility of certain expenditures and costs registered under accountancy regulations etc.

4.5 Are there any tax grouping rules? Do these allow for relief in Poland for losses of overseas subsidiaries?

In general, corporate income tax regulations do not provide grouping rules (apart from settlements concerning dividends, interest and royalties). Polish regulations do not allow for relief in Poland for losses of overseas subsidiaries. It is possible to settle losses of affiliated companies gathered in the same formal tax capital group (which is considered a CIT payer), but this applies only to Polish companies.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

In general, there is no CIT rate on retained profits. Only profits to be distributed are subject to 19% CIT or a preferential tax rate.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

The Polish tax system provides also for property taxes (real property tax, agricultural tax and forestry tax), being local taxes but standardised throughout Poland (local authorities have only a certain influence on the tax rates and tax relief).

The most important of these taxes is real property tax, generally imposed on the owners of real properties (i.e. land, buildings and constructions). The taxable basis for the land and buildings is calculated according to the type, area and the method of designated use of particular real property (private use, or related with a certain type of business activity). In the case of constructions, the taxable basis is established upon their value. Local authorities are flexible in determining the taxable rates, but cannot exceed the maximum rates standardised for the whole country.

Income of individuals (including those derived from business activity and partnerships) are in general subject to personal income

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tax. There is also a separate national tax levied on individuals receiving income from donations and inheritances.

4.8 Are there any local taxes not dealt with in answers to other questions?

The Polish tax system also provides certain less important local taxes and charges, such as tax levied on certain means of transportation and charges imposed on tourists in certain areas of Poland.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

There is no special tax regime for capital gains and losses. Capital gains are combined with other sources of income and taxed at the standard 19% CIT rate.

The amount of any tax loss incurred in a given tax year may be deducted from the taxable income assessed in any of the subsequent five tax years. Up to 50% of the original loss can be deducted in a single tax year, which means that a loss will take at least two years to relieve. Losses cannot be carried back.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The CIT rate is the same for capital gains and business profits.

5.3 Is there a participation exemption?

Polish CIT regulations provide participation exemption for inbound and outbound dividends in the case of EU (or Switzerland, Norway, Iceland or Lichtenstein) shareholders meeting certain additional criteria. Dividends paid by Polish companies to non-resident shareholders from the EU (or Switzerland, Norway, Iceland or Lichtenstein) may benefit from the participation exemption if the company who is the beneficiary of the dividend holds directly at least 10% (25% in the case of the indicated non-EU countries) of shares in the company paying the dividend for uninterrupted period of at least two years (this condition does not have to be met at the date of transaction).

5.4 Is there any special relief for reinvestment?

No, there is no such relief.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The formation of the subsidiary of a foreign company in Poland involves the payment of 0.5% transfer tax from the amount of share capital of the subsidiary (sources transferred on supplementary capital are free from transfer tax). The formation of a subsidiary will also involve non-fiscal costs such as administration charges and notary fees related with the company incorporation.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no such other duties. Please note, however, that transactions between a Polish branch and its head office fall outside the scope of VAT, whereas those between a foreign entity and its Polish subsidiary trigger VAT under general rules.

6.3 How would the taxable profits of a local branch be determined?

The tax base of a local branch of a foreign entity must be determined as if it was an independent entity with regard to some special adjustment items concerning administrative costs.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no specific branch profits tax in Poland. A branch is the organisational unit of a non-resident entity with economic independence and it is taxed according to general rules.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

The treaty relevant for country of the registered office of the foreign company should apply accordingly to the branch of the latter as constituting a PE.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax or other tax liability should apply to the remittance of profits by the branch.

7 Anti-avoidance

7.1 How does Poland address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Polish tax regulations provide a general anti-avoidance rule introducing the "substance over form" principle (Article 199a of the Tax Ordinance). It means that Polish tax authorities are able to requalify the tax implications of a transaction if they find that it was made illusory. However, in practice there are certain controversies regarding the use of anti-avoidance provisions by the tax authorities.

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Gide Loyrette Nouel Warsaw office provides tax advisory services relating to various types of transactions, such as mergers and acquisitions, restructurings, deals involving trade in real estate, industrial property and new technologies as well as financial transactions.

The Tax Department not only provides critical support for other practices, but offers a standalone service that provides high quality tax advice to the clients. In recent months, our tax advisors have developed a number of multi-jurisdictional and cross-border tax schemes that have helped our clients to save resources. The Tax Department works closely with the M&A and Real Estate departments assisting with mergers, acquisitions, privatisations, and spin-offs, providing tax optimisation structures. The Tax Department has also been active on the litigation front, representing clients on numerous domestic and international disputes.

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Romania

Andrei Dumitrache

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Romania?

At the present time, Romania has concluded approximately 76 double tax treaties, 70 of them being currently in force and 5 repealed.

1.2 Do they generally follow the OECD or another model?

As a general rule, most double tax treaties concluded by Romania follow the OECD Model regarding Income taxes and Capital taxes.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

International treaties become part of Romanian legislation upon the consent of the Romanian State to become party to the treaty. The consent may be expressed under the following procedures: ratification, approval, adhesion, or acceptance.

Income tax treaties are commonly approved by ratification. Income tax treaties are concluded at State level and have to be ratified by a law issued by the Parliament before entering into force. As a general rule, such treaties enter into force within a certain period of time after the last ratification instrument is delivered to the other contracting State (usually 30 or 60 days), and effectively apply to the taxes which become due after January 1st of the year following the year in which the treaty entered into force.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The majority of double tax treaties concluded between Romania and other contracting States do not contain provisions which would restrict the benefits of reduced taxation (e.g. by use of conduit companies). However the tax authorities have the right to deny the application of double tax treaties in case it is proven that the facilities were used abusively, for tax avoidance purposes.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

According to the Law No. 590/2003 on treaties, the provisions of the treaty ratified by Romania shall prevail over the domestic law and shall be binding for all Romanian authorities as well as for all the Romanian legal entities and individuals. Furthermore, the domestic provisions cannot be invoked for justifying failure to apply a treaty's provisions, which is in force in Romania. The provisions of an international treaty cannot be modified or revoked by internal regulations subsequent to the date of treaty enforcement but only according to its provisions or the approval of the parties involved. According to the Constitution of Romania, when the provisions of an international treaty are contrary to the Constitution, it will not be ratified by the Romanian authorities until the appropriate amendments of the Constitution's provisions have been made. The Romanian Fiscal Code (the "**Fiscal Code**") provides that, in the cases in which the withholding tax rate applicable under domestic law for income derived by a non-resident/foreign legal entity in/from Romania is different than the tax rate set out under the double tax treaty, the most favourable rate between the two tax rates shall apply.

2 Transaction Taxes

2.1 Are there any documentary taxes in Romania?

The most common documentary tax is the stamp duty, as provided by the Law No. 146/1997 regarding judicial stamp duty, as subsequently amended and modified to date by several normative acts. The tax is imposed usually on: (i) incorporation of companies and amendments to the articles of association of the company, including share transfer and changing of the shareholders' structure; (ii) registration of any deeds regarding an immovable with the local land register (e.g. establishment of a mortgage or other real property right); (iii) conclusion of deeds with a notary office - in some cases, the law requires the notarised form of a particular deed; (iv) legal claims filed with the court; and (v) claims filed with the Ministry of Justice and to the General Attorney Office of the High Court of Cassation and Justice.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The Romanian standard VAT rate is 24% on the supply of goods and services. For certain goods and services like medical products, drugs, accommodation services, school materials, books, etc., a reduced VAT rate of 9% will apply. Also, a reduced 5% VAT rate is applicable on the sale of dwellings, under certain conditions, as part of a governmental social programme.

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2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

As a rule, VAT is applicable to all economic activities having as an object the supply of goods or provision of services performed in the territory of Romania by a (VAT) taxable person acting as such in exchange for payment. Other operations subject to VAT in Romania are the import of goods by any person, intra-community acquisitions and some operations deemed as intra-community acquisitions. As regards the import of goods, VAT will be charged on the customs value of the goods, defined under question 2.6 (b).

The Fiscal Code provides, however, for the following exemptions from VAT:

a. Exemption without credit:

- activities of public interest (e.g. healthcare and healthcare related services, teaching activities (as such are defined under the law), social services, cultural activities and services, public postal services, sorts related services, TV and non-commercial radio-related goods and services, etc.);
- most of the banking, financial, insurance and reinsurance activities with some exceptions (e.g. debt collection, factoring, etc.);
- authorised gambling; and
- some forms of lease of real estate assets and sale of land not used for construction purposes; and the sale of old buildings (a building is considered old after 31 December of the year following the year when the building was used for the first time) or buildings on which the transformations costs performed did not exceed 50% of its value, exclusive of tax.

b. Exemption with credit:

- export of goods, transport and related services;
- international transport of passengers;
- intra-community supply of goods;
- some operations performed in free trade zones or free warehouses;
- supply of goods to a bonded warehouse, VAT warehouse and related services and supply of services related to goods placed under customs suspensive regime;
- supply of foreign goods placed under customs suspensive regime; and
- supply of goods and services to diplomatic missions, NATO forces and other international organisations.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

A business can recover VAT paid to the State budget in two ways, by *deduction of VAT* and/or by *reimbursement of VAT*. VAT collected for goods and services delivered to customers may, under certain conditions, be set off in the books of the taxpayer against VAT paid for the purchase of goods and services. If the taxpayer performs transactions subject to different VAT rates (i.e. the regular 24% rate and the reduced 9% rate), specific records should be maintained by the taxpayer, in order to show the allocation of goods and services to each type of transaction. The deduction is performed on a *pro-rata* basis, subject to the amount of delivered goods and services and the apportionment of purchased goods and services to transactions chargeable at each VAT rate. In cases where the amount of VAT paid for goods and services by a taxpayer during the reporting period exceeds the amount of VAT collected for goods and services delivered to customers, the taxpayer is entitled to claim the reimbursement of the VAT from the State. Reimbursement shall not be available if the amount of VAT to be reimbursed is less than RON 5,000 (approx. €1,200). Nevertheless, the tax payer may carry forward such balance between output and input VAT in order to set it off against VAT liabilities reported in future returns. VAT is usually paid on a monthly basis. Businesses with a turnover under EUR 100,000 during a fiscal year, calculated at the exchange rate from the last day of the fiscal year, may choose to pay VAT on a quarterly basis, except for the taxpayers performing intra-community acquisition of goods in Romania, for which the VAT shall be paid on a monthly basis.

2.5 Are there any other transaction taxes?

Customs duty is a tax collected by the Romanian State for goods imported (as a rule, exported goods are exempted from customs duties) in Romania from outside the European Union. Customs duties are specified in the EU Common Customs Tariff. The Romanian Customs legislation provides for a certain situation under which the goods imported could benefit from favourable treatment and partial or total relief of customs duties. Customs duties are levied on an *ad valorem* basis as well as a fixed amount applied to a specific quantity (specific taxes). Customs duties are computed on the customs value of the goods, which represents the acquisitions value of the goods together with the transportation expenses, insurance expenses and other expenses incurred.

2.6 Are there any other indirect taxes of which we should be aware?

The excise duty is another indirect tax collected by the Romanian state for several categories of goods such as beer, wines, fermented drinks other than beer and wine, strong alcoholic drinks, ethylic alcohol, tobacco products, electricity, energy products (liquid/fossil fuels), coffee, perfumes, jewellery (gold/platinum), sail and motor boats etc., regardless of their domestic or foreign origin. The excise tax is levied on the basis of unit of weight or volume, subject to the type of goods, as well as on an *ad valorem* basis. Certain exemptions regard products like ethyl alcohol and other alcoholic products if they are denaturated, or used in the nutritional, pharmaceuticals or cosmetic industry.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Dividends paid by Romanian legal entities to legal entities registered in an EU or European Free Trade Association (EFTA) Member State or to the EU or EFTA permanent establishments of such legal entities are:

a) subject to a 10% withholding tax; or

b) exempt from withholding tax in Romania, provided that the receiver of the dividends is established under a specific corporate form, is a profit tax (or similar tax) payer in its jurisdiction, and has held at least 10% of the Romanian dividend payer's share capital for at least 2 years ending at dividend distribution date.

Dividends paid by a Romanian legal entity to foreign legal entities or the Romanian permanent establishments of legal entities which do not fulfil the exemption or reduced tax rate criteria mentioned above, are subject to a 16% withholding tax, unless a more favourable tax rate is provided under a relevant double tax treaty.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

As of January 1st, 2011, royalties paid by Romanian legal entities

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to legal entities registered in an EU or EFTA Member State or to the EU or EFTA permanent establishments of such legal entities are exempt from withholding tax in Romania, provided that the effective beneficiary of the royalties has held at least 25% of the value of/number of shares in the Romanian royalties payer share capital for at least 2 years ending at the royalties distribution date.

Furthermore, as of January 1st, 2011, payment of royalties made out of Romania shall be completely exempted from any tax in Romania, if the effective beneficiary of the royalties is, among other criteria, a tax resident of a EU Member State and, according to the definition given by the law to "associated companies", is a company associated with the payer of royalties. This tax exemption for royalties paid between associated companies following transposition in the Romanian fiscal law of European Council's Directive 2003/49/EC on a common system of taxation is applicable to interest and royalties payment made between associated companies of different Member States.

Royalties paid by a Romanian legal entity to foreign legal entities or the Romanian permanent establishments of legal entities which do not fall under any of the categories mentioned above are subject to a 16% withholding tax, unless a more favourable tax rate is provided under a relevant double tax treaty.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Tax treatment applicable to interest paid by a Romanian company to a foreign legal entity is identical to the tax treatment applicable to royalties, described under question 3.2 above.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

According to the "thin capitalisation" rules applicable in Romania, interest paid by a Romanian company is fully deductable, unless the ratio between the long term debt of the company (> 1 year) and the total equity of the company is higher than 3. In case the ratio between the long term debt of the company (> 1 year) and the total equity of the company is higher than 3, the interest paid by the Romanian legal entity shall not be deductable during the relevant fiscal year but may be carried forward to the following fiscal years, until fully deducted. Such "thin capitalisation" rules shall not be applicable as regards interest paid for funds obtained from banks, credit institutions and any other legal entities that, based on authorisation, act as professional financing institutions.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

As set out under question 3.4 above, interest is a fully deductable expense as long as the debt/equity ratio in the interest paying company is lower than 3. Furthermore, the deductibility of interest paid by Romanian companies for funds obtained from legal entities, other than banks, credit institutions as well as any other legal entities which are authorised and act as professional financing institutions, is limited to the following ceilings: (i) for funds obtained in Romanian lei (RON), the reference interest rate of the National Bank of Romania, as published in the last month of each quarter; and (ii) for foreign currency, a maximum percentage whose value is yearly established by Government's Resolution (e.g. 6% in 2010).

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Save for the debt deriving from loans or credit facilities received by the company from banks, credit institutions and any other legal entities that, based on authorisation, act as professional financing institutions, the "thin capitalisation" rules extend to the entire long-term debt of the company, irrespective of whether such debt is being guaranteed by the company's parent entity or not.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Under the Romanian Fiscal Code, there are no further restrictions on tax relief for interest payments paid by a local company to a non-resident, in addition to the "thin capitalisation rules" described above in question 3.4.

3.8 Does Romania have transfer pricing rules?

The Romanian Fiscal Code enables the Romanian fiscal authorities to apply the "arm's length principle" to the transactions between related parties. If transfer prices are not set at arm's length, the Romanian tax authorities have the right to adjust the taxpayer's revenues or expenses, so as to reflect the market value. Romanian tax authorities may use certain methods for setting transfer prices as follows:

- Comparable Uncontrolled Prices, whereby the market price is established based upon the prices paid to other persons who sell comparable goods or services towards unrelated persons.
- Cost-Plus Method, whereby the market price is established based upon the costs of the good or service provided through the transaction. An appropriate gross margin ("cost-plus mark-up") is then added to such cost, to make an appropriate profit in light of the functions performed and the market conditions. The result of adding the cost-plus mark-up to the costs may be regarded as an "arm's length price" of the original controlled transaction and shall be subject to taxation.
- Resale Price Method, whereby the market price is based upon the resale price of the good/service sold afterwards to unrelated persons, after the costs deduction of such resale, of other costs of the taxpayer and to which a profit margin shall be added.
- Any other methods that are in line with the OECD Transfer Pricing Guidelines.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The standard profit tax rate in Romania is 16%.

In case of night clubs, night bars, discotheques, casinos and businesses performing gambling activities, including those legal entities obtaining such through partnerships, the companies deriving income from such activities have to pay the higher amount between the value represented by the 16% profit tax and the value represented by 5% income tax.

As of 2009 a forfeiture (minimal) tax regime became applicable to

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all Romanian companies as well as to the permanent establishments of foreign companies in Romania. In this regard, Romanian companies and Romanian permanent establishments of foreign companies shall pay a minimum fixed amount of tax whenever such minimum fixed amount of tax has a higher value than the value of the 16% profit tax. For example if a company has an income anywhere between RON 0 and RON 52,000 (approx. EUR 12,000) and the profit tax payable by the company has a lower value than, in this case, the forfeiture tax of RON 2,200 (approx. EUR 500), then the company would have to pay the forfeiture tax.

Representative offices of foreign companies in Romania are subject to a flat tax of EUR 4,000 per annum (in RON equivalent), regardless of their income during the fiscal year.

4.2 When is that tax generally payable?

The general rule set forth by the Fiscal Code is that companies have the obligation of paying an anticipated annual profit tax. The amount of anticipated income tax is determined based on the profit tax afferent to the previous exercise, indexed in consideration of the inflation rate. The anticipated annual profit tax is divided into four equal instalments and paid on a quarterly basis by the 25th day of the month following each quarter (i.e. the first payment has to be made on April 25th, at once with the filing of the annual profit statement). Certain categories of tax payers, such as partnerships without legal personality, non-profit organisations and taxpayers which obtain profits from agricultural activities, benefit from variations of the general tax payment term.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Taxable profit of a company is generally computed as the difference between the revenues derived from any source and the expenses incurred for obtaining the taxable income during the fiscal year. This difference is then adjusted for tax purposes by deducting non-taxable revenues and adding non-deductible expenses.

Dividends, among other expressly provided types of income, are not included in the taxable base, for profit tax purposes.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Subject to the conditions presented under question 4.3, profit shown in commercial accounts may be different subject to the applicability of accounting rules regarding losses, accruals and other restrictions imposed by Romanian accounting standards.

4.5 Are there any tax grouping rules? Do these allow for relief in Romania for losses of overseas subsidiaries?

The Romanian legislation gives affiliated companies (the parent company and its subsidiaries) the possibility of preparing a consolidated annual report at group level. However, there are no rules which would enable the consolidation of profit and losses of a Romanian subsidiary with the profit and losses of its foreign parent company. Group trading losses and gains may be offset under certain conditions during corporate restructuring (i.e. mergers and split-offs). For VAT purposes, under certain conditions, Romanian legal entities liable to VAT, which are linked together by financial, economic and organisational aspects, may be regarded as a fiscal group.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Generally, distributed profits are subject to the same 16% profit tax as undistributed profits. The profit tax exemptions applicable for reinvested profit shall no longer be enforceable as of January 2011.

However, under certain circumstances, undistributed profits may benefit from certain exemptions, if incorporated as a mandatory reserve. In this regard, profits apportioned for the establishment of the mandatory reserves are fully deductible. The current level of mandatory reserve is 20% of the amount of subscribed and paid-in share capital.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Property taxes (e.g. land and buildings) are levied by local authorities based on the declared value of the immovable, the location of the immovable and on the square metres.

In addition to property taxes, Romanian taxpayers (legal entities as well as individuals) have to pay healthcare taxes and other social contributions.

4.8 Are there any local taxes not dealt with in answers to other questions?

As a principle, local taxes are established by the local authorities on a yearly basis, within the limits provided by the Fiscal Code. The Fiscal Code provides for the following local taxes:

- Tax on means of transportation, such as cars, buses, trucks, tractors, motorcycles, boats, yachts, etc.
- Tax for issuing of certificates, approvals and authorisations due to be paid prior to the issuing of such documents.
- Tax for advertising and publicity services, paid by the beneficiaries of such services at rates of 1% up to 3% from the value of such services, as determined by the Local Council. The tax is not due for advertisements in the written and audio-visual media.
- Tax on entertainment activities, due for artistic shows, sports competitions and the like. The value of the tax is 2% or 5% of the income, subject to the entertaining activity. There are special rules for determining the taxes for discotheques or video saloons.
- Tax for hotel accommodation. The value of the hotel accommodation tax is determined by the Local Council, and may vary between 0.5% and 5% of the accommodation fee. The tax must be paid for the entire accommodation period, except for accommodation facilities located in a tourist resort, for which the tax must be paid only for one night, regardless of the accommodation period.
- Health tax. Providers of advertising services pay a 12% health tax for tobacco products and alcohol. The tax is computed to the value of cashed advertising revenues. The health tax is also due but in different percentages by the producers and importers of tobacco products and some alcoholic drinks (other than beer, wine and other fermented drinks and intermediary products).
- Special taxes. The local councils, the county councils or the General Council of Bucharest may levy special taxes for certain local public services, which are provided for the benefit of individuals or legal entities.

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5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains, determined in accordance with the applicable fiscal and accountancy rules, obtained by Romanian companies are included in the taxable profit of the company and subject to the 16% profit tax rate.

Capital losses related to the diminishing in the value of stockholding are deductible and may be written off during the following 7 fiscal years for loss incurred as of 2009. Capital gains obtained in Romania by foreign companies from the disposal of shares held in Romanian companies or from the disposal of real estate assets located in Romania are subject to a 16% withholding tax, unless contrary or more favourable provisions are established in the relevant double tax treaty. As regards losses incurred by a company, such annual losses established by the profit tax statement may be carried forward for a period of 7 years following the year when such losses have incurred but only for the losses incurred as of 2009.

Capital gains obtained by foreign companies from Romania by disposing of assets (e.g. participation titles in Romania entities, real estate properties located in Romania) are taxable in Romania in accordance with the 16% flat tax rate, except derogatory provisions are found in the relevant double tax treaty. Usually, double tax treaties to which Romania is party provide that, save for, generally, capital gains obtained by disposing of real estate assets located in Romania, capital gains obtained by a foreign companies from any other sources are exempted from taxation in Romania.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The tax rate applicable to capital gains is 16%, unless a more favourable rate is established by the relevant double tax treaty.

5.3 Is there a participation exemption?

There are no participation exemptions regarding capital gains.

5.4 Is there any special relief for reinvestment?

Currently there are no special reliefs for reinvestment in force in Romania.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The incorporation of a subsidiary shall differ depending upon the legal status of the company which is to be registered. For instance, as regards the registration of limited liability companies with the Register of Commerce, taxes and fees may amount to EUR 400 (including capital duty).

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

According to the provisions of the Law regarding companies, a subsidiary of a foreign company is regarded as a distinct legal entity in Romania. As opposed to a branch, which does not have distinct legal personality from its parent, hence net profit (i.e. after subtracting 16% tax/minimum fixed amount of tax) would be transferred directly to the parent and net profit of a subsidiary would have to be distributed to the parent as dividends, which often means adding a new layer of taxation on the parent's revenues. On another hand, a branch is considered a permanent establishment of a foreign company in Romania, a fact that, under most of double tax treaties applicable in Romania, could trigger, in some cases, the application of withholding tax on certain revenues instead of the exempting the income from withholding tax.

6.3 How would the taxable profits of a local branch be determined?

The taxable base used for the purpose of computing a branch's taxable profit shall only include income apportioned to the branch. Only branch-related expenses shall be taken into account for the purpose of profit tax.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Under the Romanian fiscal legislation, (as well as under the provisions of the large majority of double tax treaties following the OECD model), a branch of a foreign legal entity is considered a "permanent establishment" of such foreign legal entity in Romania and it is subject to the same tax treatment as any other legal entity functioning under the Romanian law. Therefore a Romanian branch's profit shall be subject to the general flat profit tax of 16% or the minimum fix amount of tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A branch is deemed to be a permanent establishment and shall benefit from the provisions of tax treaty (e.g. OECD model double tax treaty, followed by Romania in the majority of its double tax treaties), subject to the attribution of income and expenses rules to the branch. As a rule, only expenses incurred for the purposes of the branch, including executive and general administrative expenses, shall be deductible from the gross revenues.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

As mentioned in question 6.4 above, according to Romanian fiscal legislation, the branch is deemed to be an independent legal entity for tax purposes. Therefore the general rules applicable to the Romanian companies regarding the profit tax shall apply also to the branch.

7 Anti-avoidance

7.1 How does Romania address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

After Romania's accession to the EU on January 1 2007, the Fiscal

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Code enacted, in Title V, Chapter V, the provisions of the Directive 77/799/CEE regarding mutual assistance between competent authorities of the EU Member States in the field of direct taxation and taxation insurance bonuses, as amended.

All Romanian legal entities have the obligation of filing a report regarding payments and payment obligations to non-residents, which must describe the purpose of the payment as well as identify the beneficiary of the payment. In case of Romanian entities that have the obligation to withhold and pay the due taxes for certain incomes they paid to non-residents, such Romanian entities have to file, on a yearly bases, with the fiscal authorities, a separate report regarding withholding taxes.

Pursuant to the latest measures for fighting tax evasion, starting as of August 1st, 2010, all taxable persons and legal non-taxable persons performing intra-community operations, from a VAT perspective, shall have to register with the Intra-community Operators Registry held by the National Agency for Fiscal Administration, prior to the performance of such operations.

Furthermore, under specific circumstances, members (in case the tax payer is a partnership or family enterprise), shareholders, administrators, affiliates and third parties breaching a garnishment obligation in an enforcement procedure for tax liabilities, shall be held jointly liable with the tax payer in or with regard to which they hold the above mentioned capacities, for the tax payer's liabilities.

Joint liability is subject, among others, to the actions of the above mentioned persons leading to the breach by the tax payer of its tax payment obligations or to its insolvency having been performed in bad faith.

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Pachiu & Associates is a Romanian law firm that provides for a full range of commercial and corporate legal advice from its two centres of business: the main office in Bucharest and the office in Cluj-Napoca (west of Romania). The firm has extensive practice and expertise in matters related to mergers and acquisitions, corporate governance, incorporation of companies, direct foreign investment, real estate, construction, banking and financing, energy, securities, commercial contracts, public private partnerships and procurement, offshore and tax structures, labour law, intellectual property, secured transactions, as well as cross-border transactions and environment law.

The firm is currently counting for 20 lawyers and associates (including 5 partners), plus additional staff comprising paralegals, authorised translators and supportive staff. All lawyers are graduates of leading universities in Romania or abroad (LLM degrees), and are all members of the Bucharest Bar Association and of the National Romanian Bars Association. All lawyers are fluent in Romanian and English. Some lawyers are fluent in German, French, Italian and Spanish.

The firm maintains a close relationship with some leading multinational law firms and other small and medium-sized law firms from abroad, so as to ensure efficient liaison with important foreign business centres and jurisdictions.

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Slovakia

White & Case

Miriam Galandová

Matej Firický

1 General: Treaties

1.1 How many income tax treaties are currently in force in Slovakia?

After the break-up of the Czech and Slovak Federal Republic ("**CSFR**") in 1993, the Slovak Republic acceded to the tax treaties signed by the former CSFR. Since then, the Slovak Republic has signed a number of new tax treaties. Currently, Slovakia has tax treaties with 63 countries, of which 62 are effective. This does not include the tax treaties currently being negotiated which have not take effect yet.

1.2 Do they generally follow the OECD or another model?

The tax treaties signed by the Slovak Republic generally follow the OECD Model Tax Convention. The specific tax treaty is signed with the U.S., which follows neither the UN nor OECD Model Tax Convention.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

The tax treaty, if signed, also needs to be approved by the Slovak Parliament and subsequently ratified by the Slovak President. Afterwards, upon the counterparty ratifying the tax treaty, the treaties are published in the Collection of Laws and become part of domestic law.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Slovak tax treaties do not usually include any specific anti-treaty shopping provision, except for those incorporated in the model tax treaties, e.g. principle of limitation of benefits to the "beneficial owners" of income.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Once the Slovak double tax treaties are ratified in compliance with Slovak legislation and published in the Collection of Laws, they prevail over Slovak domestic law.

2 Transaction Taxes

2.1 Are there any documentary taxes in Slovakia?

In Slovakia, no documentary taxes have been introduced.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

As of May 1, 2004, the Slovak value added tax ("**VAT**") system complies with the principles of VAT applied within the European Union (the "**EU**") by the Sixth Council Directive 77/388/EC (Recast Council Directive 2006/112/EC) of the common system of VAT.

Generally, a standard 19% VAT rate applies on the majority of taxable supplies with the place of the transaction being in Slovakia, unless these supplies are specifically exempt from VAT. The reduced 10% VAT rate applies on qualified supplies such as supply of certain pharmaceutical products, medical equipment and books. Another reduced 6% VAT rate applies to agricultural products produced by small farmers.

As of 2011, it is proposed to temporarily increase a standard VAT rate to 20% and to cancel the reduced 6% VAT rate. Nevertheless, such an amendment is currently subject to further legislation procedure (i.e. approval of Slovak Parliament and signing by President/re-approval of Slovak Parliament is still needed).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Under the Slovak VAT system, VAT is imposed on: (i) the supply of goods for consideration in Slovakia; (ii) the provision of services for consideration in Slovakia; (iii) intra-Community acquisitions of goods; and (iv) the import of goods from countries outside the EU.

VAT-exempt supplies with an input-VAT deduction entitlement include: (i) the supply of goods from Slovakia to another EU Member State; and (ii) the export of goods.

VAT-exempt supplies without an input-VAT deduction entitlement include, among others: (i) insurance services; (ii) the transfer and lease of real estate under certain circumstances; (iii) financial services; (iv) lotteries; (v) postal services; (vi) healthcare services; (vii) social care services; (viii) educational services; and (ix) other activities in the public interest.

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2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

In general, the VAT payer is entitled to deduct VAT paid in respect of supplies used for the purposes of its taxable business activities. According to the Slovak VAT Act, input VAT cannot be deducted for example, from entertainment expenses. The VAT payer is also not able to deduct VAT paid in respect of supplies received to provide VAT-exempt supplies of goods and services (e.g. postal, insurance and financial services, the exempt supply and lease of immovable assets, see question 2.3).

If taxable supplies are received to perform taxable supplies where VAT deduction is allowed, as well as taxable supplies exempt without input VAT deduction, input VAT can be deducted proportionately based on the coefficient. The VAT paid in respect of acquired intangible assets or received services which are used for business purposes, as well as for purposes other than business, can generally be deducted only in a proportion reflecting the business use of such assets.

A taxable entity which becomes a VAT payer is entitled to deduct input VAT related to the input price of an asset, including depreciated assets (according to the Income Tax Act), acquired prior to its VAT registration. Separate rules for VAT deduction apply for late VAT registrations.

Special rules on the adjustment of input VAT that was deducted apply to capital goods. The initial input VAT deduction on acquired capital goods had to be adjusted if certain changes in the use of such goods (e.g. the use of the capital goods for exempt supplies when the input VAT had been fully deducted) occurred during the subsequent 5 calendar years, including the year of their acquisition (a ten-year period applies to real property).

2.5 Are there any other transaction taxes?

No real estate transfer, inheritance or gift taxes are levied in Slovakia.

