Taxand
Global Alliance

Newsletter

No. 5. January 2007

Index

Legal developments 2

LEGISLATION 2

1. Belgium
2. Canada
3. China
4. France
5. Indonesia
6. Luxembourg
7. Malta
8. Mauritius
9. Peru
10. Poland
11. Portugal
12. Spain
13. United Kingdom

COURT CASES AND RULINGS 16

A) EUROPEAN UNION

1. British American Tobacco case - ECJ decision
2. The Scorpio case and its implications in Spain

B) COUNTRIES

1. Brazil
2. India
3. Sweden

OTHER NEWS 24

1. Luxembourg: The future of H29 companies and the SPF (new vehicle for private wealth management)
2. Romania's accession to the EU on 1 January 2007: Key tax implications

Special features 29

1. Focus on the reverse-charge mechanism in the European Union: The extended scope of the VAT reverse charge mechanism in France, and benchmarking existing regimes in Spain and Germany
2. United States. 2006: A "more likely than not" year

Taxand news 35

Contact information 36

LEGISLATION

1. BELGIUM

1.1 Withholding tax on dividends abolished

The Belgian Government decided on 17 November 2006 to exempt from Belgian withholding taxes all dividends paid by a Belgian subsidiary to its parent company, provided the parent company is established in a country with which Belgium has signed a tax treaty. As a result of this decision, non-EU investors may benefit in Belgium from identical withholding tax exemptions as EU-investors do by applying the Parent-Subsidiary Directive.

This new withholding tax exemption is expected to enter into force at the beginning of 2007, as soon as the Government will have enacted the required legislation implementing the exemption.

1.2 Belgium introduces consolidated VAT groups

On 24 November 2006, the Belgian Government decided to pass a Royal Decree which will allow consolidation for VAT purposes between group companies. This consolidated VAT regime will apply as from 1 April 2007.

As a result of the regime, a group of related companies will be treated as a single taxable person for VAT purposes. Consolidation for VAT purposes enhances the cash-flow position of the various group members, as they will no longer have to charge VAT on intra-group transactions. Also, VAT refunds can be made immediately to one group member and have a direct cash-flow effect since they can be offset against VAT payments due from another group member to the Treasury. At present, VAT refunds can take several months before they are actually repaid by the Treasury and are often subject to a preliminary VAT inspection.

The precise conditions and details will have to be further specified, but consolidation for VAT purposes will most probably be *optional*, for groups of companies, and limited to entities established in Belgium for VAT purposes. As a result of this latter restriction, the permanent establishments of a foreign group may also join a consolidated VAT group with other Belgian group subsidiaries.

Apart from having a beneficial effect from a cash-flow standpoint, consolidation for VAT purposes can also be beneficial to the taxable person's right to recover input VAT. Therefore, the decision on whether or not a group should apply the consolidated VAT regime will have to be considered by reviewing the total amount of input VAT recoverable by the group.

1.3 New tax treaty with the United States

The US and Belgium signed a new tax treaty on 27 November 2006. The Belgian and the US Governments will now take the necessary steps to ratify the treaty, which could enter into force on 1 January 2008.

A number of relevant topics have been addressed in the new treaty.

Fiscally transparent entities have been specifically considered in the treaty (Art. 3(1)(c)).

The new treaty also provides for a withholding tax exemption on dividends between US and Belgian companies. Dividends paid by a US company to a Belgian company will not be taxed in the US if the Belgian company holds for a 12-month period, directly or indirectly, shares representing 80% or more of the voting power in the US company (Art. 10(3)). If the US company is the beneficial owner of dividends paid by a Belgian company, Belgium will not tax such dividends if the US company has a direct holding of 10% in the capital of the Belgian company (Art. 10(4)).

In general, withholding tax on interest is reduced to zero (Art. 11).

The new treaty also includes a more specific "limitation on benefits" provision (Art. 21) than the present treaty.

2. CANADA

Revised Canadian Tax Proposals for Trusts and Foreign Investment Entities

a) *Background to the new Tax Proposal*

On 9 November 2006 the Canadian Minister of Finance released revised proposed amendments to the Canadian tax treatment of so-called "nonresident trusts" (or "NRTs") and "foreign investment entities" (or "FIEs"). These proposals have had a long and chequered history. They were first proposed by a previous Minister of Finance, from a

previous government, in the Federal Government's Budget of 1999. Draft legislative proposals to implement these changes have been released on several occasions, and have been the subject of considerable criticism from tax advisers because of their breadth and because of technical issues in their application.

The most recent previous version of these proposals had last been released for public comment in July 2005 and generally were to be applicable from 1 January 2003. Needless to say, many taxpayers and their advisers were a bit baffled as to how to respond to legislative changes that were to be effective with retrospective impact, but that had not