2.6 Are there any other indirect taxes of which we should be aware?

The applicable legislation for excise duties is effective as of May 1, 2004, implementing the EU Directives. Specified consumer goods produced in Slovakia, supplied to Slovakia from another Member State, or imported from countries outside the EU, are subject to an excise duty upon various tax events specified in the relevant tax laws. Goods subject to excise duties include mineral oil, tobacco products, spirits, beer and wine. As of July 1, 2008, electric energy, coal and natural gas have also become subject to excise duty. Duty is charged according to the volume produced, imported or supplied with varying rates for each category.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

No, under the Slovak Income Tax Act, profit shares (dividends) distributed by an eligible Slovak legal entity are not subject to income tax in Slovakia. This applies for distributions made to the shareholders by the following qualified Slovak legal entities: a limited liability company (s.r.o.); a joint stock company (a.s.); and a limited partnership (k.s.), if distribution is made to limited partners (*komanditista*). The exemption does not apply to distributions made to partners of a general partnership (v.o.s.) and general partners of a limited partnership (*komplementár*).

Note that, as of 2011, it is proposed that dividend payments to a Slovak individual will be subject to Slovak health insurance payments (14% of a maximum of 36 times the average wage in the Slovak economy). The amendment is currently subject to further legislation procedure (i.e. approval of Slovak Parliament and signing by President/re-approval of Slovak Parliament is still needed).

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

According to the Slovak Income Tax Act, there is a 19% withholding tax levied on payments for the use of intellectual property rights (industrial rights, software, copyrights) and know-how made by Slovak companies, unless the respective tax treaty stipulates otherwise.

Based on the provisions implementing the Interest and Royalty Directive, the royalty payments to a related party seated in another EU Member State are exempt from WHT if certain conditions are met.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

If the creditor is a non-resident for Slovak tax purposes, interest paid by a Slovak company will generally be subject to 19% WHT under the Slovak ITA. The majority of tax treaties signed by the Slovak Republic, however, eliminate the withholding tax on interest. If this is the case, the Slovak company paying the interest may automatically apply the reduced (zero) tax rate under the tax treaty. Taking into consideration the Measure issued by the Ministry of Finance and the practical approach of the tax authorities, we recommend having a tax residence certificate confirming the recipient's tax domicile and eligibility for treaty benefits in the files of the Slovak company for the purposes of a possible tax audit.

Further, as a result of the fact that the Slovak Republic joined the EU, the Interest and Royalty Directive was implemented into Slovak law. Based on these provisions, the loan interest payments to a related party seated in another EU Member State are exempt from withholding tax if certain conditions are met.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

No thin capitalisation rules apply in Slovakia. However, if the amount of debt is significantly higher than the equity (registered capital) of a debtor, the tax authorities could theoretically object to the deductibility of interest on related party loans by invoking the general substance-over-form principle or the transfer pricing rules of Slovak tax legislation. This needs to be considered on a case-by-case basis.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

See also question 3.4 above. No further restrictions are adopted.

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3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

There are no thin capitalisation rules effective in Slovakia. For more information, see also question 3.4 above.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

No further restrictions other than mentioned in question 3.8 (transfer pricing) are adopted in Slovakia.

3.8 Does Slovakia have transfer pricing rules?

Under Slovak tax law, transactions realised between foreign related parties should be subject to Slovak transfer pricing rules. The prices agreed between them should be set on an arm's length basis. The definition of related parties includes those related through personnel (through statutory representatives, members of statutory bodies or supervisory boards), related economically (directly or indirectly holding more than 25% of the capital or voting shares), or otherwise related (through a relationship arising with the aim of decreasing the tax base).

The determination of transfer prices between related parties is generally considered to be very sensitive from the tax perspective. According to Slovak tax legislation, if the prices contracted between related parties differ from prices that would be contracted between unrelated parties on the same or similar terms, and this difference decreased a tax payer's tax base, the tax base of the taxpayer should be adjusted by the ascertained difference.

Under Slovak tax legislation, an advance ruling from the tax authority on the transfer pricing method to be used between related parties may be obtained. Slovak transfer pricing legislation stipulates the methods available based on the OECD Transfer Pricing Guidelines.

As of January 1, 2009, a specific transfer pricing documentation must be maintained by each entity preparing its financial statements under IFRS if it carries out transactions with foreign related parties. Similarly to the EU Code of Conduct on transfer pricing documentation, the transfer pricing documentation should consist of (1) a "master file" containing mainly general information relevant for all EU group members of a multinational enterprise, and (2) "country-specific documentation" containing information relating to the respective local (Slovak) entity involved. Smaller entities preparing its financial statements under Slovak Accounting Standards would still be required to collect prescribed data on such transactions and to publish them in the notes to the financial statements.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The corporate income tax flat rate is set at 19%.

4.2 When is that tax generally payable?

The corporate income tax is generally payable within three months after the end of the tax period (calendar/financial year). In addition, corporate income tax prepayments might be payable monthly or quarterly (*pro rata*) during the current tax period, depending on the tax liability reported in the previous tax period.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The corporate income tax base is generally based on profit/loss determined according to the Slovak statutory accounting standards, which is further adjusted for non-deductible expenses and non-taxable income. For specific taxpayers (e.g. banks, insurance companies, mutual fund management companies, etc.), the accounting result is compiled according to IFRS, which is further adjusted for tax base calculation purposes. These adjustments include, among others, various items to exclude the impact of IFRS accounting.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Non-deductible tax expenses include, among others: (1) entertainment and travel allowances paid in excess of the statutory limits; (2) general accounting reserves and provisions, except for specific tax deductible reserves and provisions (special rules apply for banks and insurance companies); (3) fines and penalties except for contractual penalties; (4) taxes paid on behalf of other taxpayers; and (5) shortfalls and losses exceeding compensation received, except for specific losses.

Slovak tax law further specifically sets the rules for the tax deductibility of certain items, e.g. tax depreciation of assets, financial lease payments, etc.

4.5 Are there any tax grouping rules? Do these allow for relief in Slovakia for losses of overseas subsidiaries?

Tax grouping is not possible in Slovakia. Therefore, if one company is profitable and the other is making losses, the losses may not be credited against the profits. VAT grouping within Slovakia is allowed to certain extend.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, both the distributed and retained profits are taxed at the same rate (19%).

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Municipalities are entitled to assess several municipal taxes, such as real estate tax, tax on dogs, tax on the use of public areas, tax on accommodation, tax on vending machines, tax on non-winning game slot machines, tax on entry and parking of motor vehicles in the historic parts of a city, tax on nuclear devices, and a motor vehicle tax. The level of the applicable municipal tax rate is set by the municipalities. The municipal taxes are administered by the respective municipalities, except for the motor vehicle tax, which is the responsibility of the tax authorities. The most significant of these are real estate and motor vehicle tax.

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Real Estate Tax

Only real estate located within the territory of the Slovak Republic is subject to real estate tax. In general, the owner of real property is obliged to submit a tax return for the calendar year (if any change occurs during the year) and to pay real estate tax, which is levied on buildings, land and apartments based on tax assessment.

The real estate tax base is calculated according to the area in square meters on buildings and apartments or the value of land. The basic and maximum tax rates for buildings, land, and apartments are stipulated in the Act on Municipal Taxes. However, the rates can be changed by the respective municipality.

Motor Vehicle Tax

The motor vehicle tax is payable by both individuals and legal entities for all vehicles used for business purposes. The tax rate is based on engine capacity for passenger cars, and weight and size for other vehicles. The level of the tax rate is determined by the municipalities, without any maximum limitation.

4.8 Are there any local taxes not dealt with in answers to other questions?

Except for immaterial fees, there are no local taxes other than those dealt with in question 4.7.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

No, there are no special rules for taxing capital gains and losses in Slovakia. Any capital gains and losses are included in the tax base of the Slovak company and taxed at the standard corporate tax rate of 19%.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No, the same 19% corporate income tax rate applies to all profits realised by the Slovak company.

5.3 Is there a participation exemption?

Slovakia has neither participation exemption rules nor relief for reinvestment incorporated in its income tax law.

5.4 Is there any special relief for reinvestment?

In respect of state aid, individual tax relief can be granted. Such relief, however, is not necessarily linked to reinvestment.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The setting-up of a Slovak Company (and the subsequent increase of registered capital) will not trigger any Slovak capital duty, transfer taxes or other similar implications for its shareholders or the Slovak Company.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Generally, the rules for taxation of a subsidiary and a branch are the same (Profit/Loss Statement adjusted for tax purposes).

6.3 How would the taxable profits of a local branch be determined?

Generally, a permanent establishment is taxed on a profit and loss basis ("P/L basis") in Slovakia. If it is impossible to determine the tax base on a P/L basis, another method to determine the tax base can be used, e.g. percentage from annual turnover generated in Slovakia, cost plus method, etc.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

The tax base of a branch is taxed at the same corporate tax rate as the tax base of other Slovak legal entities, i.e. at 19%. However, according to the Slovak Income Tax Act, Slovak legal entities are required to withhold 19% tax securing from payments made to foreign entities which have a tax presence in Slovakia (including branches). The guarantee tax is then offset against the corporate income tax liability of the branch. However, this obligation does not apply to branches of entities seated in an EU country or for branches paying tax prepayments in Slovakia.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

As a branch is considered to be a non-resident, the majority of tax treaty benefits can not be applied to the branch, but the tax treaty may eliminate or decrease the application of tax securing as mentioned in question 6.4 above.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

The profits of a branch attributable to the Slovak permanent establishment are first taxed in Slovakia. Subsequently, the remittance of after tax profits to the headquarters is not subject to further taxation in Slovakia.

7 Anti-avoidance

7.1 How does Slovakia address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

A general anti-avoidance principle has been incorporated in Slovak tax law. To prevent abuse, the tax authorities are obligated to take into account the substance of a transaction, and to disregard the formal structuring (Substance-Over-Form Principle). Tax authorities can use their own assessment for the determination of the tax base of a taxpayer who performed operations that, in substance or purpose, were aimed at circumventing the tax law and which resulted in a reduction in the tax base. In addition, any business relation established solely for the purpose of the decrease of tax base/increase of tax loss should be subject to transfer pricing rules.

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Slovenia

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Ursula Smuk

1 General: Treaties

1.1 How many income tax treaties are currently in force in Slovenia?

44 income tax treaties are currently in force in Slovenia.

1.2 Do they generally follow the OECD or another model?

Although Slovenia only acceded to the OECD in 2010, the treaties currently in force generally follow the OECD model, with the exception of those concluded by Yugoslavia with Cyprus and Sweden. The latter, which are applicable to Slovenia by way of succession, are the only two remaining bilateral income tax treaties, which have not as yet been renegotiated.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

In order for a treaty to take legal effect in Slovenia, it must be ratified by the Slovene Parliament and published in the Official Gazette.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Apart from some notable exceptions, such as the treaty with the United States and Malta, the relevant tax treaties generally do not incorporate specific limitation of benefits provisions.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Pursuant to the provisions of the Constitution of the Republic of Slovenia, all domestic laws and rules must comply with the general principals of international law and treaties, to which Slovenia has acceded. From this it may be derived that treaties generally may not be overridden by domestic law.

2 Transaction Taxes

2.1 Are there any documentary taxes in Slovenia?

There are currently no documentary taxes in Slovenia.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Slovenia has Value Added Tax at the standard rate of 20%. A reduced rate of 8.5% applies to items which are specifically enumerated in the Slovene VAT Act. These items include, but are not limited to food, medicine and medical equipment, and some residential buildings.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Slovene VAT regulations closely follow Directive 2006/112/EC, which gives Member States a certain degree of leeway regarding exclusions / exemptions. In general, the supply of goods and services as well as the import of goods and the Intra Community acquisition of goods, are subject to VAT. Several exclusions are, however, provided for in the Slovene VAT Act, which include but are certainly not limited to the sale of shares in a company, an active trade or business and the sale of securities. The sale of certain (used) real estate is also VAT-exempt unless the parties opt to treat the supply as a taxable transaction (in which case the standard rate of 20% applies).

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Taxable persons are generally entitled to deduct input VAT, insofar as the VAT is incurred in the provision of the business' own taxable transactions. Taxpayers rendering VAT-exempt services however, such as banking and financial services, are not entitled to deduct input VAT. Additionally, it may be noted that not all businesses are required to register for VAT purposes - namely businesses with an annual turnover of under EUR 25,000 are not obligated to register for VAT purposes.

2.5 Are there any other transaction taxes?

The transfer of real property for consideration is subject to a real estate transaction tax. The tax rate of this transfer tax is 2% and the taxable basis is the purchase price of the immovable property. If the purchase price is at least 20% lower than the estimated real market value of the property, 80% of the market value shall be considered as the taxable basis.

It is important to note that the Real Property Transaction Act specifically states that for the purpose of the taxation of the relevant transaction, transfer of title of property, for which VAT has already been charged, is not subject to real estate transaction tax.

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2.6 Are there any other indirect taxes of which we should be aware?

Goods imported from outside the EU are subject to custom duties and excise duties are levied on particular classes of goods (e.g. tobacco, alcohol and mineral oils). In addition, green taxes can apply to certain limited transactions.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

A 15% withholding tax is levied on dividends paid by a local resident company to a non-resident. The relevant tax may be reduced or eliminated pursuant to an applicable tax treaty and/or pursuant to Slovene provisions implementing the Directive 90/435/EC. Moreover, subject to certain conditions, a withholding tax is not levied on dividends paid to a non-resident pension fund, insurance fund or insurance company.

Pursuant to Slovene regulations, which implement the Directive 90/435/EC, dividends paid by a local resident company to a non-resident are not subject to a withholding tax, if the non-resident is an EU resident and holds at least 10% of capital or voting rights in locally resident company. A further condition for such tax relief is a minimum two-year holding period and that the recipient company is subject to corporate income tax in its State.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In the event that a local company pays royalties to a non-resident, a withholding tax of 15% is levied, which may be reduced or eliminated pursuant to an applicable tax treaty and/or pursuant to the Slovene provisions implementing the Directive 2003/49/EC. Under the latter, interest and royalty payments made by resident companies are exempt from withholding tax, provided that the recipient company, which is resident in another EU Member State, is subject to corporate income tax in that State, and is an associated company of the paying company.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

A 15% withholding tax is levied on interest paid by a local company to non-residents. This tax rate may be reduced or eliminated pursuant to an applicable tax treaty and/or the Directive 2003/49/EC. Neither interest paid by resident banks to non-resident banks, nor interest paid by resident banks to non-banking entities other than those resident in non-EU low-tax jurisdictions, is subject to withholding tax.

Again, it is important to note that also in the case of interest paid to a non-resident pension, investment or insurance fund, subject to certain conditions, a withholding tax is not levied on interest paid.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

As a general rule, the Slovene Corporate Income Tax Act limits the tax deductability of interest paid on loans granted by a shareholder or partner, holding at least 25% in the share capital or the voting rights of a taxpayer. Interest paid on such loans is not tax deductible if the loan exceeds five times (in 2011) the value of the shareholder's or partner's share in the capital of the taxpayer. This general limitation does not apply however, if the taxpayer manages to prove that the excess loan could have been obtained from un-associated parties.

With regards to the thin capitalisation rules, Slovenia enjoys a transitional period. This transitional period shall continue until 2012, when the debt-to-equity ration fixed at 4:1 shall apply.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The so-called "safe harbour", by reference to which tax relief is assured, may be indirectly detected in the thin capitalisation rules outlined in question 3.4. In addition a "safe harbour" may be detected within the transfer pricing rules encompassed in Slovene regulations. Pursuant to the latter, interest payments made pertaining to loans granted by associated entities are tax deductible only to the extent that interest paid does not exceed the officially determined and published interest rate.

At this point it is important to note however, that the above-mentioned thin capitalisation rules only apply to debt provided by an entity with a 25% or over direct or indirect holding in the Slovenian tax resident. In this respect, a loan granted by a sister company in a "safe harbour" would not fall within the scope of thin capitalisation rules.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

The thin capitalisation rules would also extend to such loans granted by a third party.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Interest payments made on loans granted to a Slovene resident company by a resident in a so-called low-tax jurisdiction are not tax deductible. According to the Slovene Corporate Income Tax Act, non-EU Member States with a general nominal tax rate lower than 12.5%, fall within the scope of the definition of a low-tax jurisdiction. The Slovene Ministry of Finance compiles and publishes an official list of low-tax jurisdiction States.

At this point it also must be highlighted that also the arm's length principle should be taken into consideration in order for interest payments to associated entities to be fully deductible for tax purposes.

3.8 Does Slovenia have transfer pricing rules?

The Corporate Income Tax Act of Slovenia and the accompanying rules, incorporate transfer pricing rules, which are based on the OECD guidelines.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Since 1 January 2010, a flat corporate income tax rate of 20%

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applies to all corporations. This tax applies to payments to residents and non-residents. Subject to specific conditions, a reduced 0% corporate income tax rate applies to investment funds, insurance companies, pension funds and venture capital companies, which are taxed in accordance with the Slovene Corporate Income Tax Act.

4.2 When is that tax generally payable?

An advance payment tax is generally paid on a monthly basis throughout the tax year. Each monthly advance payment amounts to one-twelfth of the tax liability determined in the tax return of the previous year.

The difference between the cumulative advance payments carried out within the relevant tax year, and the tax liability determined in the tax return filed for the respective tax year, must be paid within 30 days from the filing of the tax return.

The annual corporate income tax return must be filed within 3 months subsequent to the end of the tax year, which may differ from the calendar year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In principle, a company's net income, therefore taxable basis, is determined in accordance to Slovene accounting principles and provided for in the company's financial statements. Slovene tax law however, provides for several adjustments for tax purposes, e.g. restrictions on the deduction of certain business expenses. As a general rule, expenses incurred in connection with the company's business activities, which fall within the definition of expenses that are commonly incurred in usual business practice, are tax-deductible.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

As stated above, expenses must be incurred in connection to the company's business activities. Expenses are considered not to be in connection with the company's business if they are not usually incurred in business practice, if they are not necessary for the company's business, or if they are of a private nature. More specific rules apply to the determination of the tax deductibility of expenses in certain cases, e.g. claim write-offs are recognised as deductible expenditures for tax purposes, only if the taxpayer has exercised all available means of collection thereof.

Furthermore, another main difference is provided with regards to dividends and capital gains. In general, subject to certain conditions, dividends which are conferred upon a resident Company from a resident or non-resident, are not subject to a corporate income tax at the level of corporate shareholders. This general rule however, does not apply if the dividends are paid by residents of low-tax jurisdictions.

4.5 Are there any tax grouping rules? Do these allow for relief in Slovenia for losses of overseas subsidiaries?

Slovene regulations do not provide for tax grouping rules.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

The same tax rate is levied upon both types of profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

The Slovene system of property tax is currently being reformed and the new tax is expected to be implemented as of 1 January 2012. Currently, property is taxed by three separate local and/or national taxes and dues, depending on the circumstances pertaining to each specific case.

4.8 Are there any local taxes not dealt with in answers to other questions?

The current property tax, which is applicable both to natural and legal persons, who hold real estate is a local tax. The tax is levied on the property value as determined by law. Property tax is levied at progressive rates, from 0.1% to 1.5%, as set by local municipalities.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

In Slovenia, there is no separate capital gains tax applicable to businesses. Capital gains are therefore considered as normal business income and are thus subject to corporate income tax.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Capital gains are generally subject to the corporate income tax at the 20% rate.

5.3 Is there a participation exemption?

A participation exemption applies to capital gains or losses attributed to the disposal of qualified capital shares or other qualified participation. For the purpose of the relevant provisions, a qualified participation includes at least an 8% share of the capital or voting rights of the company that is subject to disposal. If the latter condition is met, the Slovene Corporate Income Tax Act provides that only 50% of capital gains or losses, attributed to the disposal of shares, are to be included in a Company's taxable basis. In addition to the qualified participation condition, it is important to note that this rule may not apply if the company, which is subject to disposal, is a resident in a low-tax jurisdiction, nor may it apply if the taxpayer company has not met the minimum six-month holding period requirement, in which it employed at least one employee.

Similar to dividends, 5% of related expenses are tax non-deductible.

5.4 Is there any special relief for reinvestment?

No specific relief is available for reinvested profits. However, companies can claim a tax deduction amounting to 30% of the amount invested in equipment and intangible assets. The relevant deduction may not exceed EUR 30,000, nor the taxable base. Any unused credit may be carried forward for five tax years.

Moreover, companies can also claim a tax deduction for 40% of the amount invested in research and development activities, whether these activities be carried out within the company or outsourced. The tax deduction may not, however, exceed the taxable base of the

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year in which the investments were carried out. Taxpayers carrying out their business activities in a region where the gross domestic product *per capita* (GDP *per capita*) is up to 15% lower than the average national GDP *per capita*, may claim a tax deduction for 50% of the amount invested in research and development. The amount claimed may increase to 60% of the invested amount, if the GDP *per capita* in the region where the company's business activities are carried out is more than 15% lower than the respective national average.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No taxes or fees, apart from those connected to the registration of the subsidiary, are imposed upon the formation of a subsidiary.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Currently no such taxes or fees apply.

6.3 How would the taxable profits of a local branch be determined?

The profits of a branch are subject to corporate income tax, if the branch falls within the definition of a permanent establishment. Should this be the case, the taxable income of the permanent establishment includes all income, which is acquired in or via the permanent establishment. In general, the taxable profit of a permanent establishment shall be determined in accordance with the same rules as those applicable to resident companies.

It should also be noted that transfer pricing rules should also be applied when determining the taxable basis of a local branch.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Slovene regulations do not provide for a branch profits or similar tax applicable to branches. Profits attributable to such permanent establishment are subject to the standard corporate income tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Under Slovenian tax law, a branch is considered a taxable entity for corporate income tax purposes if it qualifies as a permanent establishment within the meaning of a double taxation treaty.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

There is no withholding tax levied on the remittance of profits by the branch to the head office.

7 Anti-avoidance

7.1 How does Slovenia address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Slovene regulations do not address the issue of preventing tax avoidance as such. However, in general the substance over form rule applies, while in the case of fictitious transactions, the underlying transaction is deemed to be effective from a tax perspective. Moreover, taxable persons are required to disclose certain data, which may affect the perceived risk relating to the taxable person by the tax authorities, in their annual corporate income tax returns. The tax authorities may base their investigation strategies on the submitted information.

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Spain

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Spain?

There are 75 tax treaties in force in Spain as of October 19, 2010. In addition, there are currently 16 tax treaties in the Spanish parliamentary procedure.

1.2 Do they generally follow the OECD or another model?

The Spanish tax treaties do generally follow the OECD model, except for royalties and capital gains purposes, since most of the Spanish tax treaties reserve the right to tax royalties at source and several Spanish tax treaties provide the right to tax gains from the alienation of shares or other rights forming part of a substantial participation in a company or from real estate companies.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties must be approved by the Spanish Parliament and published in the Spanish Official Gazette in order to be effective in Spain.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Spanish tax treaties usually do not include limitation of benefits articles (exceptions are the US and Malta treaties). However, a large number of them have anti-treaty shopping rules and some of these contain provisions which exclude from its application certain companies or territories that benefit from special regimes.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Tax treaties cannot be overridden by any rules of domestic legislation. The tax treaties prevail over the Spanish domestic legislation. This principle is enshrined in the Spanish Constitution.

2 Transaction Taxes

2.1 Are there any documentary taxes in Spain?

Stamp duty is levied on notarial deeds, certain corporate documents (such as promissory notes, bonds, transferable deposit certificates, etc.) and certain administrative documents formalised in Spain or those that have legal or economic effects in Spain. A fixed rate, which is usually not significant, applies in most cases. In addition, when the documents refer to a valuable object that may be registered in a public register (i.e. commercial or property register), a variable tax rate ranging from 0.5% to 2% may apply.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

VAT is levied in Spain. Spanish VAT follows the guidelines of the European Directives and it is levied in the Spanish peninsula and on the Balearic Islands. Certain areas such as Ceuta, Melilla and the Canary Islands are excluded from the geographical scope of Spanish VAT.

The applicable VAT rates were increased as of July 1, 2010 and are currently the following: (i) standard rate of 18%; (ii) reduced rate of 8%; and (iii) super-reduced rate of 4%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Spanish VAT is generally charged on: (i) supplies of goods and services performed by individual or corporate entrepreneurs within the territory of application of Spanish VAT; (ii) intra-EU acquisitions of goods; and (iii) importation of goods.

However, some transactions are not subject to Spanish VAT (e.g. transfer of a whole business) and some others are considered exempt (e.g. second and subsequent transfers of buildings and rental of dwellings).

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Spanish VAT is not always fully recoverable by all businesses. Spanish VAT is recoverable according to a *pro rata* basis, based on the existent proportion between (i) performed transactions by an entrepreneur on which Spanish VAT is levied, in respect to (ii) all transactions performed by an entrepreneur.

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2.5 Are there any other transaction taxes?

Transfer tax is levied on the transfer of rights and assets located in Spain if such transfers are not taxed with Spanish VAT. The transfer tax rate applicable to real estate is generally 6%, except otherwise provided by the autonomous region where the real estate is located (most of them have established a 7% rate, however in 2010 some autonomous regions have increased the rate up to 8%). The transfer of an entity's shares may be subject to transfer tax if more than 50% of its assets' market value consists of real estate properties located in Spain.

Capital tax is levied on share capital increases and reductions at a 1% rate, except in case of group restructuring transactions. The Draft of State Budget Act for 2011, still pending for approval, provides a capital tax exemption for share capital increases in "small companies" performed in 2011 or 2012.

An indirect tax similar to Spanish VAT applies in the Canary Islands, known as IGIC (*Impuesto General Indirecto Canario*). This is levied on: (i) supplies of goods and services performed by individual or corporate entrepreneurs within the Canary Islands; and (ii) on the importation of goods to the Canary Islands. Another similar tax (IPSI) is levied in Ceuta and Melilla.

2.6 Are there any other indirect taxes of which we should be aware?

The most relevant of the other indirect taxes levied in Spain are the following:

- Special taxes on manufacture and importation of alcoholic drinks or products, hydrocarbons, tobacco products and electricity, to Spain.
- Special taxes on registration of certain means of transport (i.e. registry tax for vehicles).
- Special taxes on certain hydrocarbons.
- Insurance premium taxes.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

According to Spanish domestic legislation, a 19% withholding tax rate is levied on outbound dividends. However, dividends paid by a Spanish subsidiary to an EU-resident company may be exempt from withholding taxes in Spain if the requirements of the Spanish implementation of the EU Parent-Subsidiary Directive, summarised below, are met:

a) Both companies must be subject to and not exempt from a tax levied on corporate profits.

b) The profit distributed may not derive from the liquidation of the Spanish subsidiary.

c) Both companies must have one of the corporate forms that are mentioned in the annex of the EU Parent-Subsidiary Directive.

d) The parent company must hold at least a 10% direct participation in the share capital of the Spanish subsidiary, within the one year period before the profit that is distributed becomes due (commitment is accepted). The Draft of State Budget Act for 2011, still pending for approval, reduces the minimum participation percentage to benefit from the withholding tax exemption in Spain from 10% to 5%.

This regime does not apply if the majority of the voting rights of the parent company are owned, directly or indirectly, by individuals or companies that are not resident in an EU Member State, except if the parent company develops a business activity directly related to the business activity developed by the Spanish subsidiary, or its legal purpose is the administration and management of the Spanish subsidiary through the appropriate organisation of personal and material means, or it can be proved that it was incorporated for valid economic reasons and not only to benefit from this special regime.

As per an Agreement signed between the EU and Switzerland, dividends paid by a Spanish company to a Swiss company are not subject to withholding taxes in Spain under similar conditions as those laid down in the EU Parent-Subsidiary Directive.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

According to Spanish domestic legislation, a 24% withholding tax rate is levied on royalties paid by a local company to a non-resident.

However, a reduced rate of 10% applies to certain royalty payments made by Spanish companies to EU resident companies as per the Spanish implementation of the EU Interest and Royalties Directive (as of July 1, 2011, royalty payments will be exempt from withholding taxes in Spain). This special regime applies to royalty payments made by a Spanish-resident entity or by a permanent establishment located in Spain of an entity resident in another EU Member State, provided that the beneficial owner of the royalties is a company resident in another Member State or a permanent establishment located in another EU Member State of a company resident in another EU Member State, under the following requirements:

a) Both companies must be subject to and not exempt from a tax levied on corporate profits.

b) Both companies must have one of the corporate forms that are mentioned in the annex of the EU Interest and Royalties Directive.

c) Both companies must be EU tax residents and must not be considered resident of a third state by the provisions of a tax treaty with this third state.

d) Both companies must be associated. Two companies are considered to be associated if: (a) one of them holds directly at least 25% of the share capital of the other; or (b) a third EU company holds directly at least 25% of the share capital of the two companies. In both cases a continuous minimum holding period of 1 year is required.

e) Royalties must be tax deductible in the Member State where the permanent establishment paying them is located.

f) The company that receives the royalties must receive them in its own benefit and not as an intermediary or authorised agent of another person and, being a permanent establishment, the amounts received must be effectively related with its activity and must be considered when determining the permanent establishment tax base.

This regime does not apply if the majority of the voting rights of the entity receiving the payment are owned, directly or indirectly, by individuals or companies not resident in an EU Member State, except if it can be proved that such entity was incorporated under valid economic reasons and not only to benefit from this special regime.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

According to Spanish domestic legislation, as a general rule, a withholding tax rate of 19% is levied on interest paid by a local

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company to a non-resident. However, no withholding taxes are levied on interest payments made by a local company to EU residents (whether individuals or entities) or EU-located permanent establishments of EU residents.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Thin capitalisation rules are provided by the Spanish corporate income tax law. These rules apply when the direct or indirect net interest-bearing borrowing from non-Spanish but related parties (excluding banks) exceeds, on average during the tax period, a 3:1 debt-equity ratio.

However, thin capitalisation rules do not apply to debt owed to non-resident-related entities that are resident in an EU Member State, unless located in a country qualifying as a tax haven.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The law establishes a 3:1 debt-equity ratio as safe harbour. Taxpayers may apply to the tax authorities for a higher debt-to-equity ratio, under an advanced pricing agreement (APA) scheme, unless the lender is resident in a tax haven country.

Loans granted between related parties shall follow Spanish transfer pricing rules (described in question 3.8 below); otherwise, the tax relief for that interest exceeding market value may be challenged by the Spanish tax authorities.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Thin capitalisation rules may extend to debt advanced by a third party but guaranteed by a parent company. If the loan granted by a related entity resident in an EU Member State is guaranteed or in turn granted by an entity not resident in the EU, thin capitalisation rules may also apply.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

There are no other restrictions in addition to thin capitalisation rules and transfer pricing rules applicable on tax relief for interest payments by a local company to a non-resident.

3.8 Does Spain have transfer pricing rules?

Spanish corporate income tax legislation provides for new transfer pricing rules since December 2006. According to them, transactions between related parties must follow the arm's length principle. Documentation requirements concerning the set up of prices and conditions for related parties' transactions are provided for these purposes, as of February 19, 2009.

Penalties may be charged if such documentation requirements are not fulfilled. The modification of Spanish transfer pricing rules gives Spanish transfer pricing methods full consistency with OECD transfer pricing guidelines. The preferential methods are the following: (i) comparable uncontrolled price; (ii) cost plus; and (iii) resale price. Alternative methods, in case preferential methods were not applicable, are the following: (i) profit split method; and (ii) transactional net margin method.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The general tax rate for Spanish Corporate Income Tax (CIT) purposes is 30%.

Small companies (turnover of the previous tax year below €8,000,000) benefit from a reduced rate of 25% that applies on the first €120,202.41 of profit. The excess is taxed at the general tax rate. The Draft of State Budget Act for 2011, still pending for approval, provides that companies that qualified as "small companies" could still apply the reduced rate for the three following years.

CIT taxpayers that contribute to the maintenance or creation of employment under certain requirements benefit from a reduced tax rate of 20% on the first €120,202.41 of profit and the excess is taxed at a 25% rate.

However, specific tax rates apply to certain companies, among others:

- Oil companies are taxed at a 35% rate.
- Insurance and credit companies are taxed at a 25% rate.
- Cooperatives are taxed at a 20% rate.
- Collective investment vehicles (such as mutual funds) are taxed at a 1% rate.
- Pension funds are taxed at a 0% rate.

4.2 When is that tax generally payable?

CIT is payable within the first 25 calendar days following the six-month period after the end of the relevant tax period.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base for CIT purposes is the profit according to commercial accounts, which is determined according to Spanish accounting rules, subject to certain tax adjustments set out by CIT legislation.

Net operating losses from previous tax years may be off-set against the tax base within a period of 15 years as from its tax year of generation.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The main tax adjustments to the profits shown in commercial accounts are due to the following tax limitations:

- Asset depreciation is limited to a certain maximum annual rate depending on the type of asset.
- Certain expenses are not deductible for tax purposes (i.e. gifts, corporate income tax expenses, penalties, etc.).
- Provisions for bad debts are generally deductible for tax purposes when a period of six months has elapsed since the due date for payment.
- Portfolio depreciation provisions may not exceed the difference between the net book value at the beginning and at the end of the tax year of the subsidiary, taking into account the contributions and returns of contributions made during the tax year. Depreciation of tax haven subsidiaries is

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only deductible if such entities consolidate their accounts with the Spanish parent.

- Provisions for the decline of value of fixed return securities listed in organised secondary markets are tax deductible up to a limit of the overall decline in value undergone during the tax period by the fixed return securities owned by the taxpayer which are listed on such markets.
- Provisions to cover the decline in value of publishing, phonographic and audiovisual funds belonging to entities which carry on the corresponding production activity are only tax deductible when two years have elapsed since the respective productions were placed on the market.

4.5 Are there any tax grouping rules? Do these allow for relief in Spain for losses of overseas subsidiaries?

There are tax grouping rules in Spain according to which the entities that belong to the tax group are taxed on a consolidated tax base.

The main aspects to be considered with regard to the tax grouping regime are the following: (i) the controlling entity (which may also be a permanent establishment) must hold a minimum, direct or indirect, participation of 75% in the dependent entities' share capital; (ii) all entities must be subject and not exempt from CIT and taxed at the same rate; (iii) the controlling entity may not be controlled by a Spanish resident entity which in turn may be considered a controlling entity; (iv) all entities must have the same tax period; and (v) entities in bankruptcy cannot belong to the tax group.

Application for this special tax regime must take place before the start of the tax year in which the tax group regime shall apply.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is imposed at the same rate upon distributed profits and retained earnings (30%).

Dividends distributed by a Spanish resident company to another Spanish resident company are taxed at the level of the recipient at the general CIT rate of 30%. In order to avoid double taxation, the recipient is entitled to a 50% tax credit of the CIT due corresponding to such dividends. If such dividends derive from a participation of at least 5% that has been held uninterruptedly during the year prior to the dividend distribution date, the tax credit is 100% of the CIT due.

Capital gains derived by a Spanish resident company from the transfer of a participation in a Spanish resident company are taxed at the level of the transferor at the general CIT rate of 30%. In order to avoid double taxation, the transferor is entitled to a tax credit of 100% of the retained earnings generated during the holding period of the participation, if the capital gain derives from the transfer of a participation of at least 5% that has been held uninterruptedly during the year prior to the transfer.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Net worth tax is not levied in Spain on the net worth of companies.

4.8 Are there any local taxes not dealt with in answers to other questions?

The main local taxes are the following:

- Tax on economic activities: annual tax levied on the development of economic activities within the Spanish territory. CIT taxpayers with a turnover below €1 million are exempt.
- Tax on real estate: annual real estate property tax levied on the ownership of real estate. The tax base is the "cadastral value", a value established by the local authorities, which basically depends on the location of the real estate property. The general tax rate ranges from 0.3% to 1.1%. This may be raised by the local authorities.
- Business tax on income: annual tax levied on registered legal persons conducting business, professional or artistic activities in Spain.
- Tax on urban land appreciation: tax levied on the increase in value of land classified as urban land. It becomes due when a property transfer takes place. The tax base is based on the "cadastral value" and the holding period of the urban land.
- Tax on construction and installation projects: tax levied on those constructions done in a municipality for which a licence is required.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

There are no special rules for taxing capital gains and losses.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Capital gains are taxed as business profits at the general corporate income tax rate.

5.3 Is there a participation exemption?

Capital gains derived from the transfer of a participation in a non-resident company may be exempt if the requirements summarised below are fulfilled during the whole shareholding period:

- A direct or indirect participation of at least 5% in a non-resident company has been held for one year prior to its transfer.
- The non-resident company is subject to a tax comparable to Spanish CIT. This requirement is deemed to be met if the non-resident company is resident in a jurisdiction with which Spain has signed a tax treaty.
- At least 85% of the profits of the non-resident company derive from business activities in a foreign country other than a tax haven.

Limitations to the exempt capital gain apply under the following circumstances:

- If at least 15% of the assets of the non-resident company are located in Spain.
- If the acquisition value of the non-resident company was adjusted for tax purposes.
- If the stake in the non-resident company was acquired to a related entity that deducted a loss as a result.
- If in a previous transfer the stake in the non-resident company was valued according to the special rules provided by the Spanish implementation of the EU Merger Directive, and lead to no taxation.

5.4 Is there any special relief for reinvestment?

The Spanish CIT legislation provides for a 12% rollover relief

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applicable to the capital gain derived from the transfer of certain assets as long as the transfer value is reinvested in certain assets. The reinvestment must take place within a period of 1 year prior to the transfer and 3 years after the transfer.

The transfer of the following assets is eligible for the rollover relief:

- Tangible or intangible assets used for business activities for a uninterrupted period of 1 year within the 3 years prior to the transfer.
- Participation interest of at least 5% held for at least 1 year prior to the transfer.

The proceeds from the transfer must be reinvested in the following assets which must be held for a 3 year period (real estate assets must be held for 5 years):

- Tangible or intangible assets used for business activities within the reinvestment period.
- Participation interest of at least 5% (certain limitations apply to reinvestment in certain entities).

Assets acquired from related parties do not qualify for reinvestment, except for new tangible assets or real estate investments.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The incorporation of either a branch or a subsidiary is subject to 1% capital duty.

Upon the incorporation of a subsidiary, the tax base is the nominal amount of the subsidiary's share capital and share premium, with the taxpayer being the incorporated subsidiary.

Upon the incorporation of a branch, the tax base is made up by the funds assigned to the branch, being the taxpayer the head office. However, as of January 1, 2009, the incorporation of a branch will not be subject to capital duty if the head office of the Spanish branch is resident in an EU Member State.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are not any significant taxes or fees that would be incurred by a locally-formed subsidiary but not by a branch of a non-resident company.

6.3 How would the taxable profits of a local branch be determined?

For tax purposes, a Spanish branch office of a foreign company is considered a permanent establishment in Spain. The branch office is subject to Non-Resident Income Tax.

The taxable profits of a local branch are determined in accordance with similar rules to those applicable to Spanish entities. The tax base is based on the commercial profit and the application of some tax adjustments.

However, there are certain limitations to the tax deductibility of a branch's expenses and which are summarised below:

- Payments made by a branch to its headquarters for royalties, interest, or commissions, in exchange for technical assistance or for the use of other assets or rights, are not deductible. Notwithstanding the above, interest paid by a branch of a foreign bank to its headquarters or to other permanent establishments, in order to carry out their activity, are tax deductible.
- The reasonable amount of management and general administrative expenses which correspond to the permanent establishment are deductible, provided that the following requirements are met:
  - Registration in its accounting statements.
  - Evidence of the distribution amounts, criteria and modules adopted.
  - Rationality and continuity of the allocation criteria adopted.
- The costs of the own capital of the entity assigned, directly or indirectly, to the branch are not tax deductible.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Profits obtained by a branch are subject to an 19% branch tax when paid to its head office. However, such tax is not levied if the head office is located in an EU Member State (except if it is a tax haven jurisdiction) or in a country that has entered into a tax treaty with Spain (unless such tax treaty expressly entitles to charge this tax).

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A Spanish branch may only benefit from some of the provisions of the tax treaties entered into by Spain (i.e. mechanisms to avoid double taxation).

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Profits remitted by a Spanish branch to its head office are subject to withholding taxes in Spain in the same terms as dividends paid by a Spanish subsidiary to its parent company (see question 6.4 above).

7 Anti-avoidance

7.1 How does Spain address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

New legislation entered into force in 2006 in Spain in order to prevent tax avoidance. This new legislation, among others, sets up new regulations regarding transactions between related parties and new scenarios under which companies incorporated in tax haven jurisdictions would be deemed as a tax resident in Spain.

There are no general anti-avoidance rules or disclosure rules imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted. However, the Spanish tax legislation provides some anti-avoidance rules with the aim to avoid tax fraud. These anti-avoidance rules entitle the Spanish tax authorities to issue the relevant tax assessments attending to the real facts and circumstances of the transactions performed by the taxpayers, irrespective of the qualification given by them.

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Sweden

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Sweden?

Sweden has an extensive network of tax treaties, with 81 income tax treaties currently in force, including one uniform treaty with the other Nordic countries (Finland, Denmark, Norway and Iceland).

1.2 Do they generally follow the OECD or another model?

The Swedish treaties generally follow the OECD model. The credit method has become the normal method for avoiding double taxation. In recent treaties, the exemption method occurs less frequently.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Tax treaties have to be incorporated into Swedish law. The government has the power to enter into double taxation treaties, but the treaty has to be approved by the parliament. Following this approval, a statute is enacted concerning each individual treaty.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The treaties do not generally incorporate anti-treaty shopping rules. A number of treaties however include limitation of benefits articles.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

The treaties are valid in Swedish law following the enactment of the incorporation statute. Their relationship with other domestic laws is regulated by the incorporation statute. The general principle in Swedish tax law has been that domestic tax law, whether existing or subsequent to the incorporation statute, should be construed in conformity with the treaty. However, the Supreme Administrative Court has, in a much debated judgment in 2008, stated that domestic legislation may override a treaty according to the "*lex posterior*" and "*lex specialis*" principles without prejudice of any obligations Sweden may have under international law. This is therefore now the prevailing interpretation of Swedish tax law in this regard.

In addition to relief under applicable double taxation treaties, there are several possibilities of gaining relief from double taxation under Swedish domestic law. Thus, where no double taxation treaty applies (or where the application of the treaty is less generous), foreign taxes may be credited against Swedish tax to the extent that Swedish tax is attributable to foreign income (overall credit). As an alternative, the foreign tax may be deducted as a cost.

2 Transaction Taxes

2.1 Are there any documentary taxes in Sweden?

A stamp duty is levied upon the registration of new mortgage deeds in real property.

See further question 2.5 below.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Sweden has VAT and its VAT legislation gives effect to the EC VAT Directive. There are three VAT rates:

- 25% as a standard rate, which applies to all turnover of goods and services if not otherwise stated;
- 12% on e.g. food and letting of rooms in hotel business; and
- 6% on e.g. books, newspapers, passenger transport, entrance fees to cultural performances and the granting of transfer rights to certain copyrighted works.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The exclusions from VAT are as permitted or required by the EC VAT Directive. They are, for example, banking and financial services, letting and sale of real property, insurance services and medical care. A property owner or a tenant may register for optional VAT liability regarding permanent letting of business premises to VAT-liable businesses.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input VAT is recoverable only for VAT-liable business and to the extent that the input VAT is attributable to the VAT-liable business.

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2.5 Are there any other transaction taxes?

Stamp duty is levied on transfers of real property. A seller and a buyer are jointly liable to pay the stamp duty, but it is market standard that the buyer pays. The basis for stamp duty is the higher of the purchase price and the real property's tax assessment value for the year preceding the registration of ownership. The tax rate is 4.25% of the said basis for most legal entities, and 1.5% for individuals and certain legal entities. The stamp duty levied is part of the acquisition cost of the property and is capitalised.

There is no stamp duty on the transfer of shares, not even for shares in a company owning real property. Thus, it is possible, and widely practised, to avoid or reduce stamp duty by transferring real property "packaged" in companies limited by shares.

2.6 Are there any other indirect taxes of which we should be aware?

Customs duties apply to goods imported from outside the EU. Excise duties are levied on certain types of goods, such as alcohol, tobacco, fuel, electricity and waste. Excise duties are considered in Sweden to be an effective instrument to guide peoples' behaviour, and consequently the duties tend to be rather aggressive on e.g. tobacco and alcohol.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

As a main rule, withholding tax of 30% on the gross amount is imposed on such dividends. The withholding tax is normally reduced under applicable double taxation treaties to 0-15%.

Dividends from a Swedish company to a legal entity resident in another EU State are exempt from withholding tax if the recipient holds at least 10% of the share capital in the Swedish company and fulfils the requirements in article 2 in the EC Parent-Subsidiary Directive (90/435/EEC).

Dividends from an unquoted Swedish company to a non-resident company, comparable to legitimate Swedish entities as receivers, are exempted from Swedish withholding tax. The same applies for dividends from a Swedish quoted company to a non-resident legal entity if the holding represents at least 10% of the votes in the Swedish company and has lasted for at least one year at the time of the payment of the dividends.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

No, but royalties paid to a non-resident are considered as business income from a permanent establishment in Sweden and are accordingly taxed as such income, if the royalties are paid from a business with a permanent establishment in Sweden. The ordinary tax rate of 26.3% applies on a calculated net income, i.e. a non-resident recipient may deduct costs pertaining to the acquisition of the royalty, including costs for travelling, negotiations, write-offs, financing, research and general administration.

Often, taxation is mitigated by double taxation treaties, although such mitigation concerns the gross sum of the royalty payment. If the non-resident recipient has a permanent establishment in Sweden and the royalty is attributed to it, the royalty shall be included in the income from that establishment and the royalty article in the treaty shall not be applied.

According to the Swedish legislation implementing the EC Interest and Royalty Directive (2003/49/EC), no tax is levied on royalty payments from a company resident in Sweden (or a permanent establishment in Sweden of an EU company) to associated companies resident in another EU State.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

No, there would be no withholding tax on interest paid by a local company to a non-resident regardless of the jurisdiction of the receiver.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There are no thin capitalisation rules in Sweden. Interest expenses are as a general rule possible to offset against any business income. It follows that the interest is fully deductible even if the total purchase price plus costs related to the purchase have been financed through borrowings. However, deductibility for interest paid to an affiliated non-resident company pertaining to intra-group acquisitions of shares are restricted in certain situations, see question 3.7 below.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

This is not applicable as there are no thin capitalisation rules in Sweden.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

This is not applicable.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Since January 2009, the right to deduct interest costs on debts to affiliated non-resident companies regarding intra-group share acquisitions is restricted. The legislation aims to prevent deductibility of interest costs occurred in artificial restructurings between affiliated companies, resulting in the transfer of income from business in Sweden to a low tax foreign jurisdiction.

The main rule of the new legislation is that an enterprise may not deduct interest expenses relating to a debt of an associated enterprise to the extent that the debt regards an acquisition of shares or other participations from another associated enterprise. To prevent circumvention, the main rule is supplemented with provisions extending it to certain external loans (back-to-back loans) and intra-group loans replacing temporary external loans.

Two exceptions apply to the main rule: (a) if the income corresponding to the interest expense is subject to a taxation of at least 10% in the resident state of the enterprise entitled to the income; and (b) if the acquisition as well as the debt to which the interest expenses pertain are mainly motivated by business reasons.

Further, the deductibility of interest payments to a non-resident

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affiliated company may be restricted by a provision implementing the arm´s length principle, see question 3.8 below.

3.8 Does Sweden have transfer pricing rules?

Yes, an arm's length provision is included in the Swedish Income Tax Act. The provision applies only to cross-border transactions. If business income declared in Sweden is considered too low due to the economic association of interest between the parties, the income shall be increased to correspond with what it would have been if the pricing had been at arm's length between two independent parties.

The provision applies also to interest payments from a Swedish company to a foreign associated company.

Since 2007, Swedish enterprises are obliged to prepare certain documentation of transfer pricing in transactions with associated enterprises resident abroad. Since 2010, the Tax Authority may, subject to application from an enterprise liable for taxation in Sweden, conclude Advanced Pricing Agreements (APA) with other states regarding the pricing of international transactions involving the applicant.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax on corporate profits is 26.3%.

4.2 When is that tax generally payable?

Sweden has a system of tax accounts, where every person liable for tax has a tax account where almost all taxes, including VAT, are charged and payments are credited under uniform rules. Companies shall pay corporate tax continuously during the fiscal year in monthly instalments based on an estimate of the tax they will be liable to pay (preliminary tax). The final tax is decided by the Swedish Tax Authority and charged to the tax account during the tax assessment year, which for companies is the calendar year following the year when the accounting period to be taxed ends. A notice of the final tax shall be sent to the taxpayer no later than 15 December of the tax assessment year. If the taxpayer has paid too little preliminary tax and the tax account thus displays a deficit, the taxpayer must pay the remaining amount within a period of at least 90 days from the decision about the final tax.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

As a general rule, taxation follows the commercial accounts subject to adjustments. Some deductions made in the accounts are added back for tax purposes, and deductions for tax purposes may then be made. For instance, buildings and other assets attributable to real property are depreciated at fixed rates for tax purposes, regardless of how they are dealt within in the accounts. Another example of tax adjustments is group contributions; see question 4.5 below.

Further, some adjustments for tax purposes may be made, only if they are also made in the accounts, despite the fact that such adjustments do not really give a true and fair view of the company's financial position. For example, machinery and other inventories intended for permanent use in the business may be depreciated at either a 30% declining balance method or at a 20% straight line method, as long as the same depreciation is also made in the accounts.

It is optional to make a 25% allocation of the taxable income to an untaxed reserve – "tax allocation reserve". The allocation must be shown in the accounts and must be reversed and booked as income after a maximum of six years, but it may be reversed earlier, for instance to set off against a current loss arising one year. Enterprises using the reserve are charged with a standardised income of 2.3% of the allocated amount annually.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

See question 4.3 above.

4.5 Are there any tax grouping rules? Do these allow for relief in Sweden for losses of overseas subsidiaries?

A group of companies is not taxed on a consolidated basis, but each entity is taxed separately. There are, however, grouping rules that provide some effective consolidation. Generally, a group exists when a (parent) company directly or indirectly owns shares in another company (subsidiary) that renders control of more than 50% of the votes in the subsidiary. For some kind of group relief, additional requirements are set up (e.g. for group contributions, see below).

Income tax group relief

Even if each legal entity is taxed separately, it is possible to effectively offset operating losses against operating profits within a group by so-called group contributions, provided that certain conditions are met, the most significant being that more than 90% of the shares in the granting or receiving company shall be held directly or indirectly by the other company. Group contributions are deductible for the granting company and taxable income for the receiving company. The holding requirement must have been fulfilled throughout the fiscal year. Both the granting company and the receiving company must be Swedish companies. This does not mean, however, that other companies within the group can't be domiciled in other countries. Thus, a Swedish subsidiary with a non-resident parent company can grant a group contribution to a fellow Swedish subsidiary, although under the condition that the parent company can be considered equivalent to a Swedish legal person. If not, the contribution will be taxed as dividends.

Group contributions to foreign subsidiaries are not deductible. However, in 2010 legislation was introduced allowing a Swedish parent company to deduct a final loss in a wholly owned (90%) foreign subsidiary resident in an EEA State ("group deduction"). A group deduction may be made if the subsidiary has been liquidated, the liquidation is completed and has lead to a final loss and there is not any company associated with the parent company which continues to conduct business in the resident State of the subsidiary. The deduction is further subject to conditions aiming to ensure that it is a real and definitive loss, such as that the deductible loss is reduced with certain value transfers from the foreign subsidiary to an associated company within 10 years preceding the liquidation.

The legislation on group deductions results from court practice of the Supreme Administrative Court, which with reference to the case law of the EU Court of Justice, for example the Marks & Spencer case (446/03), had granted deductibility for group contributions from a Swedish company to a subsidiary resident in another EU State in certain cases. The new legislation purports to cover all situations where EU law compels Sweden to grant tax deductions for losses in foreign subsidiaries. The legislation is characterised by a minimalistic approach and it has been argued that it is too restrictive to fulfil the demands of EU law regarding the deductibility for group losses in other EU States.

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Capital gains tax group relief

Assets may be transferred between group members without tax consequences as regards capital gains and losses. The tax liability is thereby postponed until the asset is transferred outside the group. This applies also for overseas group companies. There are special rules for the transfer of shares within a group; see question 5.3.

Dividend relief

Dividends from a Swedish company or a company resident in another EU State received by a Swedish company are generally tax free if the recipient's holding of the shares is business-related (e.g. the shares are not held as a capital investment). Shares that are stock items are not considered as business-related for this purpose. A holding of non-stock item shares in a non-quoted company is always considered to be business-related, and the same applies for a holding of shares in quoted companies if the holding represents at least 10% of the votes (or 10% of the share capital for companies resident in another EU State). Even when these requirements are not met, a holding can be considered as business-related if the share owner proves a business relation in some other way. Shares in a company resident in another EU State are considered business-related, also if they are stock items.

Stamp duty group relief

Stamp duty on intra-group transfers or real property may be postponed until the property of the company owning the property is transferred outside the group. The parent company in the group must be a Swedish company limited by shares or one of certain other types of Swedish legal entities.

VAT group relief

For companies within the financial and insurance sector, there exists a possibility to register a VAT group. Turnover between the companies within the VAT group is not subject to VAT. In order for a VAT-liable entity to qualify into the VAT group, the lion's share of this company's turnover must be directed towards the entities within the group. A VAT group may only contain a business operator's permanent establishment in Sweden.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate upon distributed, as opposed to retained profits in Sweden.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Real property tax is levied on real property. All properties are assigned a tax assessment value which in principle should correspond to 75% of the market value. The tax assessment value is the base for the tax rate. The tax rate is dependent on the use of the property and varies between 0.2% and 1%. The real property tax is deductible for income tax purposes, but it is market standard that the tenants compensate the landlord for the real property tax.

Real property used for residential purposes are exempt from real property tax. Instead it is subject to a limited municipal tax of a maximum of SEK 6,387 for a 1-2 family house and SEK 1,277 for each flat in a residential building.

4.8 Are there any local taxes not dealt with in answers to other questions?

No, there are no other local taxes not dealt with in the answers to earlier questions.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Corporation tax is levied on all income, which includes business income and capital gains. However, capital gains are computed according to special rules although taxed as general business income. Further, capital losses on quoted shares are only deductible against gains on such shares. Such losses that cannot be deducted against gains in a fiscal year are carried forward indefinitely.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No, the rate of tax imposed on capital gains is not different from that imposed on business profits.

5.3 Is there a participation exemption?

A divestment through a sale of shares in a Swedish company or partnership held by a non-resident owner is not subject to taxation in Sweden.

For companies resident in Sweden or another EU State, capital gains from the sale of business-related shares are exempt from taxation. Non-quoted shares are considered business-related for this purpose and consequently exempt from capital gains taxation. A holding of shares in a quoted company is as a general rule considered as not held for business reasons. However, a shareholding representing at least 10% of the votes in the company can be considered held for business reasons and therefore not subject to capital gains taxation. For shares in quoted companies to be tax-exempt upon divestment, there is also a holding time requirement of one year.

5.4 Is there any special relief for reinvestment?

There are no particular regimes for such relief in the business sector.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed upon the formation of a subsidiary. A registration fee of SEK 2,200 is charged for registration in the company register.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

A Swedish subsidiary will be liable to Swedish corporate tax on its worldwide income. A non-resident company with a branch constituting a permanent establishment in Sweden will only be taxed on the income derived directly or indirectly from the establishment; see question 6.5. A non-resident company is further liable to Swedish tax on income and capital gains from real property in Sweden.

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6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a Swedish branch of a non-resident company will, as long as it is a permanent establishment (the Swedish definition is based on article 5 of the OECD Model Convention) be determined in the same way as for any other taxable Swedish person, that is on a net basis according to the general rules for computing business income in the Swedish Income Tax Act; see question 4.3 above. Only the part of the non-resident company's profits that is attributable to the branch is taxable in Sweden. This means that all income and costs of the non-resident company attributable to the branch must be allocated to the branch, including overhead costs.

A non-resident company is also entitled to tax relief in respect of its Swedish branch in the same way as resident taxable persons are entitled to tax relief, such as by allocation to the tax allocation reserve. Further, a company resident in another EEA State may receive tax-free dividends from business-related shares under the same conditions as Swedish companies, provided that the dividends are attributable to the branch; and EEA companies may also be a part of the group contribution system in the same way as Swedish companies (see question 4.4 above). These rules should also apply to companies resident in any non-EEA State with which there is a double taxation treaty with a non-discrimination clause in force.

Non-resident companies with a permanent establishment in Sweden may also gain relief from double taxation under Swedish internal law through credit or deduction of foreign taxes against Swedish taxes; see question 1.5 above. This applies for EEA and non-EEA States alike.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

No, there is no branch profits tax in Sweden.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A non-resident company with a branch constituting a permanent establishment in Sweden will benefit from applicable tax treaty provisions when computing its tax liability in Sweden.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No, there is no additional taxation of the profits once the current income of the branch has been subjected to Swedish taxation.

7 Anti-avoidance

7.1 How does Sweden address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Swedish tax legislation contains a general anti-avoidance rule. This legislation is applicable where the taxpayer has participated directly or indirectly in a transaction or series of transactions which has incurred a substantial tax benefit, where this benefit is found to have been the most important reason for the transaction or transactions and where a taxation based on the transaction or transactions would be inconsistent with the purpose of the pertinent legislation, as such purpose appears from the general construction of the legislation and from the rules which apply directly or which have been circumvented by the transaction or transactions. If the anti-avoidance legislation is applicable to a transaction, taxation shall be imposed in disregard of this transaction.

Further, the Swedish Tax Authority and tax courts may apply a "substance over form" approach when examining transactions in tax cases. The transactions are analysed in order to ascertain their "real economic meaning", on which the taxation is then based rather than on their formal designation.

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Kilpatrick Stockton is a full service, international law firm with nine offices across the eastern United States and in Europe. We deliver innovative business solutions and results-oriented counsel for the corporations at all stages of the growth cycle, from the challenging demands of financial transactions and securities to the disciplines of intellectual property management. A close collaboration between the firm's practice areas ensure Kilpatrick Stockton is well-positioned to serve all our clients' needs.

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The Stockholm office's tax group represents a significant number of international and Swedish clients in the areas of tax planning and general corporate taxation as well as VAT matters and tax litigation.

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Switzerland

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Switzerland?

As of 1 January 2010 there are 92 income tax treaties in force to which Switzerland is a party. In addition, there are 10 tax treaties on inheritance tax in force, as well as 22 tax treaties on the taxation of maritime and air navigation companies. Please note that Switzerland has not concluded any tax treaty on gift tax, except an agreement with France concerning tax treatment of gifts made for non-profit making purposes. From 2007 to 2010, Switzerland signed new agreements with Chile, Columbia, Malta, Qatar, Tajikistan and Turkey, which must still be ratified by the relevant authorities before they can enter into force.

As a result of article 15 of the agreement between Switzerland and the EU regarding savings tax, Switzerland is granted rules substantially equivalent to those laid down in the EU parent/subsidiary and interest/royalty Directives (i.e. 0% withholding tax). This will apply in relation to all EU Member States, including Cyprus and Malta, with which Switzerland has not previously concluded a double taxation treaty.

1.2 Do they generally follow the OECD or another model?

Most Swiss treaties follow the OECD model treaty. However, since Switzerland has traditionally had an extensive treaty network, there are some older treaties, such as, for the time being, that with the Netherlands, which do not follow the OECD model treaty. However, as a consequence of the bilateral agreements between Switzerland and the EU, most treaties with EU Member States will be re-negotiated in the near future, or have already been re-negotiated (i.e. the treaty with the Netherlands). Also, the treaty with the United States of America does not follow the OECD model exactly but rather the US model treaty. With respect to the exchange of information, Switzerland originally made a reservation with regard to Article 26 of the OECD model treaty so that the exchange of information would be granted only for the correct application of the treaty.

Since 2004, Switzerland changed its policy with respect to the exchange of information. It then accepted to exchange information in cases of tax fraud and modified its reservation to the OECD model accordingly. Switzerland has recently signed or initiated a number of revised treaties providing for administrative assistance in accordance with Article 26 of the OECD model treaty (Austria, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Japan, Luxemburg, Mexico, the Netherlands, Norway, Poland, Qatar, Singapore, Spain, Slovakia, Turkey, the UK, Uruguay and the US).

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Double taxation treaties entered into by Switzerland do not have to be incorporated into domestic law before they take effect. In accordance with the monist system, international treaties form part of federal law once they have been ratified and thus immediately become valid sources of law. Treaties in general rank before domestic law in the Swiss legal system.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Double taxation treaties entered into by Switzerland do not normally incorporate anti-treaty shopping rules or "limitation of benefits" articles. In 1962 Switzerland enacted unilateral rules to avoid treaty-shopping ("Abuse Decree"). This Abuse Decree contains a number of tests that must be fulfilled by every Swiss resident company in order to be eligible for treaty benefits. Basically, these rules are still in force. However, in 1998 facilitations were introduced for holding companies, active companies and publicly quoted companies. In August 2010, the criteria to qualify for an active company were relaxed.

The treaties with Italy, Belgium and France have incorporated anti-abuse rules which originate from the Abuse Decree. The anti-abuse rules in these treaties basically aim at excluding persons who are not fully subject to taxation in Switzerland (i.e. holding and domiciliary companies as well as individuals taxed on the basis of a so-called lump-sum arrangement) from the benefits of the respective treaties. Since the anti-abuse rules of the above treaties are considered *lex specialis* as compared to the general anti-abuse rules of the Abuse Decree, the 1998 and 2010 facilitations mentioned above do not apply in relation to Italy, Belgium and France. Furthermore, the treaty with the United States in article 22 contains limitation of benefit clauses. Other double taxation treaties express the possibility of restricting the application of the treaty through mutual agreement procedures, such as with Belgium, the United Kingdom, Morocco and the Netherlands. The double taxation treaty with Luxembourg stipulates that the treaty is not applicable to tax-privileged Luxembourg companies (such as a Holding 1929).

Lastly, according to the practice of the Swiss tax authorities, a foreign company claiming a refund of Swiss withholding tax must

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fulfil some substance requirements. This is particularly true where the treaty provides for a full refund of Swiss withholding tax, such as the treaties with the Netherlands, Luxembourg, Denmark and Sweden. When examining the situation, the Swiss tax administration looks into the real substance of the structure, and not merely its form. An "economic approach to the facts" is adopted, which gives weight to the overall business situation. The tax administration is assessing whether the structure has been arranged with the sole or the primary intention of securing full relief.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Generally speaking, treaties rank before Swiss domestic law in the Swiss legal system. Hence, as a principle, treaties are not overridden by any domestic law, whether existing when the treaty took effect or introduced subsequently. However, there is some domestic law, such as the Abuse Decree, that has treaty-overriding power to a certain extent.

2 Transaction Taxes

2.1 Are there any documentary taxes in Switzerland?

The transfer of Swiss situated real estate is regularly subject to a cantonal or communal **Real Estate Transfer Tax**. The applicable tax rates vary from canton to canton. Normally they range between 1% and 3% of the transfer value of the real estate. However, some cantons do not levy real estate transfer taxes (e.g. the canton of Zurich).

Not only is a formal transfer of real estate subject to this tax, but also a so-called "economic change of ownership" which is the case when shares in a real estate company are transferred.

Furthermore, based on the Swiss Stamp Duties Act the following stamp duties are levied by the Federation:

- Securities Issuance Tax;
- Securities Transfer Tax; and
- Insurance Premium Tax.

The **Securities Issuance Tax** is a stamp duty levied on the issue (= primary market) of certain Swiss securities, mainly shares, similar participating rights in corporate entities and bonds. The taxable person is the company or the person who issues the securities.

The rate is 1% of the capital contribution in the case of shares and participating rights. However, the issuance stamp tax levied on capital created or increased by a corporation or a limited liability company is exempted from the issuance stamp tax up to the amount of CHF 1 million. Furthermore, certain transactions, especially in the case of restructuring, are exempt from tax. Rescue companies created for restructuring purposes are exempt from issuance stamp duty, as are capital increases and additional contributions, provided previously existing losses are eliminated and the aggregated payments by the shareholders or members do not exceed CHF 10 million.

The issue of bonds is taxed at 0.06% or 0.12% per year to maturity.

The **Securities Transfer Tax** is levied on the transfer of certain Swiss securities, mainly shares, similar participating rights in corporate entities, bonds and shares in investment funds, and on foreign securities with similar functions, if a Swiss stockbroker ("*Effektenhändler*") is involved. As of July 1, 2010 remote members of the Swiss stock exchange no longer qualify as Swiss stockbrokers. Stockbrokers are mainly banks and other brokers but also companies holding taxable securities with a book value of more than CHF 10 million (holding companies).

The rates are:

- 0.15% in respect of Swiss securities; and
- 0.3% in respect of foreign securities.

The **Insurance Premium Tax** is levied on certain insurance premiums. The taxable person is the Swiss insurance company or the holder of a policy taken from a foreign insurance company. The standard rate is 5% of the premium. Life insurance premiums - if taxable - are taxed at 2.5%.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Switzerland introduced Value Added Tax in 1995. The system of tax is similar to the VAT in the European Union. The standard rate currently applicable as of 2011 is 8.0%.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The Swiss VAT system largely follows the 6th VAT Directive of the European Union (note: Switzerland is not a member of the European Union). A new VAT Act has recently been adopted in Switzerland. The principle aim of the new Act is to simplify the VAT legislation and make it more user-friendly, thus lightening the administrative burden for the taxpayers.

Taxable transactions

The following transactions are subject to VAT:

- supply of goods and services in Switzerland;
- self-supply in Switzerland; and
- import of goods or services.

Taxable persons

Taxable persons are all entrepreneurs (regardless of the legal form of the business) exercising a gainful business activity in Switzerland. However, they may request to be exempted from VAT if the turnover is less than CHF 100,000 per year. Furthermore, all persons (also private individuals) importing services for more than CHF 10,000 per year must pay VAT (to be declared in the so-called "reverse charge procedure").

VAT rates

The rates currently applicable (as of January 2011) are:

- 8.0% standard rate;
- 2.5% reduced rate (e.g. medicine, newspapers, books and food); and
- 3.8% lodging services.

VAT Exemptions and Zero-rated Transactions

Article 21 of the VAT Act provides for certain turnovers to be exempt from VAT. The most important exceptions are: hospital and medical care; education (school, courses etc.); cultural activities (theatre, museum, libraries etc.); insurance and reinsurance transactions; granting and negotiation of credits; transactions in shares and other securities; real estate transfers; and letting and leasing of real estate (in general). Input taxes in respect of exempt transactions are not deductible. In order to avoid competitive disadvantages the enterprise may, however, opt for VAT in certain cases. On the other hand, the taxpayer is allowed to deduct input taxes in these cases.

Article 23 of the VAT Act provides for a list of "zero-rated" transactions. Here the fact that no VAT is due on the respective turnover does not affect the deduction of input taxes. Typical

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examples are export of goods and services outside Switzerland and supplies in the field of international air transport.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

The VAT Act in principle grants deductibility for all VAT due or paid in respect of goods and services accumulated for the purpose of entrepreneurial activities ("input taxes"). Where a taxpayer has taxable and tax-exempt turnover (see question 2.3 above) he must reduce the input tax recovery proportionally. For smaller businesses, special rules apply. They may opt for a lump-sum method whereby reduced VAT rates for the calculation of tax due take input tax into account.

For private goods, there are possibilities to proceed with a so-called fictive input tax deduction. Self-supply is calculated as a simple correction to the input tax and is not included in the calculation of the turnover.

2.5 Are there any other transaction taxes?

No, there are no other transaction taxes.

2.6 Are there any other indirect taxes of which we should be aware?

The consumption of certain alcoholic beverages, of tobacco and of mineral oil as well as emissions of carbon dioxide and the heavy traffic are subject to State levies. The taxes are included in the retail price and are not disclosed to the end-user.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Profit distributions made by Swiss corporations, limited liability companies, and cooperatives are subject to withholding tax. Withholding tax is levied on interest, annuities, profit sharing and all other income derived from shares, social participations in limited liability companies and cooperatives, participation certificates or profit sharing certificates, issued by a person who is domiciled in Switzerland. Distributions made by partnerships are not considered as taxable dividend distributions. Profit distributions are defined as any benefit which may be financially quantified and which is made to the creditor or shareholder in excess of the paid-in nominal capital. They include ordinary dividend distributions, liquidation proceeds, stock dividends and constructive dividends (hidden profit distributions).

The Corporate Tax Reform II introduced a change from the so-called nominal value principle to the capital re-investment principle, which allows a tax exempt repayment of capital re-invested by shareholders. Only distributed profits remain subject to WHT. This new rule will enter into force as per January 1, 2011.

The applicable WHT rate is 35%, whether paid to a Swiss resident or to a non-resident recipient.

Swiss resident recipients can normally obtain a full refund of dividend WHT, provided they have properly reported the gross amount of the dividend received as taxable income.

Non-resident recipients may apply for full or partial refund of dividend WHT pursuant to the provisions of the applicable treaty.

On most inter-company cross-border dividend payments, Swiss-based companies with substantial foreign shareholders may apply for a reduction of the WHT at source and the Swiss company has to pay the non-refundable WHT only. However, before the due date of dividend payment, the paying Swiss company has to file a request for the application of the reporting procedure with the FTA.

The authorisation, if applicable, is granted on the basis of form 823B or 823C. This form has to be signed by both companies and has to be stamped by the State of residence of the parent company.

In case the reporting procedure does not apply, the 35% WHT due on dividend distributions has to be withheld by the Swiss company and be paid to the FTA. The foreign (parent) company may reclaim all or part of the WHT, based on the applicable double taxation treaty.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Switzerland does not levy WHT on royalties, whether paid to a resident or a non-resident person.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Withholding Tax

Interest paid on bonds and interest paid on bank deposits is subject to Swiss WHT. The applicable rate is 35%. There is no WHT on private and commercial loans (including inter-company loans). However, the definition of a "bond" according to Swiss WHT law is rather large.

Tax at Source

Non-resident recipients of interest paid on a loan which is secured by mortgages on Swiss real estate are subject to federal and cantonal taxes levied at source on gross income. The federal tax is 3%; the cantonal taxes vary between 13% and 21%.

System of tax Retention on Interest Payments

According to the Agreement between Switzerland and the EU on the taxation of savings income, Switzerland agreed to introduce a special withholding tax (retention tax). Interest payments from non-Swiss sources made by a Swiss paying agent to a beneficial owner who is an individual and resident of an EU Member State are subject to a retention tax in Switzerland.

Tax retention rate: Currently 20% on the gross interest amount, 35% after 2011.

The EU Member State in which the beneficial owner of the interest payment is a resident receives 75%, and Switzerland retains 25% of the retention tax.

In the case of express instructions from the beneficial owner, instead of retaining tax, the paying agent will report the interest payments to the Swiss Federal Tax Administration who will exchange the information with the tax authorities of the EU Member State of residence.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Switzerland has introduced thin capitalisation rules. They are laid down in a circular letter issued by the FTA. Interest paid by a Swiss resident payer is normally not subject to WHT. However, to the extent that interest is paid on amounts of debt exceeding maximum debt allowed according to the circular letter, it is re-qualified as a

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hidden dividend, if paid to a shareholder or a related party to the shareholder. As a consequence, such interest is not deductible for the paying company. In addition, it is subject to the 35% Swiss WHT like any other dividend.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

According to the circular letter issued by the Federal Tax Authorities for finance companies, the maximum debt allowed is 6/7 of total assets (fair market value). For other companies, the maximum debt allowed is defined for certain types of assets as follows:

- cash: 100%;
- accounts receivable: 85%;
- inventory: 85%;
- other current assets: 85%;
- bonds in CHF: 90%;
- bonds in foreign currency: 80%;
- quoted shares: 60%;
- non-quoted shares: 50%;
- investments in subsidiaries: 70%;
- loans: 85%;
- furniture and equipment: 50%;
- property, plant (commercially used): 70%;
- other real estate: 80%; and
- intellectual property rights: 70%.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

As a principle, the thin capitalisation rules are only applicable to debt advanced by shareholders or related parties to the company. However, if debt is advanced by a third party, but guaranteed by the parent company, the thin capitalisation rules could nevertheless apply.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

The provisions of the Abuse Decree Circular of 1962 as regards equity-debt ratios as well as maximum rates allowed for the remuneration in the form of interest are generally not applicable since the Abuse Decree Circular of 1999.

In addition to the thin capitalisation rules mentioned above, the FTA publishes maximum rates allowing that the interest will not be considered a hidden profit distribution (deemed dividend).

Otherwise, there could be provisions in the applicable double taxation treaty regarding beneficial ownership.

3.8 Does Switzerland have transfer pricing rules?

Historically, due to the moderate taxation of corporations in Switzerland, foreign companies have been trying to shift profits into rather than out of Switzerland. Switzerland does not have explicit transfer pricing rules in its tax laws. However, one of the general principles governing Swiss corporate income tax law is the principle of "dealing at arm's length". This is particularly important as Switzerland does not know the concept of consolidated taxation for corporate income tax purposes. Another important principle of Swiss tax law is the concept of tax avoidance. Pursuant to this rule, any transaction which in itself does not make economic sense and which can only be explained with the goal of saving tax is disregarded. Transfer pricing issues are normally dealt with by the Swiss authorities by applying these principles.

In addition, in a letter issued in 1997 the Federal Tax Administration has instructed the cantonal authorities that when taxing multinational enterprises, they have to take into account the OECD Transfer Pricing Guidelines. In 2004, it issued a new circular replacing the previously existing one. The 2004 circular states that the arm's length principle is also applicable when choosing the method of determination of mark ups, and that implies for financial services or management functions that the cost plus is not an appropriate method (or only in very exceptional cases).

Hence, although there are no explicit Swiss rules on transfer pricing, the principles to be observed in Switzerland are similar to those of other OECD Member States.

With respect to inter-company loans, the FTA publishes yearly, by way of a circular letter, rules regarding loans and advances between related parties. Thus, maximum rates are stipulated regarding loans from the shareholders to the company and minimum rates regarding loans from the company to the shareholders and related parties.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Corporate profits are taxed at the federal as well as at the cantonal level.

Corporate profits tax is itself deductible from the taxable corporate profits. Therefore, the statutory rates are higher than the effective tax rates.

At the federal level, the statutory corporate profits tax rate is 8.5%, corresponding to an effective tax rate of 7.83%.

The cantonal tax rate varies from canton to canton. A corporation is liable to corporate profits tax in each canton where it has a permanent establishment or a piece of real estate. Some cantons foresee a progressive tax rate, others foresee a flat rate. In addition to this initial tax rate, most of the cantons foresee cantonal and communal tax multipliers. These multipliers vary from year to year depending on the financial needs of the local authorities.

In 2009, effective corporate profits tax rates were (federal, cantonal and communal tax included):

- Zurich 21.17%.
- Geneva 24.23%.
- Zug 15.79%.

It should be noted that in each canton, special tax relief, which can significantly reduce the above rates of taxation, may be granted. This is especially the case for so-called auxiliary companies. Also, special rules apply to holding companies.

4.2 When is that tax generally payable?

The tax year is the business year. The basis for corporate taxation is the applicable accounting period, which may end at any date within a calendar year. During the year, companies will pay provisional instalments on the basis of the tax return of the previous year. If the amount of taxes so collected is lower than the final tax due, the difference will bear interest.

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4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base is the annual profit as reported in the commercial accounts. This tax base is subject to various adjustments such as depreciation, provisions and expenses which are not commercially justified.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

At both federal and cantonal levels, tax laws provide for the possibility of carrying forward losses for seven years. It should be noted that in certain circumstances such carry forward may also be used in mergers and similar operations.

In addition, interest paid on hidden equity (see question 3.4 above) is not tax-deductible.

4.5 Are there any tax grouping rules? Do these allow for relief in Switzerland for losses of overseas subsidiaries?

There are no tax consolidation rules with regard to corporate tax. Thus, each company is taxed as a separate tax payer. Mergers and other transactions of two or more companies are disregarded, if the only goal is to combine the tax base of the companies involved and to set off taxable profits with losses of other companies.

There is an exception with regard to VAT: A VAT group consisting of closely associated legal entities, partnerships and individuals who have their domicile or corporate seat in Switzerland can be treated as a single tax-liable entity for VAT purposes. As a consequence, intra-VAT group transactions are not subject to Swiss VAT (even if accounted by the VAT group leader).

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Whether profits are retained or distributed, they are subject to the same annual income and capital tax (capital tax is levied at cantonal and communal level only). However, the Corporate Tax Reform II introduced the option for cantons to choose to credit corporate income taxes to the capital levied in their territory (see question 4.8 below). When the company distributes its profits, it must withhold a 35% withholding tax, which is fully or partly refundable depending on the country of residence of the beneficiary. To allow for a tax-neutral repayment of excess capital to the shareholders, the Corporate Tax Reform II introduces a change from the so-called nominal value principle to the capital contribution principle, according to which the repayment of the capital reinvested by the shareholders is also tax free at the level of the shareholders. This also applies to share premiums or additional contributions. This rule will come into force as per 2011. Only distributed profits remain subject to dividend taxation.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There may be, at the cantonal level, certain other taxes payable depending on the canton. Thus, certain cantons may levy a tax on real estate situated in such cantons. In the canton of Geneva, there is a "professional tax" which is calculated as a percentage of turnover, rent paid and number of employees.

4.8 Are there any local taxes not dealt with in answers to other questions?

The Swiss cantons levy a so-called capital tax. This tax is based on the corporation's net equity (i.e. paid-in capital, open reserves and retained profits). The amount which is subject to tax may also be increased by the debt re-characterised as equity in the application of the Swiss thin capitalisation rules (see question 3.4 above). The rate of tax varies from one canton to another, but it generally does not exceed 1%. Some cantons foresee a different tax rate for holding companies or other tax-privileged companies. For example, in Geneva the maximum rate of tax is 0.2% and for holding companies only 0.03%. Again, cantonal and communal multipliers will apply.

The Corporate Tax Reform II introduced an improvement in this regard, as the cantons may opt for crediting corporate income taxes to the capital taxes levied in their territory. Hence, companies generating enough profit will not have to pay capital tax additionally. Loss-making or only low profit-making companies continue to be subject to capital tax (to some extent). Once again this new federal rule provides only a possibility for the cantons which they will then have to integrate into their legislation.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

With two exceptions, which will be dealt with hereunder (participation reduction and replacement of certain assets), there is no special set of rules for taxing capital gains realised by legal entities. Hence, as a principle, capital gains form part of taxable profit; capital losses are tax deductible.

In certain cantons special rules apply to capital gains arising from the sale of real estate. Such capital gains may be taxed separately from other income of the company; i.e. regardless of the profit of the company.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

All income (including capital gains) earned by a company is taxed as business income. The only exceptions to that rule are the realisation of a capital gain on a qualifying participation (see question 5.3 below) and the capital gain on real estate (see question 5.1 above).

5.3 Is there a participation exemption?

If a corporation realises a capital gain on the sale of a qualifying participation, it is entitled to a participation reduction.

a. Capital gains for which relief is available

To qualify for relief on capital gains, a Swiss company must make a profit on the sale of a participation which represents at least 10% of the share capital of another company which it has held for at least one year. It should be noted that if a company is a registered venture capital company, the relief is available if the participation represents 5% of the share capital of another company.

Losses incurred as a result of the sale of qualifying participations remain tax deductible.

A capital gain is defined as the difference between the proceeds

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from the sale of a qualifying participation and the acquisition cost of the investment. Hence, any amount of previously tax-deductible depreciation or provision on the participation is not taken into consideration to calculate the amount of gain which can benefit from the relief. In addition, revaluation gains from participations do not qualify.

Favourable tax treatment is also available for qualifying participations transferred to group companies abroad; the group holding or sub-holding company must be incorporated in Switzerland.

b. Calculation of tax relief

Companies with qualifying capital gains may reduce their corporate income tax by reference to the ratio between net earnings on such participations and total net profit. The following formula must be applied in each tax period to determine the amount of the tax relief available:

Tax relief = A x B / C

Where:

A= Corporate income tax;

B= Net qualifying capital gain; and

C= Total net profit.

The amount of net qualifying capital gain is determined as follows:

= Gross qualifying capital gain

– (Financing costs + administrative costs)

Financing costs are defined as interest on loans and other costs which are economically equivalent thereto. They are generally attributed to qualifying capital gains by reference to the ratio between the book value of the qualifying participation and total assets.

Administrative costs are usually fixed at 5% of gross dividend income (unless actual proven administration costs are lower).

5.4 Is there any special relief for reinvestment?

According to the provisions of the new Merger Law, a company can transfer certain business assets and investments to Swiss group companies without realising capital gains. Hence, hidden reserves available on such assets can be rolled over. In addition, in some cantons hidden reserves available on real estate can be rolled over to a new piece of real estate replacing the original piece sold (i.e. the capital gain is not taxed, but can be deferred for tax purposes in the case of replacement of certain pieces of real estate). Finally, in the canton of Geneva, the gain realised on real estate is subject to the special tax, but the amount is then credited against the tax on corporate profits.

Cantons that subject corporations to this special tax foresee the tax deferral on real estate by analogy to the generally applicable set of rules. Therefore, the tax deferral is available, whether or not the capital gain is taxed according to the special tax or the corporate profit tax.

The Corporate Tax Reform II foresees an extension of the replacement purchase. The profit generated by the sale of a production facility remains tax-free if it is reinvested to purchase a replacement. In the future, this will apply even if the operating asset serves a different purpose than the production facility sold. This rule will enter into force on January 1, 2011.

Finally, capital losses are recognised immediately, whether or not the company acquires similar assets in replacement.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

Securities issuance tax is levied upon creation or increase of the par value of participation rights (see question 2.1 above). The participation right can take the form of shares of Swiss corporations, LLCs, cooperatives, as well as profit-sharing certificates and participation certificates. A contribution to the reserves of the company (even though the share capital is not increased) made by the shareholders as well as the transfer of the majority of shares of a Swiss company that is economically liquidated, are also subject to the tax. The securities issuance stamp tax is levied at a flat rate of 1%. It is only levied to the extent that the share capital of the company exceeds CHF 1 million. Special rules apply when shares are newly issued in the course of reorganisations, mergers, spin-offs and similar transactions. Such types of transaction are normally exempt from the 1% tax.

Securities issuance tax is not levied on the capital allocated to a branch.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no such other significant taxes or fees, but notary fees on the notarisation of the articles of incorporation would become due.

6.3 How would the taxable profits of a local branch be determined?

A foreign entity is liable to Swiss corporate tax on income and capital attributable to the Swiss permanent establishment. In general, taxable income of permanent establishments is determined on the basis of its separate financial statements as if it were a corporate entity separate from its head office (direct method).

In the past, the indirect method has been preferred for both the determination of taxable income/capital of domestic permanent establishments of foreign companies and of taxable income/capital of foreign permanent establishments of Swiss companies. Accordingly, Swiss double taxation treaties normally contain a corresponding reservation in favour of the indirect method.

Special rules apply with respect to profit allocation of permanent establishments of banks and insurance companies.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

A branch is subject to the same profits tax and capital tax as a Swiss company, i.e. there is no special branch profits tax.

There is no withholding tax or other special tax on profit repatriations from the branch to its head office.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A branch would not benefit from any tax provisions of tax treaties entered into by Switzerland as it is not a resident of Switzerland, pursuant to Swiss domestic law.

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6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

The remittance of profits by a Swiss branch to a foreign head office is not subject to withholding tax or any other tax.

7 Anti-avoidance

7.1 How does Switzerland address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

In Switzerland, there are very few written and specific anti-avoidance rules, but it is the general principle of abuse of law or tax evasion that applies. In order to remove the uncertainties regarding the tax consequences of a planned transaction (the abuse of law concept is very large), the tax payer may request an advanced tax ruling. The tax administrations are prepared to discuss in advance specific questions (law or facts) on taxation. While doing this, the tax consequences of the planned activities can be defined in a binding tax ruling - the principle of protection of good faith applies.

Aggressive tax planning is generally admitted by Swiss tax law provided that the tax payer does not commit an abuse of law or tax evasion (which is not a criminal offence). According to the tax evasion concept, a structure or a transaction may be disregarded and the tax treatment assessed according to the economic situation underlying the transaction, as far as the following three cumulative conditions are met: i) the form chosen by the taxpayer is unusual; ii) the form has been chosen only for tax purposes (tax savings); and iii) the tax payer would make significant tax savings in the hypothesis in which the structure was recognised by the tax authorities. Provided that these three conditions are met, the tax authorities disregard the form chosen and used by the tax payer and re-qualify the transaction from an economic point of view. This approach is very similar to the substance over form theory. In addition to that, even though the form is not abusive, the tax authorities may disregard it in the cases where the tax law explicitly refers to economic concepts (e.g. the concept of fringe benefits).

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Taiwan

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Taiwan?

Taiwan has entered into tax treaties with 18 jurisdictions as of 18 October 2010.

1.2 Do they generally follow the OECD or another model?

These tax treaties generally follow the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

No. Article 124 of the Income Tax Act prescribes that, where there are special provisions under a tax treaty between Taiwan and a foreign country, such special provisions shall apply. Hence the provisions under these tax treaties supersede and need not be incorporated into Taiwan laws and regulations before they take effect.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Except for a few exceptions such as that with the UK, most of the tax treaties that Taiwan has entered into do not contain anti-treaty shopping rules.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No. Once a tax treaty takes effect, the provisions thereunder supersede Taiwan laws and regulations.

2 Transaction Taxes

2.1 Are there any documentary taxes in Taiwan?

The execution of certain documents in Taiwan is subject to stamp tax. These documents include: (i) receipts for monetary payments in the form of cash; (ii) deeds for sale of movables; (iii) agreements for the performance and completion of specific works or tasks; and (iv) deeds and agreements for sale, gratuitous transfer, partition or exchange of real properties or real property mortgage for submission to the authorities for registration.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

There are two types of business tax: value-added tax ("VAT"), and gross business receipts tax ("GBRT").

Currently, businesses in financial industries are subject to GBRT at 2% of income generated from their exclusively authorised businesses and 5% of income generated from their non-exclusively authorised businesses.

Businesses in industries other than financial industries are subject to VAT at 5% of the sales amount, and 0% or no VAT under certain circumstances.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The sale of goods and provision of services within Taiwan as well as the importation of goods are subject to business tax, which is payable by sellers and service providers, unless the law provides otherwise. For example, the sale of land, securities that are subject to securities transaction tax, and financial derivative products, is exempt from business tax.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

GBRT paid is deductible as cost against the GBRT operator's taxable income.

VAT in general is recoverable but not in full. The VAT paid by a VAT operator under certain circumstances may not be offset against its VAT payable, such as where the required documents could not be provided; where the goods or services purchased are not for use in business operation (unless they are for qualified donations); and where the goods or services purchased are for entertainment purposes, employee benefits, and so on.

2.5 Are there any other transaction taxes?

Securities transaction tax ("STT") is imposed on the sale of securities unless otherwise exempt. The term ''securities'' includes shares and debentures issued by companies and other securities approved by the government for issuance to the public. The rate of STT applicable to share transactions is 0.3% and that to debenture

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transactions and transactions of other securities approved by the government for issuance to the public is 0.1% of the transaction price. However, corporate bond and finance bond transactions are exempt from STT for seven years from 1 January 2010 till 31 December 2016.

Futures trading tax is levied on both the buyer and the seller of a futures transaction.

Gains realised from the sale of a piece of land are exempt from income tax, but are subject to land value increment tax, which is calculated based on the increment in value during the period from the date of purchase to the date of subsequent sale.

Registration fee in an amount equivalent to 0.1% of the sum of (i) the declared land value (usually, 80% x the government-published land value of the land), and (ii) the government-assessed value of the building, is payable, usually by the purchaser, upon registering the transfer of the titles to the land and building.

Deed tax on a building is payable by the purchaser at 6% of the building's government-assessed value, which is usually lower than the cost of constructing the building as well as the actual purchase price, and depreciates every year after its construction.

2.6 Are there any other indirect taxes of which we should be aware?

Commodity tax is levied on certain selected commodities (including rubber tires, cement, beverages, flat-glass, oil and gas, electrical appliances and vehicles), whether imported into or made in Taiwan. Commodity tax is payable by the importer or local manufacturer.

Taiwan adopts the Customs Cooperation Council Nomenclature ("CCCN") for levying customs duty. A consignee (or the holder of the bill of lading) of the imported goods is responsible for paying the customs duty on the goods imported into Taiwan. The customs duty payable is calculated based on the transaction price of the imported goods, which denotes the price actually paid or payable for the goods when sold for export to the importing country. The customs may adjust the transaction price declared if it deems it unreasonably low.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Yes. In general, when distributing dividends to a non-Taiwan tax resident shareholder, the Taiwan tax resident company should withhold income tax at 20%, or a lower rate if such is provided under a tax treaty.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes. In general, when paying royalties to a non-Taiwan tax resident licensor, the Taiwan tax resident company should withhold income tax at 20%, or a lower rate if such is provided under a tax treaty.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes. In general, when paying interest to a non-Taiwan tax resident licensor, the Taiwan tax resident company should withhold income tax at 20%, or a lower rate or 0% if such is provided under a tax treaty or other regulations.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

While there is no thin capitalisation rule yet, the Legislative Yuan (lawmakers) have completed the first reading of the amendment of the Income Tax Act, which incorporates the thin capitalisation rule therein. Such amendment will become law after the Legislative Yuan completes the second and third reading, which is expected to be conducted this year.

While there are no thin capitalisation rules, interest on loans that are not for business operations cannot be treated as a tax-deductible expense. Moreover, if the interest rate on a loan extended by a non-financial institution exceeds the highest rate set by the Ministry of Finance each year (15.6% per annum or 1.3% per month for 2010), the amount of interest exceeding such rate cannot be treated as a tax-deductible expense.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

This is not applicable in Taiwan.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

This is not applicable in Taiwan.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

In general, interest expenses that are attributable to ordinary or auxiliary operations are deductible regardless of whether the interest is paid to a Taiwan tax resident or a non-Taiwan tax resident, provided that it complies with other regulations. For example, the rate at which such interest is charged does not exceed the maximum interest rate (15.6% per annum or 1.3% per month for 2009), and the required supporting documents are available.

3.8 Does Taiwan have transfer pricing rules?

Yes. Taiwan has transfer pricing rules, which were promulgated on 1 January 2005 and are in line with the Guidelines of the Organisation of Economic Cooperation and Development in general.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Corporate income tax is levied at 17% on the portion of annual taxable income exceeding NT$120,000 (approximately US$4,000). In any event, the corporate income tax payable shall not exceed one-half of the portion of taxable income exceeding NT$120,000.

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4.2 When is that tax generally payable?

For a company with a calendar tax year, it should pay provisional income tax in September of the current tax year, and the final income tax payable in May of the following year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Corporate income tax is payable on a company's taxable income, which is the net profits pursuant to commercial accounts, subject to adjustments under tax laws.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Certain incomes that are recorded under commercial accounts are not subject to income tax. For example capital gains from the sale of securities issued by Taiwan companies and dividends received from Taiwan companies.

Certain expenses that are recorded under commercial accounts are not deductible for income tax purposes under certain circumstances. For example, the entertainment expenses exceed the tax allowance, the lack of or insufficient documents evidencing the expenses, the expenses are not for operating business, and so on.

4.5 Are there any tax grouping rules? Do these allow for relief in Taiwan for losses of overseas subsidiaries?

Tax grouping rules apply only to wholly-owned subsidiaries that are incorporated under Taiwan law and where consolidated income tax returns are filed. In addition, losses of a Taiwan company's overseas subsidiaries do not provide any relief to their Taiwan parent company, as a Taiwan company can only recognise the losses of an overseas subsidiary when the latter reduces its capital to make up its losses, or dissolves and liquidates.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No. Tax is not imposed at a different rate upon distributed, as opposed to retained, profits. However, if a company does not distribute its after-tax earnings by the end of the year following the year in which such earnings were generated, undistributed earnings tax ("UET") will be imposed at 10% of such after-tax earnings. The UET paid will further reduce the retained earnings available for future distribution by the company. When the company declares dividends out of retained earnings on which 10% UET has been paid, a proportionate amount of the 10% UET (up to 10% of the gross amount of the dividends declared) can be offset as a credit against the income tax that should be withheld upon distributing the dividends to foreign shareholders of the company.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Other national taxes include tobacco and alcohol tax, and mine concession tax.

4.8 Are there any local taxes not dealt with in answers to other questions?

Yes, land tax, hence tax, vehicle licence tax, and amusement tax.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains from the sale of securities issued by Taiwan companies are exempt from income tax; while capital losses incurred therefrom are not tax-deductible.

Capital gains from the futures transactions that are subject to futures transaction tax are exempt from income tax; while capital losses incurred therefrom are not tax-deductible.

Capital gains from the sale of a piece of land are exempt from income tax, but are subject to land value increment tax (question 2.5 above); while capital losses incurred therefrom are not tax-deductible.

All other capital gains generated by Taiwan companies are taxable; while losses are deductible.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Except for capital gains from the sale of securities, futures or a piece of land, as advised in question 5.1 above, all other capital gains should be consolidated into other taxable income when filing annual income tax return and subject to income tax accordingly.

5.3 Is there a participation exemption?

Taiwan has no participation exemption rule.

5.4 Is there any special relief for reinvestment?

Taiwan has no relief for reinvestment. However, dividends received by a Taiwan company from an invested company in Taiwan are not subject to income tax.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No tax is payable upon the formation of a subsidiary.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

A Taiwan incorporated subsidiary and a Taiwan branch of a non-Taiwan tax resident company are both subject to Taiwan income tax for their taxable income; whereas the former is subject to tax for its worldwide income, and the latter is subject to tax for its Taiwan-sourced income.

As advised in our answer to question 4.6 above, if a company does not distribute its after-tax earnings by the end of the year following the year in which such earnings were generated, undistributed

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earnings tax ("UET") will be imposed at 10% of such after-tax earnings. A Taiwan branch of a non-Taiwan tax resident company is, however, not subject to UET.

6.3 How would the taxable profits of a local branch be determined?

A Taiwan branch's taxable profit is arrived at by deducting all deductible costs and expenses incurred in generating Taiwan-sourced income, from such income.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

A Taiwan branch of a non-Taiwan tax resident company is not subject to any income tax other than corporate income tax, as explained in our answer to question 6.2 above.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

No. A Taiwan branch of a non-Taiwan tax resident company is deemed the permanent establishment ("PE") of the latter in Taiwan. While tax treaties generally provide tax exemption for business profit generated by a non-Taiwan tax resident company that is incorporated in a treaty jurisdiction, income attributable to its PE is taxable.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

The repatriation of profits by a Taiwan branch to its foreign head office is not subject to any tax in Taiwan.

7 Anti-avoidance

7.1 How does Taiwan address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

While there is no specific provision under Taiwan tax law on anti-tax avoidance, the substance-over-formality principle was incorporated into the Tax Collection Act on 13 May 2009. Accordingly, the tax collection authority makes tax assessments based on, among others, actual economic relationships, benefits and interests.

In addition, Article 66-8 of the Income Tax Act stipulates that, in the event that any individual or profit-seeking enterprise is found to have evaded or improperly reduced his/her/its/another's tax burden by transferring shareholding or through any other false arrangements, the tax collection authorities may, with the approval of the Ministry of Finance and based on the information obtained during investigation, make necessary adjustment(s) on the dividends, surplus earnings or tax credit that should have been received or is receivable by such individual or profit-seeking-enterprise.

Article 42 of the Enterprises Mergers and Acquisitions Act prescribes that, if a company and its subsidiary, or a company or its subsidiary and a Taiwan or foreign individual or entity, evade or reduce tax obligation through any irregular transactional arrangements, or evade or unlawfully reduce tax obligation of another or itself/himself/herself through an acquisition of shares, transfer of property or any other fraudulent arrangements, the tax collection authorities may, with the approval of the Ministry of Finance, make adjustment(s) based on regular transactional practices and/or verified information in order to assess the correct income and tax payable.

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- Labour: Representing multi-national companies in handling employee transfer in connection with business acquisition and spin-off; and handling dispute in relation to employment.

Lee and Li is the largest law firm in Taiwan with a team of around 650 professionals and support staff. It has 28 practice groups which provide in-depth advice, sophisticated legal solutions, and wide services.

Lee and Li's Tax Practice Group consists of local and foreign licensed attorneys and CPAs. These tax specialists provides a full range of tax services, and are experienced in identifying and resolving tax issues concerning various industries and transactions for regulatory compliance, while satisfying clients' commercial interests. They regularly advise on tax matters in connection with cross-border investments, mergers and acquisitions, technology licensing, investment tax credit, administrative remedies, and so on. A number of international publications have named Lee and Li as one of the best tax firms in Taiwan.

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Thailand

Hatasakdi Na Pombejra

HNP Counsellors Limited – Taxand Thailand

Chinapat Visuttipat

1 General: Treaties

1.1 How many income tax treaties are currently in force in Thailand?

As of August 2010, Thailand has 54 income tax treaties in force with the following countries: Armenia, Australia, Austria, Bahrain, Bangladesh, Belgium, Bulgaria, Canada, Chile, China, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Great Britain and Northern Ireland, Hong Kong, Hungary, India, Indonesia, Israel, Italy, Japan, Korea, Kuwait, Laos, Luxembourg, Malaysia, Mauritius, Nepal, Netherlands, New Zealand, Norway, Oman, Pakistan, Philippines, Poland, Romania, Russian, Seychelles, Singapore, Slovenia, South Africa, Spain, Srilanka, Sweden, Switzerland, Turkey, Ukraine, United Arab Emirates, United States of America, Uzbekistan and Vietnam, and 3 treaties not yet in force with Brunei, Ireland and Kenya. In addition, Thailand has completed the treaty negotiation process with 5 countries, while another 13 countries are in the negotiation process.

1.2 Do they generally follow the OECD or another model?

Thai treaties generally follow both the the OECD and United Nation Model. For example, most of the Thai treaties with OECD countries include assembly project or supervisory activities in connection with the project and the furnishing of services in the PE definition. However, the actual treaties are often customised to suit the economic, trade, investment situation, and tax system in Thailand.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

The tax treaty has to be incorporated into Thai law by way of a statutory instrument. A treaty will then enter into force from the date determined by the treaty, e.g. on the date of exchange of instruments of ratification. A treaty will have effect in relation to each tax covered from the dates specified by the treaty.

1.4 Do they generally incorporate anti-treaty shopping rules (or “limitation of benefits” articles)?

In general, Thailand does not have anti-treaty shopping or limitation of benefits rules in its treaties, however, it is included in some treaties with OECD countries.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Thai laws grant the Thai tax exemption or reduction according to the tax treaty entered into or to be entered into between the Government of Thailand and a foreign government. Therefore, practically, when there is a transaction between a Thai person/entity and a foreign person/entity residing in a country which has a tax treaty with Thailand, the provision of the tax treaty will be applied instead of the Thai laws.

2 Transaction Taxes

2.1 Are there any documentary taxes in Thailand?

Stamp Duty (SD) is levied on the execution of 28 different types of documents or instruments specified in the SD schedule in the Revenue Code (RC) at varying rates. The following are examples of some common instruments and rates: a lease agreement for immovable property at 0.1% of the total rental or other payment under agreement; a hire-of-work agreement at 0.1% of the total service fee; a loan agreement at 0.05% of the total amount of the loan (capped at THB 10,000); and a share transfer instrument at 0.1% of the paid-up value of shares or a nominal value of the instrument, whichever is greater. An instrument which is executed outside Thailand is subject to SD if it is brought into Thailand at a later date.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Thailand has implemented the VAT system since 1992. Currently, there are two VAT rates:

- The zero-rate of VAT is 0% (e.g. exports of goods, provisions of services that are used abroad, international air or sea transportation services).
- The statutory rate of VAT is 10%. However, the current rate is 7%. This is a reduced rate for a temporary period under the special Royal Decree. Unless the period is further extended the rate will revert to 10% on 1 October 2012. This rate applies to any imports of goods or sales of goods or provisions of services not subject to a 0% rate or exempt.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

VAT is not charged on all transactions. Some key examples of VAT-

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exempted transactions are:

- Businesses subject to specific business tax (SBT). Please see more details below in question 2.5.
- Leasing of immovable property.
- Sale of agricultural produce, animals and animal products (except canned foods).
- Sale of newspapers, periodicals and textbooks.
- Hospital, auditing and litigation services.
- Domestic transport of all types unless domestic air transport is eligible to register for VAT purposes.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input VAT is only creditable by a VAT operator (a person who is registered for VAT). In principle, the input VAT on purchases of goods or services related to the business of registered VAT operators may be credited in full against output VAT.

Input VAT incurred to make VAT-exempted transactions or not related to VAT business is not creditable at all. In case the input VAT is incurred for both taxable and VAT-exempted transactions and cannot directly attributable to either one of them, such input VAT must be apportioned between these transactions, i.e. according to the ratio of transactions subject to VAT to total transactions expressed as percentage.

Some examples of unclaimable input VAT include: input VAT on entertainment; input VAT under tax invoices issued by a person not authorised to do so; or input VAT with substantially incomplete or incorrect information in tax invoices.

2.5 Are there any other transaction taxes?

Specific Business Tax (SBT) is levied on certain services, especially in the financial service sectors. SBT was introduced at the same time as VAT. SBT is collected on gross revenue at the varied fixed rates. Any persons (natural or juristic person, government agencies or cooperatives) who are conducting transactions with a financial services nature in the regular course of business are required to register as SBT operators. The following are businesses subject to SBT and applicable rates:

- Commercial banking, financial and credit foncier business 3.3%
- Factoring 3.3%
- Life insurance 2.5%
- Sale of immovable properties 3.3%
- Sale of securities in the stock exchange 0.1% (currently exempt)
- Transactions similar to commercial banking 3.3%

Note that the above rates including the municipal tax of 10% of the SBT.

In addition, a sale of immovable properties (i.e. land, house and condominium) transaction would be subject to the transfer fee at 2% of the appraisal value and is payable by transferor and transferee at 1% each unless agree otherwise.

2.6 Are there any other indirect taxes of which we should be aware?

Customs duties are generally imposed on goods imported into Thailand. Classification of imports is based on the Harmonised Commodity Description and Coding System (so-called “Harmonised System”). The value of imports is based on their CIF. The duties range between 0% and 80% (the rate may be reduced or exempt subject to a relevant Free Trade Agreement).

Excise taxes are imposed on particular class of goods, whether manufactured locally or imported (e.g. liquor, beverages, cigarettes containing tobacco, cosmetic and perfume products, electrical appliances, motor vehicles and boats, fuel oil, etc.). Excise rates are based on *ad valorem* or a specific rate, whichever is higher.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

A withholding tax (WHT) is imposed on dividends paid by a Thai resident company (a company which is incorporated in Thailand) to a non-resident at the rate of 10%. Note that there is a dividend exemption but they are provided only to a Thai company which receiving dividends from another Thai company, provided that certain thresholds are met.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

A WHT is imposed on royalties paid by a Thai resident company or a Thai resident individual (an individual who is staying in Thailand for more than 180 days) to a non-resident at the rate of 15%. The definition of royalty under the Thai RC includes a fee of goodwill, copyright or any other rights. Note that the WHT rate may be reduced under the applicable tax treaties.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

A WHT is imposed on interest paid by a Thai resident company or a Thai resident individual to a non-resident at the rate of 15%. The definition of interest under the Thai RC includes interest on a bond, a deposit, debenture, bill, and loan, whether with or without security, or the difference between the redemption value and the selling price of a bill or a debt instrument issued by a company and sold for the first time at a price below its redemption value, or income assimilated to interest, benefit or other consideration derived from the provision of a loan or from a debt-claim of every kind whether with or without security. Note that the domestic WHT on certain interest payments to certain non-resident recipients may be exempted under the Thai RC. In addition, the WHT may be exempted or reduced under the applicable tax treaties.

3.4 Would relief for interest so paid be restricted by reference to “thin capitalisation” rules?

At present, Thailand has no “thin capitalisation” rules.

3.5 If so, is there a “safe harbour” by reference to which tax relief is assured?

This is not applicable in Thai law.

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3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

This is not applicable in Thai law.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

In general, under the Thai RC, interest payments can be used as deductible expenses for corporate income tax (CIT) computation purpose if they are incurred for the purpose of business activities or for profit-generating activities of a company in Thailand.

However, Thailand has foreign exchange regulations issued by the Bank of Thailand to control the interest payments by a local company to a non-resident. In addition, Thai investment promotion laws provide rules concerning the debt to equity ratio to be limited at not more than 3:1.

3.8 Does Thailand have transfer pricing rules?

Although, there are no specific transfer pricing tax laws in Thailand, a transfer pricing concept has long been applied by Thai tax authorities through the CIT provisions, e.g. the authority has power to reassess the value of a transaction if the transfer of an asset, provision of service or loan was charged without a consideration or with a consideration lower than the market price without reasonable cause.

In addition, Thailand has two transfer pricing guidelines which were announced in May 2002 and recently in May 2010. Both are not law but a guideline to tax authorities and Thai taxpayers in relation to the transfer pricing concept. The first guideline, namely the Departmental Instruction Paw 113/2545, provides guidance for the determination of the transfer price based on market prices, methodologies acceptable to the Revenue Department (RD) and a list of 10 documentation requirements which should be requested from the taxpayer when a transfer price of inter-company transactions is suspected. The second guideline is called "Guidance on APA Process". Its intention is to provide a guideline for a Thai taxpayer who wishes to file a bilateral APA application with the Thai RD. It is also important to note that although Thailand is not a member of the OECD, the transfer pricing concept applied in Thailand generally follows the OECD Transfer Pricing Guidelines.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of CIT is currently 30% of net profits. The tax on gross receipts of 3% is applied to the international transportation by a foreign carrier. For SME companies with paid-up capital of not more than THB 5 million, CIT is paid at progressive rates ranging from 15 – 30%. In addition, CIT rate can be reduced to 10% for regional operating headquarters set up in Thailand provided the conditions specified by the Thai RD are met.

4.2 When is that tax generally payable?

CIT is paid twice a year. A half-year tax return must be filed (due and payable) within two (2) months after the end of the first six (6) months of the accounting period. An annual tax return must be filed (due and payable) within 150 days from the closing date of the company's accounting period. The tax year for a company is its accounting period, which shall be of twelve (12) months' duration.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In principle, corporate income or profit is taxed based on the commercial accounts subject to tax adjustment, specified under Section 65 *bis* and *ter* of the Thai RC. Net profit must be computed on the accrual basis with certain exceptions. For a half-year return, tax to be paid must be based on one-half of the estimated annual profit (no audited financial statements need to be submitted). The taxes already paid at the half-year can be used as a credit for annual tax to be paid (audited financial statements must accompany the tax return).

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Under the Thai RC, certain income which is not shown (or shown) in the commercial accounts may (not) be regarded as income or profits for tax computation purposes and certain expenses which are based on the commercial accounts may not be allowed as tax deductible expenses and must be adjusted for tax computation purposes.

For example, a dividend received by a Thai resident company from another Thai resident company (provided that certain thresholds are met) is included in the commercial accounts but for the tax account it is excluded because of a dividend exemption provision or any expenses incurred for the purposes of business activities outside Thailand are not tax deductible even they are treated as expenses for commercial accounts, and hence must be added back for tax computation purpose.

4.5 Are there any tax grouping rules? Do these allow for relief in Thailand for losses of overseas subsidiaries?

At present, there is no group taxation or group relief in Thailand. However, please note that there is a discussion on the idea to allow for relief in Thailand for losses of overseas subsidiaries.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

When the net profits after 30% CIT is distributed as dividends, a 10% WHT is imposed. There is no tax imposed on the retained profits.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Generally, all tax being imposed in Thailand is national taxes. However, certain taxes are collected by a local authority. Please see the details in question 4.8 below.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are other taxes including local development tax, house and land tax (HLT) and signboard tax, which are imposed by a local authority, namely the municipality. Local development tax is based on the value of the land and ranges from between 0.25% to 0.95% annually. HLT is imposed on the owner of lands or buildings (except for owner-occupied residences) at the rate of 12.5% of the actual or imputed

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annual rental value of property. Signboard tax is imposed annually at varied rates, depending on the size of the board and the language used in the board, on the signs or billboards which display a name or trademark or product for the purpose of business advertising. These local taxes are deductible expenses for CIT purposes.

Please note that, local development tax and HLT is expecting to be replaced by the new property tax. The proposed Act has been approved by the cabinet and is currently in the process of public hearing. The Draft Act contains a new tax of 0.5% of land and buildings used for commercial purposes, 0.1% of land and buildings used for residential purposes and 0.05% of land used for agricultural purposes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Under the Thai RC, a CIT is chargeable on all profits (losses) derived by a company from or as a consequence of carrying on business, which includes both income and capital gains. In other words, there is no special set of rules for taxing capital gains and losses. Generally, losses arising from or as a consequence of carrying on a business can be carried forward for five (5) accounting periods for offset against future profits from all sources.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

A CIT is imposed on all profits of a company at the same rate of 30% of net profits. However, capital gains paid to non-resident company are subject to final WHT at 15% on gross payment, unless exempted under certain Thai tax treaties.

5.3 Is there a participation exemption?

There is no participation exemption for capital gains in Thailand.

5.4 Is there any special relief for reinvestment?

There is no special relief for reinvestment under the Thai RC.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There is no capital duty or other taxes imposed on the formation of a subsidiary in Thailand.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

A Thai resident subsidiary is subject to CIT on all profits derived from both domestic and foreign sources, while a Thai branch of a foreign company is subject to Thai CIT on profits arising from or as a consequence of the business carried on in Thailand. A Thai CIT is imposed on a non-resident company only where such non-resident company is carrying on business in Thailand through a permanent establishment (PE) in case a tax treaty is applied.

However, please note that, the term "carrying on business in Thailand" under the Thai RC is broad and has wider scope than a PE. It includes the presence of an employee, representative or go-between, that result in the foreign company deriving income, profits or gains in Thailand.

6.3 How would the taxable profits of a local branch be determined?

As previously mentioned above in question 6.2, the taxable profits of local branch of a non-resident company is, determined on the same basis as a Thai company, the net profits arising from or as a consequence of the business carried on by a branch in Thailand only, taking into account relevant expenses incurred exclusively for the purpose of acquiring profits or for the purpose of the branch's business in Thailand. In addition, expenses made by a foreign head office or foreign branch can be allocated to a Thai branch only if it complies with rules, procedures and conditions specified by the Thai RD. Under the Thai tax treaties, subject to any provisions to the contrary, the taxable profits of a PE are determined based on either the attributable principle or a force of attraction principle, depending on the relevant treaties.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

A branch of a non-resident company is subject to CIT at the normal rate of 30% on locally-earned profits only.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A Thai branch of a non-resident company is not entitled to use the tax treaties concluded by Thailand and therefore cannot claim any treaty relief. This is due to the fact that a branch is not regarded as a Thai resident company and hence is not covered by the tax treaty. A company would be a Thai resident company if it is incorporated under the laws of Thailand. Additionally, the unilateral tax relief is also not provided to a branch of a non-resident company.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Branch profits remitted to the foreign head office are subject to WHT of 10%. Remittance of profits shall be deemed to include the following:

(1) disposal of profits or other type of money that is set aside from profits or is deemed to be profits from profit and loss accounts or another book of accounts in order to settle debt or to set off against liability or to enter as a credit in an account of any person abroad;

(2) in case where the fact in (1) not applicable, there is a request to purchase and transfer foreign currency which is profit or other money that is set aside from profits or is deemed to be profits disposed abroad; or

(3) any other action which results in (1) or (2).

7 Anti-avoidance

7.1 How does Thailand address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is no general anti-avoidance rule or a disclosure rule provided

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under the Thai RC. However, the Thai tax authorities have applied the transfer pricing concept to prevent tax avoidance on certain transactions through the CIT provisions. Please see the answer to question 3.8 above for more details. Other provisions often applied by tax authorities to prevent tax avoidance would be, for example, treating certain expenses as non-deductible for CIT purpose, e.g. private expenses and gifts, artificial or fictitious expenses, any expense determined on and payable out of the profits after the end of accounting period, etc.

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Ukraine

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Ukraine?

As of 15 October 2010, Ukraine has 67 income tax treaties in force. Four of these treaties, those with Cyprus, Spain, Malaysia and Japan, were entered into with the USSR and are still applied by Ukraine as a legal successor of the USSR. 63 of the treaties were entered into by Ukraine, including two new Ukrainian treaties that came into force at the end of 2009 and 2010 with Singapore and Libya (the provisions of the Ukraine-Libya Tax Treaty will only be applicable in Ukraine starting from 1 January 2011). New treaties with Cuba and Pakistan have been ratified by Ukraine, but have not yet entered into force, and a treaty with Luxemburg has been signed but not yet ratified by Ukraine (ratification is not presently under consideration).

On 21 February 2007, the previous Ukrainian Government authorised the Ministry of Finance of Ukraine to conclude a new double tax treaty between Ukraine and Cyprus to replace the USSR-Cyprus treaty that is still being applied by Ukraine, and a text for this new treaty was apparently agreed in negotiations, though it has not yet been signed or officially published. It is unclear how actively the new Ukrainian Government, that took office in March 2010, will pursue execution and adoption of this new Cypriot-Ukrainian treaty, but it is presently expected to continue to push for its adoption, despite rumoured Cypriot opposition that has developed following the negotiations, apparently because the new Treaty would impose a 5 per cent. withholding tax on dividend payments.

1.2 Do they generally follow the OECD or another model?

Generally, Ukrainian income tax treaties are based on the OECD Model Treaty, with certain variations. The income tax treaties entered into by the USSR that are still applied by Ukraine, as noted above, are simpler in structure, do not limit their benefits to the "beneficial owners" of income and are, in principle, more favourable than the treaties entered into by Ukraine. The tax treaty with the USA also stands apart, as it generally follows the U.S. Model Treaty.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

In order to enter into force, an income tax treaty has to be ratified by the Ukrainian Parliament (*Verkhovna Rada*), and then the ratification instrument has to be exchanged with that of the other country.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

The treaty between Ukraine and the USA contains comprehensive anti-treaty shopping rules, generally following the U.S. Model Treaty. The treaty with the United Kingdom includes a "limitation of benefits" article. Under certain other treaties, particularly the recent ones, only a "beneficial owner" of income may claim certain treaty benefits, such as reduced or eliminated tax rates for interest, dividends and royalty payments. In practice, however, presently these standards are applied in a formalistic way, with legal owners presumptively treated as beneficial owners, so in practice the limitations have not been enforced so as to actually prevent the use of treaty benefits. This may change in the future.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Under the Constitution of Ukraine, duly ratified international treaties constitute an integral part of Ukrainian legislation. Thus, under the Constitution of Ukraine, provisions of treaties and domestic legislation have the same legal force, which presumably permits the application of the later-in-time rule. However, Ukrainian tax statutes currently in force, and the proposed draft Tax Code, explicitly provide that in the case of a conflict between the provisions of ratified treaties and domestic laws, the provisions of the treaties prevail.

2 Transaction Taxes

2.1 Are there any documentary taxes in Ukraine?

Ukraine does not have a stamp duty in the traditional sense. However, certain transactions in Ukraine are subject to a State duty and payments to the State pension fund. State duty is payable for the notarisation of certain contracts and unilateral deeds and the filing of documents with courts. Documents which are subject to mandatory notarisation, and thus to the payment of such State duty, include contracts for the sale or other disposition of buildings, land and other real estate, mortgage and property management agreements, agreements for the leasing of buildings or the part

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thereof for a duration exceeding three years, agreements for the foundation of a joint stock company where an individual is involved, agreements for the leasing of vehicles to an individual and certain powers of attorney and wills. The parties to a contract may also choose to notarise it even if this is not mandatory, for example to evidence its execution, and in this case, they will have to pay the State duty.

The rates for the State duty vary as follows:

(1) for the notarisation of documents, depending on the type of document being notarised, the duty generally ranges from 0.01 to 1 per cent. of the contract value. Where the contract value cannot be determined (e.g. for powers of attorneys, wills, etc.), the rate generally varies from 0.05 to 1 per cent. of the official non-taxable monthly minimum income of a citizen (equivalent to about USD 0.11 and 2.13, correspondingly); and

(2) for the notarisation of documents for a lawsuit that are filed with a court, depending on the type of filing and the court involved, the state duty can range from 0.1 per cent. of the official non-taxable monthly minimum income of a citizen (which is about USD 0.21) to 1 per cent. of the value of the claim involved in the lawsuit.

State duty is also payable for the issuance of securities (with some exceptions, including for State and municipal bonds) at the rate of 0.1 per cent. of the nominal value of the securities.

The following transactions are subject to payments to the State pension fund: the purchase of real estate (other than, *inter alia*, the purchase of real estate by State enterprises using State or municipal budget funds); the transfer of passenger cars (other than those provided to disabled people or transferred by inheritance); the sale of jewellery made of gold, platinum and/or precious stones (other than wedding rings); and mobile phone services, with certain exceptions. These payments to the State pension fund are based on rates of 1 per cent. for the purchase of real estate, 3 per cent. for the transfer of cars, 5 per cent. for the sale of jewellery and 7.5 per cent. for mobile phone services.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

There is a value added tax ("VAT") in Ukraine. The standard VAT rate of 20 per cent. is charged on the majority of VAT-taxable transactions. The export of goods and certain other transactions are presently subject to a zero VAT rate. Under the currently proposed draft of the new Ukrainian Tax Code, that is presently being considered by the Ukrainian Parliament and that is expected to be adopted in 2010 in order to come into force on 1 January 2011, the standard 20 per cent. VAT rate will be reduced to 17 per cent., beginning 1 January 2014.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

In Ukraine, generally the supply of goods and services within Ukraine and the import and export of goods are VAT-taxable events, subject to certain exceptions. To begin with, certain transactions are VAT-exempt, including the sale of land on which there are no buildings or other structures, the issuance and sale of securities, certain banking, insurance and asset management services and the importation of natural gas. The sale of certain goods, such as many infant foods and medicines, as well as municipal transport services, are also exempt from VAT. Similarly, certain goods (except for excisable goods) imported by UEFA or participants of the EURO 2012 Football Championships are exempt from VAT until 1 September 2012. In addition, the export of goods and the sale of certain services are presently taxed at a zero VAT rate.

The proposed draft Tax Code extends the list of VAT-exempt operations.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

In general, a VAT-taxable person may receive a credit for all input VAT, provided that it intends to use the goods or services purchased in its commercial activities in VAT-taxable transactions. If such goods or services are later used in VAT-exempt transactions, or if as goods they constitute fixed assets and later become non-production assets, for VAT purposes such goods or services will be deemed to have been sold for an arm's length price (but not below the original purchase price) in a deemed transaction that will then be subject to VAT, so that the original credit is effectively extinguished.

No VAT credit is available for input VAT if: (a) the goods or services are originally intended for use in VAT-exempt transactions or for non-commercial purposes; (b) the goods are cars, other than taxis; or (c) the input VAT is not confirmed by a VAT invoice or a customs declaration or other required document. Input VAT for the purchase of cars may, however, normally be deducted or, for fixed assets, depreciated for income tax purposes.

If goods or services are used only partially in VAT-taxable transactions, appropriate allocations must be made and the corresponding part of the input VAT is credited.

No VAT credit is available to a person not registered in Ukraine as a VAT-taxable person. A foreign entity may recover input VAT incurred, but only for transactions conducted through its permanent establishment (i.e. branch office) in Ukraine that it has registered as a VAT taxable person.

The VAT system has for many years been experiencing difficulties concerning the making of VAT reimbursements from the State. However, in the 2010 State Budget Law, it was decided to reimburse outstanding unpaid VAT with internal State bonds having a maturity term of 5 years, and progress in agreeing such reimbursements is being made.

The proposed draft Tax Code, in addition to maintaining the existing procedure for VAT reimbursement from the State (i.e. on the basis of a taxpayer's application), introduces a procedure for automatic VAT reimbursement. This automatic VAT reimbursement procedure is intended to be applied to taxpayers subject to certain criteria and would eliminate the need for taxpayers to submit applications for VAT reimbursement, as is currently required. In addition, the draft Tax Code provides for a substantial penalty on the State authorities responsible for the late reimbursement of VAT. Thus, the new Government seems intent on implementing quickly its announced policy to resolve the current problems with the reimbursement of VAT in Ukraine.

2.5 Are there any other transaction taxes?

There are presently no other transaction taxes. The draft Tax Code also does not provide for other transaction taxes.

2.6 Are there any other indirect taxes of which we should be aware?

The most important of the other indirect taxes are excise tax and custom duties.

Excise tax is imposed on certain excise taxable items produced in, or

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imported into, Ukraine. In particular, excise tax applies to tobacco and alcohol products, petrol, diesel and certain other fuels and motor vehicles. The rates of excise duty are specific for each type of product and are calculated either as a percentage of the sales price or as a fixed amount based on the quantity, weight or volume of the goods.

Import customs duties are imposed on goods imported into Ukraine and may be of the following types: preferential; privileged; or full. Goods from most countries are subject to privileged rates ranging from 5 to 15 per cent.

The Ukrainian Unified Customs Tariff Law provides for certain exemptions (including on a temporary basis) from customs duties for specific categories of goods. For example, a temporary exemption is presently applied (1) for the importation of certain goods by companies in the aircraft industry (effective until 1 January 2016) and (2) for the importation of certain goods for the construction of EURO 2012 sport facilities and for use by UEFA or participants of the EURO 2012 Football Championships (effective until 1 September 2012 and not applicable for excisable goods).

Ukraine still retains some customs export duties, which apply to limited types of goods, including in particular, natural gas, scrap metal, livestock, raw hides and certain oil seeds.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Unless an income tax treaty provides otherwise, dividends paid abroad are subject to a withholding tax at a 15 per cent. rate when paid to a non-resident company or individual.

Under the majority of Ukraine's income tax treaties, this withholding tax rate may be reduced to 5 per cent., provided that the recipient owns a 20 or 25 per cent. (depending on the treaty) shareholding in the local Ukrainian company making the distribution. The Ukrainian tax treaties with Finland, France, the Netherlands and Sweden provide for a zero withholding tax rate for dividends subject to certain conditions, and the Soviet income tax treaty that is still applied for Cyprus provides for a general zero withholding tax rate for dividends.

We understand that the negotiated Ukraine-Cyprus tax treaty will increase withholding taxes on dividends to 5 per cent., but this treaty has not yet been signed or ratified. The most recently effective Ukrainian tax treaties provide the following withholding tax rates on dividends: (1) the treaty with Mongolia – 10 per cent.; and (2) the treaty with Libya – 5 or 15 per cent. (the lower rate applies where the recipient owns at least 25 per cent. of the Ukrainian company's capital).

As indicated below, before or at the time of a dividend distribution, an advance tax of 25 per cent. of the amount of the dividend must also be paid by the distributing company (the amount of the dividends is not reduced by the amount of the advance tax). This advance tax payment may then be used by the distributing company to offset its corporate profits tax liabilities. However, with effect from 19 May 2010, the holding company in Ukraine has been made exempt from paying advance corporate tax on its distribution of dividends to the extent that the amount distributed was received from resident companies in which it had at least a 20 per cent. direct or indirect share participation.

Under the draft Tax Code, the rate of the advance tax payment on the distribution of dividends shall be equal to the effective standard corporate profits tax rate at the time of the distribution (as discussed below).

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Unless an income tax treaty provides otherwise, royalties paid abroad by a local company are subject to withholding tax at a 15 per cent. rate when paid to a corporate or individual non-resident. The majority of Ukraine's income tax treaties reduce this withholding tax rate for royalties to 10 per cent. A number of treaties, including the treaties with Austria, Belgium, Canada, Denmark, Finland, France, Germany, Japan, the Netherlands, Spain, Switzerland, Sweden and the United Arab Emirates provide for a zero withholding rate for royalties payable for certain types of intellectual property.

A general zero-tax rate for any types of royalties is provided for by a few income tax treaties, including the old Soviet treaty with Cyprus and the Ukrainian treaties with Armenia and the United Kingdom.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Unless an income tax treaty provides otherwise, interest paid abroad by a local company to a non-resident company is normally subject to a 15 per cent. withholding tax. No tax is charged on interest payable to non-resident companies on Ukrainian State securities placed abroad through authorised non-resident representatives, or on interest payable to non-residents for loans provided to the Ukrainian State which are reflected in the Ukrainian State budget or the budget of the National Bank of Ukraine.

In addition to the aforesaid exemptions, the draft Tax Code provides no tax on interest payable to non-resident companies on Ukrainian State securities or debt securities guaranteed by the State, or on interest payable to non-residents for loans provided to enterprises and guaranteed by the State.

Interest payable from Ukraine to non-resident individuals is also subject to a 15 per cent. withholding tax, except for interest on deposits with banks and certain other financial institutions and on saving certificates, which are currently entirely exempt from taxation but which, starting on 1 January 2013, will be subject to a 5 per cent. withholding tax.

Pursuant to the draft Tax Code, interest payable to non-resident individuals on deposits with banks and certain other financial institutions and on saving certificates will be subject to a 5 per cent. withholding tax beginning on 1 January 2011, provided that the monthly amount of interest exceeds 2 minimal salaries as established as of 1 January of the reporting year.

Under the majority of Ukraine's income tax treaties, the withholding tax on interest, if applicable, is reduced to 10 per cent. The old Soviet tax treaties with Cyprus and Spain, and the Ukrainian tax treaties with the United Kingdom and the USA, provide for a zero withholding tax rate for interest.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

There are no prescribed debt-equity ratios as such.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

Not relevant.

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3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Not relevant.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Yes. If 50 per cent. or more of the charter capital of a local company is owned or "managed" by (1) non-residents and/or (2) resident tax exempt shareholders (such as certain non-profit organisations, organisations of invalids and companies providing tax-exempt services) and/or resident companies paying income tax below the standard 25 per cent. corporate profits tax rate, then any interest payable by the local company to any such shareholders or to their affiliates is deductible only to the extent that such interest does not exceed: (a) the interest income received by such local company within the applicable reporting period; plus (b) 50 per cent. of the taxable income of the local company calculated without taking into account any interest income received by it. If this 50 per cent. threshold is reached, the rule applies to any interest payable to any such shareholder, irrespective of the size of its shareholding in the company paying the interest.

3.8 Does Ukraine have transfer pricing rules?

Yes. In general, arm's length prices should be used (1) for determining the corporate profits tax consequences of transactions with related parties and persons paying tax at tax rates other than the standard 25 per cent. corporate profits tax rate (such as those resident entities using the simplified taxation system, non-residents, individuals other than registered entrepreneurs and those registered individual entrepreneurs who qualify to pay of the reduced single tax), as well as for barter transactions and certain other transactions involving in-kind transfers, and (2) to determine the taxable base for VAT purposes. As discussed below, such transfer pricing rules may also apply to transactions between foreign companies and their branches in Ukraine.

Arm's length price rules are applied, to begin with, by presuming that the stated contract price is an arm's length price, but this presumption may be challenged by the tax authorities. The principal method used for determining arm's length prices is, with certain exceptions, the Comparable Uncontrolled Price method pursuant to which the tax authorities may adjust the price of transactions between related parties to the "usual price" for profits tax purposes. The usual price is essentially the market price for equivalent transactions where the goods or services are sold to independent persons under usual economic conditions. Where these rules apply, if the contract price is higher than the usual price at the time of the purchase, the usual price should be applied for tax purposes.

For natural monopolists, the arm's length price may be established by the Resale Price method or, in certain cases, by the Cost Plus method, under regulations to be promulgated by the Cabinet of Ministers of Ukraine.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The standard corporate profits tax rate is 25 per cent. This rate applies to the taxable income of Ukrainian companies and the permanent establishments in Ukraine of foreign companies. As an exception, the income of resident insurance companies, defined as the amount of insurance and reinsurance premiums received by such companies reduced by the amounts of any insurance premiums payable by such companies to residents for reinsurance, is taxed at either a zero or a 3 per cent. tax rate, depending on the type of insurance involved.

Certain legal entities may opt to use the simplified taxation system according to which VAT registered entities pay tax at a rate of 6 per cent. of their sales proceeds, and non-VAT registered entities pay at a rate of 10 per cent. There is also a minimal tax under a simplified taxation method provided for private entrepreneurs with relatively small turnover.

In addition, some types of income (such as dividends, interest, royalties, lease payments, income from the disposal of real estate located in Ukraine, income from transactions with securities or other corporate rights, broker fees, agency fees and several other types of Ukrainian source income) paid by Ukrainian residents or Ukrainian permanent establishments of non-residents to non-resident companies are subject to a 15 per cent. final withholding tax. Reduced tax rates (or tax relief) may apply based on tax treaties applied by Ukraine, as discussed above, and special rules may apply if the recipient is a company having a permanent establishment in Ukraine.

Under the draft Tax Code, beginning 1 January 2011, the standard corporate profits tax rate will be 19 per cent., which will be effective until 31 December 2012. Starting from 1 January 2013, the standard corporate profits tax rate will be reduced to 18 per cent., and beginning 1 January 2015, to 17 per cent. The final standard corporate profits tax rate will be established at 16 per cent. starting from 1 January 2016. In addition, according to this draft Tax Code, certain types of insurance compensation paid to non-residents by resident insurance companies will be subject to a 4 per cent. withholding tax.

The draft Tax Code also provides that certain corporate profits tax payers may benefit from complete tax holidays (i.e. a zero per cent. corporate profits tax rate will be applied). Such tax holidays are proposed to be effective until 1 January 2016.

4.2 When is that tax generally payable?

Under the generally applicable rules, corporate profits tax must be assessed and reported for each of the first three quarterly fiscal periods, including for the fiscal year through each such quarter, and for the full fiscal year reporting period, within 40 days after the end of each such period. The tax should be paid quarterly, within 10 calendar days after each tax declaration for a reporting period must be filed, so that the tax must be paid within 50 calendar days after the end of each of the first three quarterly reporting periods and after the end of the fiscal year. A fiscal tax year is a calendar year.

Withholding taxes should be paid no later than on the date that the income is paid.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The calculation of the tax base for corporate profits tax is not based on financial accounting standards. Instead, the taxable income for corporate profits tax purposes is solely determined based on Ukrainian tax accounting rules, by deducting from the adjusted gross income any allowable gross expenses and depreciation

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deductions. The adjusted gross income includes all revenues from all types of activities received or accrued by a taxpayer during the relevant tax accounting period, both from Ukrainian and foreign sources.

An exception exists for insurance companies for which, as indicated above, the tax base is determined following special rules.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Generally, taxable income differs significantly from the profit shown in commercial accounts. This is mostly due to the exemptions for certain types of income not to be considered as taxable income, the existence of severe restrictions on the deductibility of certain expenses for tax purposes and the application of different depreciation methods under tax accounting rules as compared to financial accounting standards.

4.5 Are there any tax grouping rules? Do these allow for relief in Ukraine for losses of overseas subsidiaries?

There is no system for group taxation in Ukraine, and therefore the members of a corporate group must file separate tax returns. There are no provisions under Ukrainian law that would allow the losses of one group member to be applied to reduce the profit of another group member.

Under the general rules, if a Ukrainian company has a branch (which is not a separate legal entity) located in a regional or municipal jurisdiction different from that where the company itself is principally registered, such branch should also be separately registered as a payer of corporate profits tax. The company, however, may decide to file a consolidated tax return, in which case the amounts of corporate profits tax payable respectively at the principal location of the company and at the location of each branch are allocated following a set procedure.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

The same corporate profits tax rate applies both to distributed and retained profit.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

The most significant national taxes and duties not discussed above include personal income tax, land tax, rental payments and other fees on oil and gas activities, tax on the owners of motor vehicles and the mandatory payments to the State Pension Fund.

Beginning 1 January 2011, a Single Contribution Law will come into force pursuant to which a single social insurance contribution will be introduced. According to the Single Contribution Law, such single social insurance contribution must be paid by employers and certain other tax payers instead of the present mandatory insurance contribution to the Pension Fund and the other social insurance funds.

4.8 Are there any local taxes not dealt with in answers to other questions?

The principal local taxes and fees include the advertising tax, community charge, market-place fee and parking fees.

The current draft Tax Code introduces a residential real estate tax. This will tax residential real estate having a size exceeding 100 sq.m. in cities and 200 sq.m. in villages at an annual rate of UAH 10 (equivalent to about USD 1.25) per each metre exceeding the 100 sq.m. threshold.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

There is no separate special regime for the taxation of capital gains and losses, other than for gains and losses from transactions qualifying as trading in securities or in certain other corporate rights and certain other exceptions as noted below.

To begin with, profits and losses by corporate entities and registered entrepreneurs from such qualifying transactions are determined and accounted for separately for each type of securities or corporate rights. Losses from trading in securities of a certain type may not be used to offset income from other activities or trading in securities of a different type. Instead, the losses exceeding those that may presently be offset for a particular type of securities may be carried forward indefinitely and used to offset income from trading in the same type of securities in future periods. This special tax treatment does not apply to the issuance of securities or their redemption by the issuer.

Similar rules exist for the taxation of the capital gains of individuals (other than registered entrepreneurs) from transactions with securities and corporate rights. As opposed to capital gains and losses for companies and registered entrepreneurs, however, the financial results of transactions in all types of securities and corporate rights by an individual conducted within a tax year are aggregated. The resulting capital gains, if any, are included in the annual taxable income of the individual and are taxed at the end of the year under the generally applicable tax rules, unless a special rule applies so that such capital gains are taxed by withholding at the time of the realisation of such gains. Any net losses may be carried forward indefinitely and used to offset gains from the individual's transactions in securities and corporate rights in future periods.

Starting from 1 January 2007, capital gains by individuals (other than registered entrepreneurs) from the initial sale or other disposition during a tax year of certain types of real estate, i.e. dwellings (houses, apartments or parts thereof) and summer houses, are exempt from tax to the extent that their size does not exceed 100 sq.m. A 1 per cent. rate of individual income tax is imposed on gains related to the initial sale or other disposition in a tax year of such real estate exceeding 100 sq.m. Gains on subsequent sales of such real estate of any size within a tax year are subject to tax at a rate of 5 per cent.

The gains by such individuals from the disposal of movable property are generally taxed at the standard personal income tax rate, currently at 15 per cent. However, the sale of one passenger car, motorcycle, motor scooter or motorboat (with or without a sail) during a tax year is subject to a 1 per cent. tax rate.

Pursuant to the draft Tax Code, capital gains by such individuals from the initial sale or other disposition during a tax year of certain types of real estate, i.e. dwellings (houses, apartments or parts thereof) and summer houses will be exempt from tax, while the sale of one passenger car, motorcycle or motor scooter will be subject to a zero per cent. tax rate, subject to certain conditions.

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5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

In general, the same corporate profits and personal income tax rates apply both to capital gains, such as gains from securities transactions, and to business profits or any other income, subject to the exceptions noted above and certain other minor exceptions.

5.3 Is there a participation exemption?

Dividends paid to a Ukrainian company by a foreign or local company are excluded from the taxable income of the recipient, provided that the Ukrainian company has at least a 20 per cent. direct or indirect share participation in the company distributing the dividends. However, dividends paid in Ukraine to a permanent establishment of a foreign company are subject to taxation at the standard corporate profits tax rate. Dividends paid to non-resident individuals or companies are subject to withholding tax, as discussed above.

The draft Tax Code provides that all dividends paid to a Ukrainian company by a local company will be excluded from taxable income irrespective of the extent of the shareholding of the corporate shareholder.

The distributing company is required to pay an advanced corporate tax rate of 25 per cent. on the amount of the distributed dividends, subject to certain exemptions mentioned below. Such advance tax may ordinarily be used by companies to offset their corporate profit tax liabilities. An exception from paying such advance corporate tax is provided for Ukrainian holding companies distributing dividends based on amounts received from resident companies, as mentioned above.

As mentioned above, under the draft proposed Tax Code, the advance tax payment for dividend distributions is to be paid based on the standard corporate profits tax rate, as provided by this new Tax Code. Under the present draft, as explained above, this profits tax rate will be reduced to 19 per cent. for 2012, and will then decline further, until it reaches the final rate of 16 per cent. in 2016.

5.4 Is there any special relief for reinvestment?

Where the dividends are paid to individual shareholders in the form of shares (or participation interests for limited liability companies) in the company making the distribution, and such distribution does not change the shareholding ratio among the shareholders in the company and results in an increase of the charter capital of the distributing company, such dividends are not taxed to the recipient individual shareholders.

Where such a pro-rated distribution of shares (or of participation interests) is made, irrespective of whether the distribution increases the charter capital of such company, the distributing company is not required to pay the advance corporate tax (presently at the standard 25 per cent. profits tax rate) on the dividend amount. The draft Tax Code does not change this exemption from payment of the advance corporate tax.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

Normally, there is no tax or capital or similar duty payable on the formation or increase of the capital of a company under Ukrainian law, except for the formation of an open joint stock company. For an open joint stock company, an issuance of shares requires the payment of a State duty in the amount of 0.1 per cent. of the par value of the shares issued, as observed above, but not exceeding 5 minimum salaries as established on 1 January of the respective year.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

Generally, no other significant taxes would be incurred.

6.3 How would the taxable profits of a local branch be determined?

For Ukrainian tax purposes, a Ukrainian branch of a foreign company constituting a permanent establishment in Ukraine is treated as a separate entity independent of its head office, and it is generally taxed under the same rules as a Ukrainian legal entity is taxed. However, several special methods may be applied for calculating the income that will be subject to tax in Ukraine of such a permanent establishment.

Under the principal method, known as the “direct method”, the taxable income of such branch is determined by reducing the actual and deemed income of the branch (that is, the income of the branch including income that it would have received for goods transferred and services provided to the non-Ukrainian offices of its company, had it actually been independent of the head office) by the deductible expenses incurred directly by the branch. Transfer pricing rules apply to transactions between the foreign company and its branch in Ukraine.

Where the foreign company has operations both in Ukraine and in other jurisdictions and does not account separately for profits received in Ukraine, the amount taxable in Ukraine is determined by the so-called “indirect method” by an allocation of the income and expenses between the non-Ukrainian offices and the Ukrainian branch, based on a correlation of the total expenses, number of employees, value of fixed assets, etc. of the foreign company as a whole as compared to those of the branch, with certain adjustments.

If such a direct calculation may not be used to determine the amount taxable in Ukraine, then the Ukrainian taxable amount is established by reducing the gross income of the branch by 30 per cent. in respect of its expenses (i.e. by multiplying its gross income by 0.7).

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax as such in Ukraine. As observed above, under the general tax rules, a branch of a foreign company in Ukraine constituting a permanent establishment is generally taxed under the same rules as a Ukrainian legal entity and, for most taxation purposes, is treated as if it is a separate legal entity independent of its head office.

As a result, the remittance of profits by a branch to its head office, even though technically not a dividend, may be viewed by the tax authorities as a payment to an independent company subject to taxation of 15 per cent. withholding tax under a statutory “catch all” rate provision which subjects to withholding taxation any “other income” of non-residents. This controversial position of the Ukrainian tax authorities on the taxation of such remittances is, however, presently subject to dispute. The issue is not addressed by the draft Tax Code. Such remittances to a head office should not be subject to the advance tax that applies to dividend distributions.

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6.5 Would a branch benefit from tax treaty provisions, or some of them?

As a rule, tax treaties contain criteria for the determination of whether a branch constitutes a taxable permanent establishment in Ukraine. If the activity of the branch does not meet the criteria for a taxable permanent establishment under the applicable tax treaty, then it should not be taxable, and the non-resident should therefore not be subject to profits tax in Ukraine based on its branch. Ukrainian's tax treaties do not exempt payments from a branch to its head office from withholding tax.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

As indicated above, whether or not a withholding tax applies to the remittance of profits by the branch abroad is not yet a settled issue of law or practice. The Ukrainian tax authorities presently take the position that, under a literal interpretation of the relevant law, such remittances should be taxed under the general rules, that is, they should be subject to a 15 per cent. withholding tax.

Certain Ukrainian legal practitioners disagree with this position and insist that such remittances can be made from Ukraine tax-free. Until the issue is litigated, in order to avoid uncertainty, in practice instead of profits being remitted directly to the foreign company, profits from branches are often structured to be repatriated abroad to third parties by using interest and royalty payments, which may be exempt from withholding tax under provisions of applicable double tax treaties, as well as by using payments for service which are not subject to withholding taxation in Ukraine. Careful attention needs to be used in developing such structures to avoid prosecution by the tax authorities.

7 Anti-avoidance

7.1 How does Ukraine address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is no general anti-avoidance provision under Ukrainian law. However, as indicated above, there are certain restrictions aimed at preventing tax avoidance. To begin with, transfer pricing rules apply to VAT and corporate profits tax for certain types of transactions between related parties to prevent expenses from being overstated or income being understated. There are also certain restrictions that limit the deductibility of interest paid abroad on a loan provided by a related party.

In addition, a limitation is provided on the deductibility of expenses incurred in transactions with companies registered in certain countries designated as tax havens. Only 85 per cent. of payments, of whatever kind, to residents of tax havens are deductible for tax purposes. The tax havens affected are those designated as such in the relevant resolution that is periodically issued by the Cabinet of Ministers of Ukraine.

Under the current draft of the proposed new Tax Code, it will be prohibited to deduct any royalties paid abroad for corporate profits tax purposes. This proposed limitation is very controversial, and is currently under active discussion. There is a good possibility that this prohibition will be excluded, or at least greatly restricted, when the new Tax Code is adopted.

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B.C. Toms & Co was the first western law firm to open a Ukrainian office, in 1991, and our Kyiv office is now one of the larger law firms in Ukraine. Our firm was founded by Bate C. Toms, a Yale Law School graduate with substantial previous experience practicing in the US and Western as well as Eastern Europe as a partner of a large multinational law firm. We are ranked both in the European Legal 500 (www.legal500.com), the IFLR 1000 (www.iflr1000.com), the PLC Which Lawyer (www.practicallaw.com) and in the Chambers Europe (www.chambersandpartners.co.uk), the principal European legal directories, as among of the leading law firms in Ukraine. Our law practice areas includes banking and securities, oil and gas and natural resources, agricultural investments, trade and project finance, real estate, construction, energy, mergers and acquisitions, project finance, tax, privatisation and litigation.

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Chapter 47

United Kingdom

Graham Airs

Slaughter and May

Zoe Andrews

1 General: Treaties

1.1 How many income tax treaties are currently in force in the United Kingdom?

The UK has one of the most extensive treaty networks in the world, with over 100 comprehensive income tax treaties currently in force. There are income tax treaties with nearly all western European countries and most of the Commonwealth. The UK also has income tax treaties with many Eastern European countries including most of the former Soviet republics. The UK Government reviews the UK's tax treaty priorities each year and there is a rolling programme for the negotiation of new treaties to replace current treaties.

1.2 Do they generally follow the OECD or another model?

They generally follow the OECD model but certain articles in the UK treaties can differ significantly from the OECD model. The UK's agreements are often tailored to the UK tax system or to the foreign tax system. An example of this is the Dividends Article which in most of the UK's older agreements was tailored to the UK's imputation system of corporation tax and the tax credits available on dividends paid by UK companies. Since the tax credit fell to one ninth of the net dividend in 1999, however, the tax credit has been of little value to an overseas investor and this provision is not included in the more recent treaties (see, for example, the UK/US treaty signed in 2001, the UK/France and UK/Netherlands treaties signed in 2008, and the UK/Germany and UK/Hong Kong treaties signed in 2010).

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. A tax treaty must be incorporated into UK law and this is done by way of a statutory instrument. A treaty will then enter into force from the date determined by the treaty and will have effect in relation to each tax covered from the dates determined by the treaty.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, the UK has avoided wide limitation of benefits articles but has instead made specific provisions in particular articles. For example, the Dividends, Interest or Royalty article may provide that the UK will not give up its taxing rights if, broadly, the main purpose or one of the main purposes of the creation or assignment of the relevant shares, loan or right to royalties is to take advantage of the article.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Once a double tax treaty has been made part of the UK domestic legislation, it may override UK law but this is a matter of construction. The UK legislation that describes and limits the consequences that a tax treaty may have in UK law requires treaties to take effect "notwithstanding anything in any enactment". This means that the treaty prevails over domestic legislation whether that legislation is prior to or subsequent to the treaty, unless the UK legislation is clearly expressed to override the treaty or the intention of Parliament to override the provisions of a treaty is clear.

2 Transaction Taxes

2.1 Are there any documentary taxes in the United Kingdom?

Stamp duty is a tax on certain documents. Since 1 December 2003 stamp duty is chargeable only on instruments relating to stock and marketable securities, on instruments transferring an interest in certain partnerships and on bearer instruments. See the answer to question 2.5 below for details of the stamp duty land tax that applies to land transactions.

There is an *ad valorem* rate of duty on a transfer on sale of stock or marketable securities of 0.5% of the consideration. Bearer instruments can be transferred by delivery and so the stamp duty charge arises on issue, or in certain cases on first transfer at the ad valorem rate of 1.5%.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The UK has had VAT since becoming an EC Member State in 1973. The UK VAT legislation gives effect to the EC Directives. There are three rates of VAT:

- the standard rate of VAT is 17.5% (rising to 20% on 4 January 2011) (this rate applies to any supply of goods or services which is not exempt, zero-rated or subject to the reduced rate of VAT);
- the reduced rate of VAT is 5% (e.g. fuel); and
- the zero-rate of VAT is 0% (e.g. certain food, books, children's wear).

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2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The exclusions from VAT are as permitted or required by the Directive on the Common System of VAT (2006/112/EC) and some examples of exempt supplies are:

- certain supplies of land;
- insurance services; and
- banking and other financial services.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is only recoverable by a taxable person (a person who is or is required to be registered for VAT). Input tax is attributed in accordance with the nature and tax status of the supply intended to be made by the business.

Input tax on supplies wholly used to make taxable supplies is deductible in full. Input tax wholly used to make exempt or non-business supplies is not deductible at all. Where a taxable person makes both taxable and exempt supplies and incurs expenditure that is not directly attributable to either, e.g. general overheads, the VAT on the expenditure must be apportioned between the supplies. The standard method of apportionment is according to the ratio of taxable supplies to total supplies expressed as a percentage. The Commissioners for Her Majesty's Revenue and Customs ("HMRC") may allow or direct the use of a different method of apportionment.

2.5 Are there any other transaction taxes?

Stamp duty land tax ("SDLT")

SDLT is a tax on transactions involving immovable property and is payable by the purchaser at the rate of 4% of the consideration for the property (there are lower rates of SDLT for consideration of less than £500,000). It is a compulsory, self-assessed transaction tax and is chargeable whether or not there is a written document.

Stamp duty reserve tax ("SDRT")

SDRT is charged in respect of an agreement to transfer chargeable securities for money or money's worth whether or not the agreement is in writing. Subject to some exceptions, "chargeable securities" are stocks, shares and units under a unit trust scheme. SDRT is imposed at the rate of 0.5% of the amount or value of consideration. Prior to 1 October 2009, a higher rate of 1.5% was imposed in respect of certain transactions involving depositary receipts and clearance services. However, with effect from 1 October 2009, the Government announced that this 1.5% charge is disapplied on issues of shares into EU depositary receipt systems and into EU clearance systems. The Government announcement does not disapply the charge in relation to non-EU depositary receipts systems and non-EU clearance systems but as the ECJ case of HSBC Holdings (C-569/07), which prompted the disapplication of the charge, involved a breach of the Capital Duties Directive, the 1.5% charge on issues into non-EU depositary receipts systems and non-EU clearance systems is arguably also contrary to EU law.

SDRT liability is imposed on the purchaser and is directly enforceable. Where a transaction is completed by a duly stamped instrument within six years from the date when the SDRT charge arose, there is provision in many cases for the repayment of the SDRT paid or cancellation of the SDRT charge.

2.6 Are there any other indirect taxes of which we should be aware?

Customs duties are generally payable on goods imported from outside the EU. Excise duties are levied on particular classes of goods (e.g. alcohol and tobacco). Insurance premium tax is charged on the receipt of a premium by an insurer under a taxable insurance contract. There are the following environmental taxes: landfill tax; aggregates levy; and climate change levy.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

No withholding tax is imposed on dividends paid by a locally resident company to a non-resident.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In the absence of a double tax treaty and provided that the UK legislation implementing the EC Interest and Royalties Directive 2003/49/EC does not apply, the rate of withholding tax on patent royalties and copyright royalties is 20% for the tax year 2010-2011. There is no withholding tax on film and video royalties.

The UK legislation implementing the EC Interest and Royalties Directive provides that there is no withholding tax on the payment of interest or royalties by a UK company (or a UK permanent establishment of an EU company) to an associated EU company. The exemption does not apply to the extent that any interest or royalties would not have been paid if the parties had been dealing at arm's length. An EU company for these purposes is a company resident in a Member State other than the UK.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In the absence of a double tax treaty and provided that the UK legislation implementing the EC Interest and Royalties Directive does not apply, the rate of withholding tax on interest paid to a non-resident is generally 20%. There is no withholding tax, however, on interest on quoted Eurobonds.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The UK has a thin capitalisation regime which has applied since 1 April 2004 to domestic as well as cross-border transactions as a result of changes to the UK legislation prompted by the Lankhorst-Hohorst case (C324/00).

A borrower is considered according to its own financial circumstances in isolation from the rest of the group for the purposes of determining the maximum amount which it would have borrowed from an independent lender. The assets and income of the borrower's direct and indirect subsidiaries can be taken into account to the same extent that an unconnected lender would recognise them, but the assets and income of other group companies are disregarded.

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3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There are no statutory safe harbour rules. In Tax Bulletin 17 of 1995, however, the Inland Revenue, as they were then called, explained their practice of accepting that where a loan otherwise meets the arm's length test, a company will not be thinly capitalised where:

- the level of debt to equity does not exceed a ratio of 1:1; and
- its income to interest cover is at least 3:1.

The Tax Bulletin emphasised, however, that there are no hard and fast rules in this area and that each case has to be considered on its own facts. This is reaffirmed in the International Manual at INTM578040.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes. A company may be thinly capitalised because of a special relationship between the borrower and the lender or because of a guarantee given by a person connected with the borrower. The UK legislation contains a wide definition of the word "guarantee" and includes any case in which the lender has a real expectation that he will be paid by, or out of the assets of, another connected company. There is no requirement for a guarantee to be in writing.

The legislation gives a compensating adjustment to a guarantor in circumstances where interest has been disallowed because of the guarantee. The effect of the rule is to treat the guarantor as if the guarantor had taken the loan and paid the interest instead of the actual borrower. The guarantor will obtain a tax deduction for the interest provided it meets the usual conditions for an interest deduction. The effect where the borrower and the guarantor are both subject to UK tax is, therefore, neutral.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

The Finance Act 2009 has introduced, with effect for accounting periods beginning on or after 1 January 2010, a further restriction on tax relief for finance expenses of groups of companies in certain circumstances. The new "worldwide debt cap", as it is known, limits the aggregate UK tax deduction for the UK members of a group that have net finance expenses to the worldwide consolidated gross finance expense of that group. The intention behind the new legislation is to prevent groups "dumping" debt in the UK in order to achieve a UK tax deduction.

The complex legislation contains a "gateway test" which is intended to be more simple to apply than the full regime. The gateway test simply compares the aggregate of the average net debt of each UK company for an accounting period with the average worldwide gross debt income. If the aggregate UK net debt does not exceed 75% of the worldwide gross debt then the debt cap provisions need not be considered further.

Financial services groups fall outside the new rules if certain conditions are met.

3.8 Does the United Kingdom have transfer pricing rules?

Yes. Since 1 April 2004, the transfer pricing rules have applied to both cross-border and domestic transactions between associated companies.

If HMRC do not accept that pricing is arm's length they will raise an assessment adjusting the profits or losses accordingly. It is possible to make an application to HMRC for an advance pricing agreement which has the effect that pricing in accordance with its terms is treated as arm's length.

In cross-border transactions the double taxation caused by a transfer pricing adjustment can be mitigated by the provisions of a tax treaty.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax is 28% for 2010/11 but is going to be cut to 27% for 2011/12 and by a further 1% per annum resulting in a rate of 24% for 2014/2015.

4.2 When is that tax generally payable?

For companies other than "large" companies, corporation tax is due and payable nine months after the end of the accounting period for tax purposes.

Large companies are generally companies with profits in the accounting period in question in excess of £1.5m, but this £1.5m threshold is proportionately reduced if there are associated companies or the accounting period is less than 12 months. Large companies have to pay corporation tax in quarterly instalments based on an estimate of the tax they are likely to pay. The first instalment payment is due 6 months and 13 days from the start of the accounting period and the last instalment (which will be the balance of the corporation tax liability) is due 3 months and 14 days from the end of the accounting period.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In general terms, the tax follows the commercial accounts subject to adjustments.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Certain items of expenditure which are shown as reducing the profits in the commercial accounts are added back for tax purposes and deductions for tax purposes may then be allowable. For example, in the case of depreciable plant or machinery, capital allowances on a reducing balance basis at various rates depending on the type of asset and the level of expenditure incurred) are substituted for accounting depreciation.

The UK tax legislation has been amended to deal with various issues arising from companies adopting International Accounting Standards to draw up commercial accounts for accounting periods beginning on or after 1 January 2005 and in certain circumstances, adjustments to the profits shown in the commercial accounts are required for tax purposes.

4.5 Are there any tax grouping rules? Do these allow for relief in the United Kingdom for losses of overseas subsidiaries?

Yes. The UK does not permit group companies to be taxed on the

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basis of consolidated accounts but the grouping rules achieve a degree of effective consolidation. A group consists in most cases of a parent company and its subsidiaries which may in turn have subsidiaries. The exact test for whether a group exists depends on the type of group, but the common factor is that a specified percentage of issued share capital is required to be beneficially held directly or indirectly by the parent.

Group relief group

Losses (other than capital losses) can be surrendered from one UK resident group company to another UK resident group company. Losses can also be surrendered by or to a UK permanent establishment of a non-UK group company. A UK permanent establishment of an overseas company can only surrender those losses as group relief if they are not relievable (other than against profits within the charge to UK corporation tax) in the overseas country. Similarly, a UK company can surrender the losses of an overseas permanent establishment if those losses are not relievable (other than against profits within the charge to UK corporation tax) in the overseas country. A consultation on the UK taxation of overseas branches, including options for retaining branch loss relief, will take place over summer 2010 with a view to the rules being amended in 2011. For more details of this consultation see Chapter 1 by Graham Airs.

Following the judgment of the ECJ in Marks and Spencer v David Halsey, (C446/03) on 13 December 2005, the UK's loss relief legislation for groups of companies was amended by Finance Act 2006 to provide, in certain very limited circumstances, for group relief to be given in the UK for the otherwise unrelievable losses incurred by EC companies, even if they are not resident or trading in the UK. The new rules apply from 1 April 2006. The measures also contain an anti-avoidance rule, introduced with effect from 20 February 2006, which denies relief for a loss arising to a non-resident company as a result of arrangements which have as one of their main purposes the obtaining of group relief.

The Finance Act 2006 provisions are narrowly drafted, and some think that they do not properly give effect to the ECJ judgment. Accordingly, the Chartered Institute of Taxation wrote to the European Commission requesting that the Commission consider whether the Finance Act 2006 provisions implement adequately the decision of the ECJ. In September 2008, the European Commission issued a "reasoned opinion" under Article 226 of the EC Treaty listing the conditions in the Finance Act 2006 provisions which it considers are incompatible with freedom of establishment and requested the UK to properly implement the Marks & Spencer ruling. The European Commission then referred the matter of non-compliance to the ECJ in October 2009.

Capital gains group

There is no consolidation of capital gains and losses but it is possible to make an election for a gain on a disposal made by one capital gains group member to be treated as a gain on a disposal by another group member.

Capital assets may be transferred between capital gains group members at no gain/no loss. This has the effect of postponing tax liability on transfers until the asset is transferred outside the group or until the company holding the asset is transferred outside the group. When a company leaves a capital gains group holding an asset which was transferred intra-group in the previous six years, a degrouping charge may arise for the transferee. A joint election may be made for this degrouping charge to be reallocated to another group company. A consultation document published in February 2010 proposed simplification of the current degrouping charge rules. Amendments to the degrouping rules as a result of this consultation are expected to be made in 2011.

Stamp duty and SDLT groups

Transfers between group companies are relieved from stamp duty or from SDLT where certain conditions are met.

VAT group

Transactions between group members are disregarded for VAT purposes (although HMRC have powers to override this in certain circumstances). Generally, two or more bodies corporate are eligible to be treated as members of a VAT group if each is established or has a fixed establishment in the UK and:

- one of them controls the other;
- one person (whether a body corporate or an individual) controls all of them; or
- two or more individuals carrying on business in partnership control all of them.

On 24 June 2010 it was announced that the European Commission has decided to refer seven Member States (including the UK) to the ECJ in relation to their VAT grouping rules. The Commission argues that the UK VAT grouping rules are in breach of the provisions of the VAT Directive because the UK rules allow non-taxable persons (such as dormant companies and holding companies) to join a VAT group. The view of HMRC, the Law Society and many UK advisers is that this is permitted by the VAT Directive.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate upon distributed, as opposed to retained, profits in the UK.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

Business rates are payable by the occupier of business premises based on the annual rental value. There are two rates for the year ending on 31 March 2011: 40.7% (for businesses that qualify for small business rate relief); and 41.4% (for all other businesses). Business rates are a deductible expense for corporation tax purposes.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are no other local taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Corporation tax is chargeable on "profits" which includes both income and capital gains. There is a separate regime for computing capital gains which contains more exemptions and has an inflation-linked basis adjustment which means that the effective rate of tax can be less than the headline corporation tax rate.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The same rate of corporation tax is applied to both trading income and capital gains – but the effective rate may be lower for capital gains – see the answer to question 5.1 above.

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5.3 Is there a participation exemption?

Non-resident shareholders disposing of UK investments continue to be outside the scope of UK tax. A shareholder within the scope of UK tax may benefit from the substantial shareholdings exemption. The substantial shareholdings regime allows trading groups to dispose of trading subsidiaries without a UK tax charge provided that the strict conditions for the exemption are met.

The substantial shareholdings exemption is narrower and more complex than the participation exemption which may be found in other countries.

5.4 Is there any special relief for reinvestment?

There is rollover relief for the replacement of business assets, but the definition of "business assets" does not include shares. Rollover is available to the extent that the whole or part of the proceeds of disposal of certain business assets are, within one year before or three years after the disposal, applied in the acquisition of business assets to be used in the same or a different trade.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed on the formation of a subsidiary.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

A UK resident subsidiary would pay corporation tax on its worldwide income and gains, whereas a UK branch would be subject to corporation tax only on the items listed in the answer to question 6.3. The charge to UK corporation tax imposed on a non-resident company only applies where the non-resident company is trading in the UK through a permanent establishment. This means that a branch set up for investment purposes only and not carrying on a trade is not subject to UK corporation tax.

6.3 How would the taxable profits of a local branch be determined?

Provided that the local branch of a non-resident company is within the UK statutory definition of "permanent establishment" (which is based on the wording of Article 5 of the OECD Model Convention), it will be treated as though it were a distinct and separate entity dealing wholly independently with the non-resident company and having the equity and loan capital which it would have if it were a distinct entity. This means that the thin capitalisation rules will apply to the UK permanent establishment and it will be assumed that it has the same credit rating as the non-resident company. To the extent that the UK thin capitalisation rules restrict the financing costs of the permanent establishment, the profits attributed to the permanent establishment, and therefore subject to UK corporation tax, will increase.

Subject to any treaty provisions to the contrary, the taxable profits of the permanent establishment would comprise:

- trading income arising directly or indirectly through or from the permanent establishment;
- income from property and rights used by, or held by or for, the permanent establishment (but not including exempt distributions from UK resident companies); and
- chargeable gains accruing on the disposal of assets situated in the UK while the UK trade is carried on and effectively connected with the operations of the permanent establishment.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

The UK domestic legislation does not give treaty relief against UK tax unless the person claiming credit is resident in the UK for the accounting period in question. This means that the UK branch of a non-resident company cannot claim treaty relief.

Unilateral tax credit relief may be allowed for tax paid outside the UK in respect of the income or chargeable gains of a UK branch or agency of a non-UK resident person if certain conditions are fulfilled. Tax payable in a country where the overseas company is taxable by reason of its domicile, residence or place of management is excluded from relief. The maximum credit relief is limited to that which would have been payable if the branch or agency had been a UK resident person and the income or gains in question had been income or gains of that person.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax or any other tax would be imposed as the result of a remittance of profits by the branch.

7 Anti-avoidance

7.1 How does the United Kingdom address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There is currently no general anti-avoidance rule ("GAAR") in the UK, although it was announced in the Budget on 22 June 2010 that there would be a new consultation on the possibility of a GAAR.

Disclosure rules were introduced in the UK in 2004 and their scope has subsequently been extended so that the rules now apply to certain tax planning arrangements relating to direct tax, SDLT, VAT, pension contributions and national insurance contributions. The disclosure rules are designed to provide HMRC with information about potential tax avoidance schemes at an earlier stage than would otherwise have been the case. This enables HMRC to investigate the schemes and to introduce legislation to counteract the avoidance where appropriate.

The rules seem to have been a success for HMRC and many disclosed schemes have subsequently been blocked with targeted anti-avoidance legislation which prevents other taxpayers from using the same schemes.

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Chapter 48

USA

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1 General: Treaties

1.1 How many income tax treaties are currently in force in the United States?

The U.S. currently has 58 bilateral income tax treaties in force. These treaties cover 67 countries, including nearly every member of the European Union, Switzerland, Canada, Mexico, China, Japan, Australia and New Zealand. Although the U.S. has a treaty with Bermuda, the Bermuda treaty is available only to non-U.S. insurance and reinsurance companies. The only G-20 nations not covered are Argentina, Brazil and Saudi Arabia. The income tax treaty network in South America is limited, with a treaty in force with Venezuela and a treaty with Chile awaiting ratification. The U.S. also has entered into Exchange of Information Agreements with certain countries where an income tax treaty has not been agreed.

Some, but not all, of the U.S. income tax treaties also provide relief from the excise tax imposed by the U.S. on certain policies issued by non-U.S. insurers or reinsurers covering U.S. lives or U.S. perils (the "FET").

1.2 Do they generally follow the OECD or another model?

The United States generally follows the U.S. model income tax treaty, most recently modified in 2006, which is similar but not identical to the OECD model treaty. There are several notable differences between the U.S. model and the OECD model. For example, the U.S. model includes a "limitation of benefits" article (see question 1.4) and a "savings clause" that prevents U.S. citizens and residents from using the treaty to avoid taxation of U.S. source income. Although the United States uses the U.S. model rather than the OECD model treaty as the basis for negotiating new or amended treaties with other countries, the U.S. model technical explanation notes that the development of the 2006 U.S. model took into account the OECD model and deliberately adopted many OECD model provisions.

The U.S. model lags behind some of the current U.S. negotiating positions on treaty articles. For example, although not reflected in the U.S. model, a trend has developed in U.S. treaties in favour of a zero-rate of withholding on dividends paid by a U.S. affiliate to its non-U.S. parent, subject to certain stock ownership requirements.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

No. Although not incorporated into domestic law, treaties have the force of federal law, and pre-empt State and local law (see question 1.5). Under the U.S. Constitution, the President makes treaties, and the Senate must advise and consent to their ratification by a 2/3 vote. In practice, tax treaties are negotiated by the Treasury Department, signed by a representative of the executive branch, signed by the President, and sent to the Senate for ratification. Once the other Contracting State carries out its corresponding internal procedures, instruments of ratification are exchanged between the Contracting States. A U.S. treaty signed by the President has no effect, however, prior to its ratification by the U.S. Senate; there are currently several new and revised treaties, as well as protocols amending existing treaties, pending before the Senate, and the timetable for Senate ratification of treaties is uncertain.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Yes. Most United States treaties incorporate a limitation of benefits ("LOB") article. The purpose of the LOB provision is to prevent bilateral treaties from conferring benefits on persons that do not have a sufficient relationship to one of the Contracting States, i.e., persons other than "qualified persons". The definition of qualified person varies widely among different treaties. In the U.S. model treaty, a qualified person includes an individual, a publicly-traded corporation and subsidiaries that meet certain trading and ownership requirements, as well as certain tax-exempt organisations, pension funds, trusts, estates, partnerships, and other companies. In some treaties, a resident of a Contracting State that is not a qualified person may be entitled to claim treaty benefits with respect to certain items of income derived from one State if it is derived in connection with the active conduct of a trade or business in the other State. In general, LOB provisions in more recent U.S. treaties are more restrictive than those negotiated in earlier treaties, and there is significant variation in the formulation of the LOB provisions from treaty to treaty.

In addition to the LOB articles included in U.S. treaties, the United States has authority to limit treaty-shopping by statute and under the common law. These include anti-conduit and hybrid entity regulations, as well as certain case law anti-abuse doctrines.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Yes. A treaty may be overridden by a domestic law enacted after a treaty takes effect. Under the U.S. Constitution, and as restated in the Internal Revenue Code, treaties and federal statutes have the equal force of law; in general, therefore, the one enacted later in time will

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prevail. When possible, a U.S. court will attempt to construe statutes to avoid any conflict with the terms of ratified treaties and vice versa. In the case of a direct conflict, however, a later-in-time federal statute will override the provisions of a ratified treaty. For example, in 1980 the Foreign Investment in Real Property Tax Act ("FIRPTA") introduced a tax on dispositions of foreign-owned real estate, and explicitly overrode existing treaty provisions. More recently, rules adopted to prevent "earnings stripping", or deductions for certain interest paid by a corporation to a tax-exempt or partially tax-exempt related person, arguably contradict the non-discrimination article of previously-enacted U.S. treaties, and the recently enacted "FATCA" information reporting and withholding tax statute may override or delay the availability of benefits available under income tax treaties. Additionally, the U.S. has recently codified the common law "economic substance" doctrine, which could potentially apply even when the technical requirements of a treaty are satisfied.

Treaties pre-empt any inconsistent provision of State or local law. By their terms, however, most income tax treaties apply only to U.S. federal income taxes (and, in treaties that cover it, the FET).

2 Transaction Taxes

2.1 Are there any documentary taxes in the United States?

There are generally no documentary or stamp taxes imposed by the U.S. federal government. State and local governments often impose transfer taxes on the recordation or registration of documents, especially with respect to transfers of real estate.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The United States does not have VAT or any similar tax. While there is no federal-level consumption tax, State and local governments generally impose sales and use taxes on retail sales of tangible personal property and certain services, the incidence and rates of which vary among jurisdictions.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

There is no VAT in the United States. Although exemptions from State and local sales tax vary by jurisdiction, common exemptions include "occasional" or "casual" sales; goods or services purchased for resale; goods or services used or consumed in manufacturing; certain corporate transactions, such as transfers in connection with incorporations, liquidations, and reorganisations; and essential purchases, such as food, prescription drugs and occasionally clothing. Tax-exempt organisations are generally excused from sales and use taxes on purchases pertaining to exempt purposes.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Although retailers are generally required to collect and remit sales tax, the tax is imposed on the ultimate consumer. Therefore, as a technical matter, sales taxes are not paid out of business revenues, making recovery unnecessary.

2.5 Are there any other transaction taxes?

No, there are not.

2.6 Are there any other indirect taxes of which we should be aware?

Federal excise taxes apply to a range of goods and services, including tobacco, alcohol, air transport and telephone services. Federal tariffs are levied at various rates on most imported commodities. State severance taxes are imposed on extractive sources such as timber and minerals. *Ad valorem* real and, in a few cases, personal property taxes are typically assessed on an annual basis at the State and local level.

As discussed in question 1.1, the FET is an excise tax on certain policies written by foreign insurers and reinsurers, and the U.S. Internal Revenue Service ("IRS") has ruled that in certain cases the FET may be assessed even where a non-U.S. insurer retrocedes to another non-U.S. reinsurer. Legislation generally codifying this interpretation has been proposed, but whether or not such legislation will be enacted is uncertain.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Yes. There is a 30% withholding tax on dividends paid by a U.S. company to a non-resident shareholder. This tax can be reduced, and in some cases eliminated, by an applicable treaty. Treaties often apply different withholding rates for dividends paid by Real Estate Investment Trusts ("REITs") and Regulated Investment Companies ("RICs"). The U.S. recently enacted a statute intended to prevent the avoidance of the withholding tax on dividends by use of "equity swaps" and other derivative transactions.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Yes. There is a 30% withholding tax on royalties paid by a U.S. company to a non-resident recipient. This tax can be reduced, and in some cases eliminated, by an applicable treaty. Under some treaties, different withholding tax rates apply to different types of royalties (e.g., motion picture and television, industrial and natural resource).

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Yes. There is a 30% withholding tax on interest paid by a U.S. company to a non-resident lender. As with dividends and royalties, this withholding tax may be reduced or eliminated by applicable treaty.

However, unlike its treatment of dividends and royalties, the United States provides a broad statutory exemption from withholding tax for "portfolio interest". The portfolio interest exemption generally applies to interest payments by U.S. persons on: (1) registered-form obligations if the holder certifies its status as a non-U.S. person; and (2) foreign-owned bearer form obligations. The exemption for bearer form instruments has been repealed for obligations issued on or after March 18, 2012. Non-U.S. holders of registered-form obligations usually satisfy the certification requirement by providing a completed IRS Form W-8BEN to the payor of the interest. Portfolio interest does not include interest: (1) received by a 10% shareholder of the borrower; (2) received by a controlled foreign corporation related to the borrower; (3) received by a bank on a bank loan; or (4) "contingent interest" (interest based on the

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receipts, sales, cash flows, income, profits, dividends or distributions of a debtor or a related party). Due to these limitations, non-U.S. recipients of interest are often required to provide a statement that they are not a bank or related to the borrower.

In addition, short-term original issue discount and bank deposit interest paid by a U.S. bank (or its non-U.S. branch) are each exempt from withholding tax.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The United States does not condition its available exemptions from withholding tax on interest on the level of equity capitalisation of the borrower. A thinly capitalised borrower, however, could result in the IRS asserting that the debt is equity for tax purposes, in which case the stated interest on the debt may be subject to the dividend withholding tax. Additionally, two statutory regimes may potentially limit the deduction of interest by a relatively thinly-capitalised U.S. borrower.

Under the "earnings stripping" rules, a borrower will defer, and may lose, its deduction for "excess interest expense" (i.e., interest expense in excess of 50% of cash flows) paid to or guaranteed by certain related parties. In addition, a thinly-capitalised U.S. issuer can deduct only a relatively minimal amount of interest on "corporate acquisition indebtedness" (generally, convertible subordinated debt issued to fund an acquisition).

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There is no safe harbour for determining whether debt will be recharacterised as equity, and the debt-equity analysis is ultimately based on all of the facts and circumstances surrounding the borrowing. The earnings stripping rules described above do not apply to corporations with debt to equity ratios of less than 1.5 to 1; and the limitations on corporate acquisition indebtedness described above do not apply to corporations where such ratio is less than 2 to 1.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

If a foreign parent guarantees third-party debt of a thinly-capitalised U.S. subsidiary, the IRS may assert that in substance the loan was actually made to the foreign parent, which in turn advanced the funds to its U.S. subsidiary as an equity contribution. In this situation, any payments by the U.S. subsidiary to the third party lender would be recharacterised as dividends to the foreign parent. Additionally, a guarantee by a foreign parent may trigger application of the earnings stripping rules discussed in question 3.4, even though the lender is unrelated to the U.S. subsidiary, and under a recently enacted statute, in general guarantee fees paid to the foreign parent will be treated as U.S. source income and thus potentially subject to U.S. withholding tax.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

Other than the restrictions on the portfolio interest exemption discussed in question 3.3, there generally are no other restrictions on tax relief for interest payments by a local company to a non-resident. However, the anti-conduit rules, the newly-codified "economic substance" doctrine and certain common-law doctrines could be asserted by the U.S. tax authorities to recharacterise a transaction that formally complies with these restrictions as either non-compliant or not a true loan, which could limit or deny the availability of the tax relief described above.

3.8 Does the United States have transfer pricing rules?

Yes. U.S. transfer pricing rules allow the IRS to apportion income, deductions, credits, or allowances from cross-border transactions among related entities, if it determines that such apportionment is necessary in order to prevent evasion of taxes or to reflect income clearly. These rules may apply to transfers of services, tangible property or intangible property. Large multinational companies with significant operations in the U.S. often engage experts to review their transfer pricing arrangements to ensure compliance with U.S. law.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

Currently, the top federal tax rate for corporations is 35%. Most States and some local governments also impose income or similar taxes on corporate earnings.

4.2 When is that tax generally payable?

A corporation's tax year must match the annual period it uses for its commercial books and records, which can either be a calendar year or a fiscal year. Estimated tax payments are due quarterly. A corporation's final tax return and the payment of its remaining tax liability is due on the 15th day of the 3rd month after the end of its tax year (March 15 for a calendar year corporation), although an automatic 6-month extension is available with interest on any unpaid tax liability.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The United States has a parallel but separate system of tax accounting for determining a corporation's tax base that is distinct from other regimes that may apply for commercial, financial or statutory purposes. This system is set out in the Internal Revenue Code. Under this system, a corporation must first calculate its gross income, which includes income from services, sales of inventory (minus cost of goods sold), dividends, royalties, interest, rent and other income. Gross income also includes capital gains from sales of property. From gross income, a corporation computes its taxable income by subtracting various deductions for costs incurred in its business such as wages, depreciation, rents, interest and other ordinary and necessary business expenses.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Although the United States generally accepted accounting principles, referred to as GAAP, and tax accounting are similar in many respects, they differ in a few important ways. GAAP generally polices a reporting company's incentive to accelerate revenue and defer

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expenses, while tax accounting polices a company's incentive to defer income and accelerate expenses. In many cases, differences between the two systems can be traced to these competing biases. GAAP and tax accounting differ, for example, in the treatment of prepaid or contingent income and expenses. Under GAAP, income is recognised over the period to which it relates, and if a payment is received before it is earned it is held in suspense as deferred revenue. For tax purposes, income is generally recognised upon the earlier of the date of receipt or the date on which it is earned. GAAP recognises expenses in the period to which such expenses are economically attributable and often provides for the recognition of unpaid estimated expenses through reserves. By contrast, for tax purposes business expenses cannot be deducted until the amount can be determined with reasonable accuracy, all events have occurred that fix the fact of the liability and economic performance has occurred. As a result, reserves for estimated expenses are generally not deductible in computing taxable income.

4.5 Are there any tax grouping rules? Do these allow for relief in the United States for losses of overseas subsidiaries?

Yes. In the United States, corporate members of an "affiliated group" may, and almost always do, elect to file a consolidated Federal income tax return. An affiliated group is one or more chains of U.S. corporations where a common parent corporation owns at least 80% of the stock (by vote and value) of another "includible corporation", and one or more "includible corporations" (including the common parent) own at least 80% of the stock of the next lower tier of "includible corporations". Generally speaking, the consolidated return regime taxes affiliated corporations as if they were a single taxpayer with respect to transactions with third parties. This provides affiliated groups with the benefit of being able to use losses from one affiliate to offset the income of another affiliate. Income and losses on transactions between affiliates, however, are generally deferred under complex rules until realised in a transaction outside of the group.

Non-U.S. companies, tax-exempt corporations, and certain other companies are not includible corporations, so they may not be members of an affiliated group. Nevertheless, in certain circumstances the U.S. owner of a non-U.S. company may elect to treat that company as a pass-through entity for U.S. tax purposes. (This election is available only if the foreign corporation is not a type of entity that is required to be treated as a corporation under applicable U.S. tax regulations.) If the election is made, the subsidiary's income, gains, expenses and losses flow through to its U.S. parent and, thus, appear on the consolidated return.

State laws governing whether and when corporations may file consolidated returns do not necessarily correspond to the federal rules described above, and vary from State to State.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No. A corporation is generally taxed at the same rate on its distributed and undistributed earnings. There is, however, a second level of tax imposed at the shareholder level when earnings are distributed by the corporation. The earnings of partnerships and certain types of specialised corporations are not subject to this double taxation. Partnerships and electing small business corporations do not pay an entity level tax on their earnings, but their distributed or undistributed earnings flow through to their shareholders and are taxed at the shareholder level. RICs and REITs do not pay corporate level tax on their distributed earnings, but they are subject to tax on some of their retained earnings.

There are two "penalty tax" regimes imposed on corporations: an extra "accumulated earnings" tax applies to retained earnings, the purpose being to discourage corporations from accumulating excessive earnings to avoid the shareholder level tax on dividends; and certain personal holding companies are subject to tax on personal holding company income (generally income from passive activities), but only to the extent such income is undistributed.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There are a number of federal excise taxes, as noted above. There are also social insurance taxes that are currently imposed at a 15.3% rate on the first $106,800 of wages, and 2.9% thereafter (technically, the liability is 50% on the employer and 50% on the employee, although the employee portion must be withheld from wages by the employer and paid directly to the IRS.) There are also federal unemployment taxes.

Recent healthcare reform legislation enacted several new taxes, the most important of which for businesses are excise taxes on certain employer-provided health insurance, and a 3.8% surtax on high-income individuals and certain trusts and estates (but not corporations) in respect of "net investment income" (generally, passive income, including dividends), effective as of January 1, 2013.

The U.S. has an estate and gift tax regime that is beyond the scope of this discussion.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are a host of State and local taxes that might apply to corporations conducting business in the United States. The State governments have plenary taxing authority in their own right, and as such these tax regimes vary widely. Large multinational corporations doing business in multiple States often devote significant resources to State and local tax planning.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Corporate taxpayers may deduct capital losses, but only to the extent of capital gains. Excess capital losses may be carried back three years and carried forward five years to offset capital gains from such years.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

While individual taxpayers are entitled to preferential rates on gains derived from the sale or exchange of a capital asset held for more than one year, corporate taxpayers bear tax at the same rate on both capital gain and ordinary operating income (maximum 35% rate). As a result, the principal issue for corporate taxpayers is not a rate difference, but the character mismatch described in question 5.1.

5.3 Is there a participation exemption?

There is no participation exemption in the United States. A U.S. corporation is fully-taxed on dividends received from a foreign subsidiary and on gain from the sale or exchange of stock in a

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foreign subsidiary. Additionally, there are anti-deferral regimes that generally require current inclusion of passive income of a more-than-50% owned foreign subsidiary.

A foreign tax credit generally is available, subject to complex limitations, for foreign taxes paid by the U.S. corporation and for its allocable share of the foreign taxes paid by the foreign subsidiary when dividends are distributed by that foreign subsidiary.

Non-U.S. shareholders are generally exempt from U.S. tax on capital gain from the sale of stock of a U.S. corporation, subject to certain exceptions for U.S. corporations that own substantial amounts of real estate.

5.4 Is there any special relief for reinvestment?

Several means of relief are provided under U.S. law. For example, many mergers and other transactions involving stock consideration are exempt from immediate taxation as tax-free "reorganisations", under the theory that the transaction represents a mere change in corporate form and the assets invested remain in corporate solution. Also, corporate sellers of publicly-traded securities may defer recognition of gain if they reinvest the proceeds in a "specialised small business investment company". Finally, certain exchanges of "like-kind" or replacement property are exempt from immediate taxation.

Additionally, the "penalty tax" on accumulated earnings is avoided to the extent that a corporation reinvests such accumulated earnings (or expects such accumulated earnings will be required to meet the reasonable needs of the business).

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no federal taxes upon incorporation of a subsidiary.

There may be State filing fees and State franchise taxes imposed upon formation, the magnitude of which depends upon the particular jurisdiction of incorporation.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No. There are no additional federal taxes that would be incurred by a locally-formed subsidiary, but not by a branch of a non-resident company. Annual State franchise taxes and filing fees may differ, depending upon the particular jurisdiction of formation.

However, if a foreign parent forms a U.S. subsidiary that is a corporation (or elects to be taxable as a corporation), such a U.S. subsidiary, this would be treated as a U.S. taxpayer in its own right, and would be subject to tax on its worldwide income in the same manner as any other domestic U.S. corporation. A branch of a non-resident company, by contrast, is generally only subject to U.S. tax on its U.S. effectively connected income ("ECI") or, if the foreign parent is treaty-eligible, its income that is attributable to a U.S. permanent establishment.

6.3 How would the taxable profits of a local branch be determined?

In the absence of an applicable treaty, a U.S. branch of a foreign corporation will be subject to U.S. corporate income tax at regular rates on net ECI income. Generally, ECI will include gross income and expenses properly allocable thereto. Complex rules govern the allocation of a foreign corporation's worldwide interest income and expense to its U.S. branch, and include special rules applicable to non-U.S. banks and non-U.S. insurance companies. If a treaty applies, then a branch will be subject to U.S. federal income tax only on the profits attributable to a "permanent establishment" in the U.S., as defined in the treaty. The tax burden may be reduced (but never increased) if a treaty applies.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Yes. In the absence of a treaty, a branch of a foreign corporation is subject to a 30% branch profits tax on its after-tax "dividend equivalent amount". A branch's dividend equivalent amount is its effectively-connected earnings and profits for the taxable year to the extent that they are not reflected in the corporation's U.S. net equity.

A branch cannot literally pay a "dividend" for U.S. income tax purposes, because a dividend is defined as a distribution from a corporation to its shareholders. The branch profits tax is therefore intended to tax the branch on the repatriation of its earnings in a manner similar to the taxation of a dividend paid by a U.S. subsidiary, which is subject to withholding tax at a 30% or reduced treaty rate.

Treaties may reduce or eliminate the branch profits tax. Typically, treaties that reduce the rate of dividend withholding tax also reduce the rate of branch profits tax. If a treaty reduces the rate of dividend withholding tax but does not address the branch profits tax, the branch profits tax is generally limited by statute to the treaty rate of dividend withholding.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A U.S. branch of a non-U.S. entity generally will not be treated as a resident of the U.S. within the usual treaty definition, and thus will not be eligible for benefits provided by treaty to U.S. persons.

An entity with a U.S. branch may, however, benefit from a reduction of U.S. tax under a treaty between the United States and the entity's home country. For example, if the entity is a tax resident of the treaty partner, the amount of its branch's income subject to U.S. tax may be limited to its profits attributable to a permanent establishment in the United States, which may reduce its tax burden (see question 6.3). If the entity is a qualified resident, remittances from the branch may be eligible for a reduction of the branch profits tax under a treaty (see question 6.4).

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Yes. The branch profits tax imposes a tax if profits are remitted by the branch (see question 6.4).

7 Anti-avoidance

7.1 How does the United States address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

Although there is no overarching anti-avoidance rule under U.S.

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federal tax law, numerous statutory and regulatory provisions are designed to discourage evasive tax planning. Examples include: civil penalties covering a range of noncompliant activities, including inaccurate filings and tax shelters; prohibitions on acquiring another corporation with losses or other tax attributes with the principal purpose of evading federal income tax; anti-deferral regimes that prohibit inappropriate deferrals of U.S. tax on foreign earnings of U.S. multinational corporations; transfer pricing regimes that prohibit deferrals or avoidance of U.S. intercompany tax by U.S. multinational corporations through sales or other transactions on non-arm's length terms; treaty-shopping restrictions; and reporting requirements for taxpayers who engage in certain abusive transactions. Additionally, the United States has recently codified the "economic substance" doctrine, which may result in the recharacterisation of transactions that do not change the taxpayer's economic position (apart from U.S. tax) in a meaningful way and do not have a substantial non-tax purpose, and the incremental tax liability imposed as a result of such recharacterisation will be subject to a 20% penalty, increased to 40% if the transaction is not disclosed to the IRS.

In addition to specific statutory provisions, judicial doctrines have been developed to prevent tax results that are inconsistent with the intent of Congress. For example, a court or the IRS may apply the "step-transaction" doctrine by combining multiple parts of an overall plan when the separate treatment of each part produces an inappropriate tax result. The step transaction doctrine seeks to tax a particular transaction in accordance with its substance, without regard to its legal form; that is, where literal statutory or regulatory compliance results in an unintended tax consequence, a court may recharacterise the transaction appropriately.

The United States also recently enacted a new information reporting and withholding tax regime, generally applicable to certain "withholdable payments" made after December 31, 2012 by "foreign financial institutions" (in each case defined very broadly). The regulatory framework relating to this regime, known as "FATCA", is still being developed by the IRS and the Treasury Department, and it is expected that prior to the effective date, substantial new regulations will be issued implementing FATCA, affecting virtually all multinational enterprises that have direct or indirect connections to the United States.

In addition, the Obama administration continues to seek enactment of additional anti-avoidance measures in conjunction with the President's 2011 budget proposal. The proposals include a previous proposal to further limit on taxpayers' ability to shift income through intangible property transfers, although as of the date of this publication, this proposal has not been enacted. It is widely expected that this and other potential anti-avoidance measures will continue to be proposed in future budgets.

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Venezuela

Candal - Taxand

Manuel Candal

1 General: Treaties

1.1 How many income tax treaties are currently in force in Venezuela?

Venezuela has in effect treaties to avoid double taxation and prevent tax evasion with Austria, Barbados, Belgium, Canada, China, Korea, Cuba, Czech Republic, Denmark, France, Germany, Indonesia, Iran, Italy, Kuwait, Malaysia, Norway, Portugal, Qatar, Russia, Spain, Sweden, Switzerland, The Netherlands, Trinidad and Tobago, the United Kingdom and the United States.

Additionally, Venezuela has subscribed income tax treaties, which will enter into force with the exchange of the corresponding diplomatic notes, with Belarus, Brazil Mexico and Vietnam.

1.2 Do they generally follow the OECD or another model?

Additionally, it is important to notice that in Venezuela, the doctrine applicable to the interpretation of tax treaties has not been extensively developed. Therefore, it may be possible to have contrary interpretations of income tax treaties between the Tax Administration and the taxpayers.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Treaties do not have to be specifically incorporated into domestic law before they enter into effect. However, treaties should be approved by the National Assembly, ratified by the President of the Bolivarian Republic of Venezuela and published in the Official Gazette before entering into force, which will occur after the proper diplomatic notes are exchanged by the corresponding authorities in both countries.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Most income tax treaties do not include anti-treaty shopping rules or any provision on limitation of benefits (except for instance the Tax Treaty signed between the United States and Venezuela). However, regarding royalties and interest, the treaties usually provide that they will not apply to the payments between related parties in excess of what would have been agreed in absence of said relationship.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Treaties are not overridden by domestic law. According to the Venezuelan Master Tax Law, the income tax treaties provisions prevail over domestic legislation.

2 Transaction Taxes

2.1 Are there any documentary taxes in Venezuela?

There are documentary stamp taxes in Venezuela, which are levied on different legal transactions, including the registration of trademarks, the holding of foreign private debt, import licences, mergers and acquisitions, technology agreements, establishment of new industries, and individual visas. Rates range from 0.001 Tax Units (TU) (in 2010, 1 Tax Unit is equivalent to Bolivars 6,500). Promissory notes are subject to stamp tax at a rate of one per thousand, bills of exchange issued or discounted by financial institutions are subject to the same tax rate of one per thousand. Furthermore, pay orders to contracting companies for construction or other services provided to the public sector are subject to a similar stamp tax of one per thousand, starting from 150 TU.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Venezuela has a Value Added Tax (VAT), levied on the transfer of goods, the provision of independent services, commercial property leasing and import of goods and services. Some specific transactions are levied with a zero tax rate (0%), such as exports of goods and services, and the sale of natural hydrocarbons by mixed corporations to Petroleos de Venezuela, S.A. Currently, VAT is levied on all types of transactions at a rate of 12%. The rate may change every year, always between 8% and 16.5%. An additional 10% tax rate is applicable to sales or transactions involving specific goods considered of sumptuary consumption, such as rustic automobiles valued over US$30,000, motorcycles with cylinder capacity exceeding 500cc, coin or token machines, helicopters, airplanes, fighting bulls, trained horses caviar and jewellery with precious stones valued at a price exceeding US$500.

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2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

A number of significant VAT exemptions are provided by law. Several transfers are excluded or exempted from VAT, such as the transfer of Real Estate, the sale of intangible movable property, such as shares, trademarks, bonds, and commercial effects, movable values, loans in money, bank and insurance transactions, among others. In addition, particular or specific products and services are exempted, products such: as food (rice, salt, coffee, tuna, milk, butter, bread, sugar and others); fertilisers; medicines; wheelchairs; books; magazines; newspapers; and others; the provision of services of transport; electricity, water and gas only for domestic purposes; educational services; and accommodation services for students or disabled people, among others.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Individuals or corporations may recover VAT, when some requirements are met, thus, they must be registered at the Fiscal Information Registry. Taxpayers doing exempt transactions shall not be able to deduct the VAT credits generated from the purchase of goods and the provision of services related to those transactions. This VAT must be considered as a cost of doing these types of sales. Exporters have the right to recover the VAT credits generated from their export activities. Moreover, the National Executive Power may, by means of Decree, exonerate some specific transactions because of its nature, and may provide any special VAT recovery procedure.

2.5 Are there any other transaction taxes?

In Venezuela there are no other transaction taxes.

2.6 Are there any other indirect taxes of which we should be aware?

Custom duties are payable in almost all cases. Excise taxes are payable on the sale of alcoholic beverages, tobacco and in some services related to the sale of the mentioned products.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

There is a withholding tax imposed on dividends paid by a local company to a tax non-resident. The withholding tax is calculated on a flat rate of 34%, based on the profit distributed, via dividend, which was not subject to income tax at the corporate level of the payer. There are some specific rules to be considered for the purpose of the calculation of the dividend subject to tax. However, the treatment may be different if the beneficial owner has its tax residence in a country that has entered with Venezuela into an income tax treaty; in that case, the withholding tax rate may vary from 0% to 10%, depending on the participation held by the non-resident parent company in the capital of the Venezuelan company paying the dividends.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

There is a withholding tax on royalties paid by a local company to a tax non-resident. In Venezuela, the legal definition of royalty includes the assignment of the use of trademarks, logos, and brand names subject to patenting. The taxable income is deemed to be 90% of the gross income, which is taxed with a maximum rate of 34% and withheld at source (with an effective withholding tax rate of 30.6%). However, the tax rate may be reduced if the company receiving the royalties is a tax resident of a country with which Venezuela has an income tax treaty; in that case, the withholding tax rate may vary from 7% to 15%.

Contracts providing for royalty payments to foreign companies must be registered before the Superintendence of Foreign Investment Office (SIEX), within the following 60 days after the date of execution of the contract.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

There is a withholding tax on interest paid by a local company to a tax non-resident. Interest income received by a tax non-resident corporation other than a bank or a foreign financial institution is subject to withholding tax with a maximum rate of 34%, based on a deemed taxable income of 95% of the gross interest received (with an effective withholding tax rate of 32.30%). The interest income shall be included as part of the regular income in the annual tax return; the withholding tax will be considered as a tax credit against the tax due on the annual tax return.

Interest income received by a non-resident bank or financial institution is subject to a withholding tax rate of 4.95%.

However, income tax treaties usually reduce the withholding tax rate for interests; the rate may vary from 4.95% to 15%.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

In February 2007, a new thin capitalisation regime was introduced. According to this regime, interests paid directly or indirectly to related parties, considered as entities that have a direct or indirect participation in the control, direction or capital in other entities, will be deductible only if the total amount of the related and independent parties does not exceed its net equity (1:1 ratio).

Additionally, the debts with related parties exceeding the above ratio shall be treated only for income tax purposes as net tax equity: therefore, tax deduction of interest and/or foreign exchange losses on such debts are not allowed. However, the re-classification of foreign debt into net tax equity may generate a tax deduction deriving from the annual adjustment for inflation of the tax equity under the mandatory adjustment for inflation system.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

The Venezuelan thin capitalisation regime does not include "safe harbour" rules to determine the amount of deductible interest.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

The Income Tax Law does not expressly provide whether a loan granted by an unrelated creditor but guaranteed by a related party is to be considered as related-party debt for tax purposes. However, the Law does establish certain criteria / assumption that the tax

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authorities may eventually use to determine whether the loans in question should not be treated as debt.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

The only restriction, additional to the thin capitalisation rules mentioned above, is regarding the transfer pricing rules, in which only arms length's interest will be deductible for income tax purposes.

3.8 Does Venezuela have transfer pricing rules?

Venezuela has transfer pricing rules. Venezuela had a significant tax reform in 2001, especially in the area of transfer pricing. The Master Tax Law provides for several transfer pricing principles, including: (i) penalties relating to non-compliance with transfer pricing regulations; (ii) specific rules for transfer pricing audit procedures; and (iii) the introduction of Advance Pricing Agreements (APA).

The transfer pricing rules in Venezuela are based on the "arm's length" principle. The domestic legislation: (i) considers applicable the OECD Transfer Pricing Guidelines for interpreting any matter not addressed by the law; (ii) eliminates the safe harbour regime established in 1999; (iii) imposes transfer pricing documentation and filing requirements; and (iv) contains specific APA provisions.

Under the new rules, taxpayers are specifically required to base related parties transactions on the arm's length principle for tax reporting purposes, notwithstanding the prices actually used.

Related parties are defined as parties that are directly or indirectly managed, controlled or owned by the same party or group of parties; intermediary agents; and any relationship between a Venezuelan taxpayer and entities located in a low tax jurisdiction. In this regard, it is not clear from the definition of related parties if it includes transactions celebrated not only with non-resident companies, but with local entities as well. However, the Income Tax Law provides that transfer pricing methods are only applicable to the import and export of goods and services transactions.

The arm's length principle applies to all transactions including transfers of tangible and intangible property, services and financial arrangements.

The transfer pricing methods are basically identical to those included in the OECD Guidelines:

- comparable uncontrolled price method (CUP);
- resale price method (RPM);
- cost plus method (CPM);
- profit-split method (PSM); and
- transactional net margin method (TNMM).

The choice of method must be properly justified. The first method to be evaluated by the taxpayer should be the CUP.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The rate of tax on corporate profits is progressive, and varies as follows:

For the fraction up to 2,000 TU, the tax rate is 15%; for the fraction exceeding 2,000 up to 3,000 TU, the tax rate is 15%; and for the fraction exceeding 3,000 TU, the tax rate is 34%.

There is a specific tax rate of 50% for corporations engaged in hydrocarbon activities and related activities.

4.2 When is that tax generally payable?

The income tax must be calculated and paid each fiscal year. The annual tax return must be filed and paid during the three-month period immediately following the end of the fiscal year. However, the Tax Authorities may determine another date to file the tax return (i.e. Special Taxpayers, designated as such by the Tax Authorities in Venezuela, have a particular calendar).

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

Resident corporations are subject to income tax on their worldwide income, whether derived in cash or in-kind.

The tax base is the annual global net income (increases in the net wealth), which results from subtracting costs and deductions provided in the Income Tax Law, from the taxpayer's gross receipts. The Venezuelan source net income obtained will be affected by an inflation adjustment calculation.

Non-resident corporations with a PE or fixed base in Venezuela are taxed exclusively on their income (national or foreign) attributable to such PE or fixed base.

Dividends tax is only levied on the amount of dividends paid by a Venezuelan corporation that was not subject to the underlying corporate tax. Dividends received by Venezuelan taxpayers from foreign companies are fully subject to tax at a flat rate of 34%. Nevertheless, a tax treaty may establish another treatment.

The Venezuelan source income of a non-resident corporation without a permanent establishment in Venezuela may be generally taxed on the gross payment, if the taxpayer cannot demonstrate the incurring of any cost and/or expense directly related to the business activity.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

There are several differences, i.e. the tax profit or loss does not include some financial effects that are included in the financial results in accordance with the Venezuelan General Accepted Accounting Principles (VENGAAP), for instance: the financial inflation adjustment effect, among others; the application of a tax inflation adjustment that is not included in the commercial accounts; the moment of considering income as obtained may also differ from tax and accounting rules; there are some financial costs and expenses that do not meet the legal requirements in order to be deducted; some of the procedures to calculate certain deductions are different than those followed by the VENGAAP; and some revenue may be considered for accounting purposes but not for tax, according to legal exemptions or exonerations.

In the annual tax return, there are sections related to the conciliation between the accounting and tax profit.

4.5 Are there any tax grouping rules? Do these allow for relief in Venezuela for losses of overseas subsidiaries?

There are no tax grouping rules in the Venezuelan Income Tax Law.

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4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

In Venezuela, distribution of profits is taxable via withholding. The tax is imposed on dividends with a flat tax rate of 34%, levied on dividends based on the amount not subject to the underlying corporate tax, when the dividend is distributed, paid or credited into account.

In the case of stock dividends issued by the paying company to shareholders (individuals or companies), the payment of the dividend tax levied should be made through tax advances equivalent to 1% of the total dividend distributed. This tax advance may be credited by the taxpayer against the dividend tax due, which will result when the shares received as stock dividends are sold.

No cost will be attributed to stock dividend, as well as those arising from the re-valuation of assets.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There are other national taxes.

National taxes includes the Income Tax, the Value Added Tax, as well as all taxes related to international commerce, Excise Taxes on the production and sale of certain goods such as tobacco, and alcohol beverages.

In addition, in Venezuela there is a Gift and Inheritance Tax (GIT), which is applicable to the transfer of goods through donations or inheritance, estates and trusts. The tax rates on both inheritance and gifts vary from 1% to 55% of the wealth transferred, depending on the individual relationship with the testator or decedent.

Also there is a Law on Special Contributions over Extraordinary Prices of the International Oil Market.

This special contribution must be paid by those exporting or transporting abroad natural or upgraded liquid hydrocarbons and derivatives. The tax applies when, in a given month, the average price for spot sales of crude oil in the North Sea (Brent) for free delivery on board at Sullom Voe, UK, as published in Platts Oilgram Price Report on working days, is more than $70 per barrel, based on the methodology established by the Ministry of People's Power for Energy and Oil.

This special contribution per barrel is equal to 50% of the excess of the average Brent price in a given month over $70. If the average Brent price exceeds $100, the excess will instead be subject to a 60% rate.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are local taxes based on the fair market value of immovable property, the use of vehicles, licit games and gamble, commercial publicity and propaganda, among others.

In addition, Corporate and business entities, as well as individuals, or *de facto* partnerships, are subject to the Municipal Business License Tax (MBLT), which is calculated based on the gross income from any industrial or trading activities carried out in a particular municipality during the fiscal year. The rate varies from 0.1% to 10%, depending on the activity and on the Municipality.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Capital gains from the sale of shares, movable and immovable property located in Venezuela or abroad, when owned by a Venezuelan tax resident, are taxed as ordinary income. In that case, the tax resident individual or corporation will be entitled to offset as foreign tax credit, under certain limitations, income tax withheld or paid abroad on such income.

If the shares or the property located in Venezuela belong to a tax non-resident company or individual, it would qualify as domestic source income.

Furthermore, if an income tax treaty is applicable, in general, the transfer or sale of immovable property located in Venezuela would be taxable in Venezuela. Although, the transfer of shares may be taxable in the country of residence of the transferor - if the shares to be transferred correspond to a company whose assets principally consist of immovable property situated in Venezuela, any capital gain obtained would be taxable in Venezuela.

In the event of a capital loss, by the sale of shares of corporations, it shall only be admissible when the following circumstances occur:

- the acquisition price of the shares does not exceed the price established in the Venezuelan Securities Exchange or in case such price is not provided, a reasonable amount similar to the shares book value;
- the transferor has owned the shares for a period of no less than two years at the moment of the sale; and
- the transferor demonstrates to the Tax Authorities that the company, of which the shares were sold, was engaged in an economic activity for the last two annual fiscal periods before the sale of the shares.

However, if the capital loss is carried out by a tax non-resident corporation and it is produced by shares of Venezuelan corporations, the latter can only be offset against domestic source income. If no offsetting is possible in the tax year of the sale, the tax loss can be carried forward for the three following years, against domestic source income.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The capital gains tax rate is the regular tariff applicable to corporations or individuals. The applicable tax rates according to the Venezuelan Income Tax Law are the regular tariffs that vary from 15% to 34% for corporations and from 6% to 34% for individuals. Sales of shares not registered in the Venezuelan Stock Exchange are subject to a 5% withholding tax, which is an advance to be offset against any final tax due on the tax return.

The capital gains would be calculated based on the sale price, subtracting their tax cost, which will be determined according to some specific rules.

The sale of shares registered in the Venezuelan Securities National Commission, and made through any of the Venezuelan Stock Exchange, would be taxed with a flat withholding tax rate of 1% based on the sale price.

5.3 Is there a participation exemption?

No, there is not a participation exemption regime.

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5.4 Is there any special relief for reinvestment?

No, there is no a special relief for reinvestment.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The incorporation of a subsidiary will generate a registration tax equivalent to 1% of the share capital of the subsidiary, as well as to any increase of the latter. Additionally, there are some incorporation documentary stamp taxes.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no other significant taxes or fees that would be incurred by a locally formed subsidiary which are different from the ones levied on branches.

6.3 How would the taxable profits of a local branch be determined?

Non-resident corporations with a permanent establishment (PE), such as a branch, in Venezuela, are taxed exclusively on their income (national or foreign) attributable to such PE or fixed-base.

In order to determine the net income of a branch, the expenses incurred with the purpose of performing the branch transactions, including management and general administration expenses, shall be deducted, whether they are paid in the country or abroad. Nevertheless, payments made, if applicable, by the branch to the central office of the group or any of its other branches, affiliates, subsidiaries, parent company or in general related entities, for royalties, fees, technical assistance or similar payments for the right to utilise patents or other rights or as a commission for services provided, with exception of the payments made for reimbursement of actual expenses, shall not be deductible.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

It is important to consider that a resident branch of a foreign corporation is treated in the same way as a Venezuelan corporation for income tax purposes. Both are subject to the same general provisions of the tax law and to the same tax rates.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Some of the tax treaties signed by Venezuela include specific provisions limiting the exposure of the so-called "branch tax", which takes place when the branch distributes profits to its home office. Those provisions give a more convenient treatment to the distributions in comparison with the domestic law treatment.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

Companies incorporated and domiciled abroad, with a permanent establishment or branch in Venezuela, will be obliged to pay a branch tax on behalf of their shareholders of 34%. The tax, which shall be calculated based on its net income, not exempted or exonerated, which exceeds the fiscal net taxable income, may not proceed when the branch shows evidence of having reinvested in the country the entire difference between the net income (accounting profit) and net-taxed income for a tax period that may not be less than five years. In this latter case, the branch should file annually, along with the income tax return, a certificate issued by an external auditor evidencing that the aforementioned profit was maintained and reinvested in Venezuela.

As it was mentioned above, the exposure of this tax may be limited or eliminated in accordance with specific provisions included in some of the tax treaties signed by Venezuela.

7 Anti-avoidance

7.1 How does Venezuela address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

The Venezuelan Income Tax Law and the Master Tax Code contain general anti-avoidance provisions that empower the tax authorities to disregard legal forms or procedures when the fundamental purpose of the taxpayer is to achieve tax benefit. There are no disclosure rules imposing a requirement to disclose avoidance schemes prior to filing the company's tax return.

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Vietnam

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Vietnam?

Vietnam has entered into income tax treaties with 60 countries around the world, of which 50 tax treaties are currently in force.

1.2 Do they generally follow the OECD or another model?

Though Vietnam is not a member of the OECD, in general Vietnamese tax treaties follow the OECD model with some modifications. In particular, certain provisions (e.g. provisions relating to the definition of permanent establishment or the rights to tax "at source income" rather than "residence" criteria) conform with the United Nations model which is appropriate for a developing country such as Vietnam.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. A tax treaty must be incorporated into domestic law before it takes effect. Under the Law on Conclusion of, Accession to, and Implementation of International Treaties, depending on the nature of the treaty, the Vietnamese competent authorities will decide whether to: (i) directly apply the whole or a part of the treaty in cases where the treaty is clear and specific enough for implementation; or (ii) revise, supplement or repeal existing domestic regulations or issue specific legal documents to implement the treaty. In respect of an agreement for the avoidance of double taxation, the Prime Minister must issue a decision to approve the executed agreement prior to its implementation.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, there are no "limitation of benefits" articles applied to almost all double tax treaties which Vietnam signed with other countries. However, in some treaties, there are some provisions relating to this area. For instance, the treaty with the Philippines contains a clause which provides that the competent authorities of the Contracting States may deny the benefits of this treaty to any person, or with respect to any transaction, if, in their opinion, the granting of those benefits, under the circumstances, would institute an abuse of the treaty according to its purpose. Similarly, the treaty with Hong Kong provides that nothing in the treaty shall prejudice the right of each Contracting Party to apply its domestic laws and measures concerning tax avoidance, whether or not described as such.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Under Vietnamese regulations, in cases where there is discrepancy between an international treaty and Vietnamese laws in respect of an issue, the regulations of the international treaty shall prevail.

2 Transaction Taxes

2.1 Are there any documentary taxes in Vietnam?

Stamp duty, which was formally referred to as a registration fee in Vietnam, is a tax on the required registration of acquisition of certain assets, e.g. land use rights, boats/ships, cars, motorcycles. Under current regulations, the stamp duty rates vary from 0.5% to 15%, but the duty is capped at VND500 million per asset (approximately, US$26,000), except for passenger cars with less than ten seats. For instance, the rate of 0.5% is applicable to house and land, and 1% is applicable to boats/ships.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Vietnamese Value Added Tax ("**VAT**") is applied to all goods and services used for production, trading and consumption in Vietnam. VAT is charged on the selling price (exclusive of VAT) of the goods and services supplied. The standard VAT rate is 10%, and the preferential rates are 5% and 0%. While the rate of 0% mainly applies to export goods and services, the rate of 5% applies generally to essential goods and services such as clean water, books, foodstuffs, medicine and medical equipment, various agricultural products and services, etc. The 10% rate applies to the remaining goods and services.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

VAT exemption is applied to many categories, including:

- Certain agricultural products.
- Transfer of land use rights.

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- Financial derivatives and credit services.
- A number of insurance services (e.g. life insurance, non-commercial insurance).
- Medical services.
- Teaching and training.
- Certain cultural, artistic, sport services/products.
- Transfer of technology and software services.
- Imports of machinery equipment and special means of transport used in technology research and development activities and which cannot be produced in Vietnam.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input VAT for service/goods purchased to be directly used for the making of VAT taxable supplies are fully creditable. If the output of an enterprise (i.e. an enterprise sells goods and services which are not subject to VAT) are VAT-exempt, the relevant input VAT is non-creditable. Input VAT on fixed assets used in manufacturing and performing businesses for both VATable and non-VATable goods and services are however fully credited.

Input VAT is creditable in the month when such VAT input is incurred or within six months. A valid tax invoice must generally be retained to support claims for input tax credits. The tax invoice must state the pre-tax price, the VAT and the total amount payable.

Input VAT is only creditable if:

- the claim is supported by proper invoices for the purchase of goods or services or vouchers;
- payments for goods or services in excess of VND20 million (approx. US$1,200) must be made by and supported with bank transfer documentation; and
- goods and services are purchased for business related purposes. In practice, if an expense is viewed as non-deductible for corporate income tax purposes, it is likely that related input VAT is also non creditable.

2.5 Are there any other transaction taxes?

Prior to 2009, the transfer of land use rights was subject to a tax of 4% on the sale proceeds, which were chiefly calculated based on the land price promulgated by the local provincial People's Committee. This tax on transfer of land use rights, however, is currently not in force.

2.6 Are there any other indirect taxes of which we should be aware?

Special Sales Tax is a type of excise duty which applies to the production or importation of a number of goods and services which are considered as a luxury in relation to the economic conditions of the country and are therefore not encouraged to be consumed in Vietnam, such as cigarettes, liquor, beer, automobiles of less than 24 seats, airplanes, boats, playing cards, discotheques, massages, karaokes, casinos, and gambling.

Import and export duties generally apply on import and export goods, except for some exemptions. The import duty rates change frequently and are classified into three categories: ordinary rates; preferential rates; and special preferential rates. Exports are however generally encouraged. Therefore, zero rate export duty is applicable to almost all types of export goods except crude oil and minerals.

Other indirect taxes include fuel surcharges.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

There is no withholding tax imposed on dividends paid by a locally resident company to a non-resident who are not individuals.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalties paid by a local company to a non-resident are currently subject to withholding tax which is normally referred to as foreign contractor withholding tax (**FCWT**) in Vietnam. The FCWT regime applies to foreign contractors and foreign subcontractors doing business in Vietnam or having Vietnam-sourced income on the basis of contracts, agreements or commitments with Vietnamese organisations/individuals. FCWT includes two components VAT and corporate income tax (**CIT**). The royalties are however not subject to VAT but only subject to CIT at 10%. The tax treatment/protection may be impacted differently under any relevant double tax treaties ("**DTTs**").

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Any interest paid by a Vietnamese entity to foreign lenders who are not individuals will be subject to withholding tax (under the FCWT regime as discussed above) at 10% of CIT on the gross amount of interest paid, unless otherwise stipulated in DTTs. Similarly to royalties, interest is not subject to VAT.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Vietnam does not have thin capitalisation rules. It did previously have a maximum 70:30 debt to equity limit, but this was removed in 2006, and the debt to equity structure of the company will be subject to individual negotiations with and approval of the licensing authority. In practice, this ratio may still apply to foreign invested companies, and Vietnamese authorities may refuse to grant a licence if the charter capital is less than about 20% of the total amount of investment capital, depending on the nature and size of the project. If the offshore loans are in line with the issued business registration certificate/investment certificate, there will be no restriction on the interest so-paid.

Notwithstanding the above discussion, interest expenses shall not be deductible for CIT purposes for a local borrower in the following cases:

- Interest expenses on loans corresponding to the portion of committed charter capital not yet contributed.
- Interest on loans from non-economic and non-credit organisations exceeding 1.5 times the interest rate set by the State Bank of Vietnam at the time the loan is concluded.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There are no safe harbour rules under Vietnamese law.

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3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

As discussed in question 3.4, there are currently no "thin capitalisation" general rules in Vietnam.

3.7 Are there any restrictions on tax relief for interest payments by a local company to a non-resident in addition to any thin capitalisation rules mentioned in questions 3.4-3.6 above?

There are no relevant regulations under Vietnamese law.

3.8 Does Vietnam have transfer pricing rules?

Yes. The first detailed transfer pricing guidelines of Vietnam were issued and effective in 2006 and were recently replaced by a new circular issued in April 2010.

The guidelines apply to transactions between related parties both domestically and internationally and to transactions between an offshore parent and its subsidiaries, and/or other brother-sister corporations.

There is a comprehensive definition of related parties. The control threshold is much lower than in many other countries (20%) and therefore this significantly increases the number of companies potentially subject to transfer pricing rules in Vietnam.

Although not a member of the OECD, the methodologies generally follow the principles put forward in the revised OECD transfer pricing guidelines and the internationally accepted "arm's length principle", but with additional prescriptive requirements. The acceptable methods of determining an arm's length price are: (i) Comparable Uncontrolled Price (**CUP**); (ii) Resale Price Method; (iii) Cost Plus; (iv) Comparable Profits Method (**CPM**); and (v) Profit Split.

A declaration of transactions with related parties is required to be completed in a prescribed form, to be filed together with the CIT return which details of associated transactions and the methodologies adopted must be described.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of tax is currently 25%.

The rate applicable to the activities of prospecting, exploration and mining of petroleum and gas ranges from 32% to 50%.

4.2 When is that tax generally payable?

CIT has to be provisionally paid on a quarterly basis no later than the 30th day of the subsequent quarter. The deadline for paying annual finalisation CIT is no later than the 90th day from the end of the fiscal year.

In the context of the economic downturn, the Vietnamese government has allowed small and medium enterprises to defer the payment of 2010 CIT liabilities as follows:

- provisional CIT for the first quarter of 2010 shall be paid by 30 July 2010;
- provisional CIT for the second quarter of 2010 shall be paid by 30 October 2010;
- provisional CIT for the third quarter of 2010 shall be paid by 31 January 2011;
- provisional CIT for the fourth quarter of 2010 shall be paid by 30 April 2011; and
- final CIT 2010 shall be paid by 30 June 2011.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base is the accounting profit in the annual financial statements prepared in accordance with Vietnamese accounting standards, subject to adjustments stipulated by the Law on CIT.

In particular, assessable income shall equal to the taxable income less exempt income and losses carried forward from previous years. Taxable income is computed by starting with revenue/turnover and deducting allowable incurred expenses. Additional adjustments are made for expenses that are not deductible for income tax purposes. To be deductible for tax purposes, expenses must be supported by proper invoices or receipts.

Taxable income is the difference between total revenue, whether domestic or foreign sourced, and deductible expenditures, plus other additional income.

The following key adjustment items can be noted:

Items increasing the tax base

Generally, adjustments increasing taxable income are mostly related to the difference between accounting and CIT treatment and are typically related to expenses which are disallowed for tax deduction, including:

- incurred expenses not relating to business activities;
- expenses which are not supported by legitimate invoices and source vouchers;
- depreciation of fixed assets which are not correctly calculated in accordance with CIT regulations;
- business management expenses allocated by a foreign parent company to its local branch that exceed permitted levels;
- accruals and provisions which are not actually and fully spent;
- advertisement and promotional expenditures which exceed the deductible cap as provided by CIT regulations;
- employment costs which are non-deductible under CIT regulations (e.g. life/health insurance or any other kind of insurance which are not compulsory under Vietnamese regulations relating to employees);
- unrealised foreign exchange losses due to the revaluation of foreign currency items other than accounts payables at the end of a financial year; and
- interest payments on loans corresponding to the unpaid portion of committed charter capital.

Items decreasing the tax base

- losses carried forward incurred within five years;
- income earned from the performance of technical services directly serving agricultural production;
- after tax dividends;
- interest income from bonds which are tax exempt;
- foreign tax credit claims;
- differences in the recognition of accounting revenues and revenues for taxation purposes; and
- amounts related to science and technology development funding, which can be up to 10% of pre-tax annual income.

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4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The accounting profit in the annual financial statements should be used along with the adjustments required by CIT regulations (see the answer to question 4.3 above) for the determination of the tax base.

Income from the assignment of capital in a Limited Liability Company and the transfer of securities and income from real property transfers are subject to the following specific treatments:

- Assessable income from a capital assignment shall be the excess of the transfer price less the cost base which is the initial value of the capital contribution portion and any assignment expenses.
- Assessable income from a transfer of securities shall be equal to the selling price less the purchase price of the transferred securities and less any expenses related to the transfer.
- Assessable income from a real property transfer shall equal to the taxable income less losses carried forward from real property transfer of previous years. Taxable income from a real property transfer shall equal to revenues from the real property transfer less the initial cost of the real property and less any related deductible expenses.

4.5 Are there any tax grouping rules? Do these allow for relief in Vietnam for losses of overseas subsidiaries?

There are no tax grouping rules or tax group reliefs in Vietnamese law.

Although Vietnamese accounting law provides a possibility for a parent company to prepare consolidated financial statements at the end of annual accounting periods, Vietnamese tax law does not permit a group company to file a consolidated tax return.

There is no relief in Vietnam for losses of overseas subsidiaries. Losses arising from an offshore investment project of a Vietnamese company shall not be permitted to be offset against the Vietnamese taxable income generated by the company for CIT purposes.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, tax is not imposed at a different rate upon distributed, as opposed to retained, profits in Vietnam.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

The most relevant Vietnamese taxes (excluding the above mentioned CIT and VAT) are the following:

- personal income tax;
- import and export tax;
- special sales tax;
- foreign contractor withholding tax;
- natural resource tax;
- registration fees (similar to stamp duty in other jurisdictions);
- business licence tax;
- property tax: currently there are no actual property taxes in Vietnam but there are land use fees to be paid to the government by certain users such as foreign invested enterprises; and
- compulsory social insurance/health insurance and unemployment insurance contributions (which may be similar to payroll tax in other jurisdictions).

4.8 Are there any local taxes not dealt with in answers to other questions?

There are no other local taxes.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Vietnam does not have a separate capital tax rule. Tax on capital gains is covered under income tax (corporate income tax and/or personal income tax). Further to the discussion in question 4.4 above, generally, the tax treatment of capital gains/capital transfer is subject to particular guidance. For example, the transfer of an interest or shares by non-resident investors who are not individuals in a Vietnamese entity shall be subject to tax as follows:

- 25% CIT on gains when transferring an interest in a limited liability company. The gains will be defined as the excess of the sale proceeds less the cost base (i.e. initial value of capital contribution for first sale) and transfer expenses.
- 0.1% CIT on the sale proceeds in the case of a transfer of listed shares or the transfer of shares in a public company registered for trading at a securities trading centre.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The tax rate of 25% is commonly applicable to income from capital assignment and transfer of securities generated by residents who are not individuals (see the answer to question 5.1 for tax treatment of capital gains generated by non-residents). Income from capital assignment or securities transfer is however not entitled to tax incentives (e.g. CIT preferential tax rate or CIT exemption/reduction).

5.3 Is there a participation exemption?

There is no participation exemption in Vietnam.

5.4 Is there any special relief for reinvestment?

Since 2004, there has been no special relief for reinvestment in Vietnam.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed on the formation of a subsidiary.

However, registration fees must be paid for the establishment of a subsidiary in Vietnam in certain sectors, in particular, banking, securities or insurance.

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6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, both a Vietnamese resident subsidiary and a Vietnamese branch of a non-resident company would pay CIT on taxable income generated in Vietnam as well as on taxable income arising outside Vietnam (which relates to its operation, in case of a Vietnamese branch of a non-resident company).

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch must be determined in the same way as other independent entities in Vietnam as discussed above. A local branch can however claim a tax deduction on the management expenses which are allocated to the branch by its overseas head office up to the level allowed by CIT regulations.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax in Vietnam.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A branch registered in Vietnam is not a Vietnamese tax resident, and may not benefit from a corresponding tax treaty. Moreover, a branch of a non-resident company is considered a permanent establishment of such non-resident company in Vietnam, which may sometime take away the treaty protection of the Vietnamese double tax treaties for such non-resident companies.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax or other tax would be imposed to the remittance of profits by the branch.

7 Anti-avoidance

7.1 How does Vietnam address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

There are neither general anti-avoidance rules nor disclosure rules in Vietnam. In practice, there are ways for the tax authorities to deal with tax avoidance, such as regulations on transfer pricing, and the application of fixed prices issued by the authorities for a number of assets/goods/products such as land, imported goods, etc. to determine tax liabilities. In general, Vietnamese laws address the issue of preventing tax avoidance by applying heavy monetary penalties and other administrative measures to deal with violations on tax declarations and payment obligations.

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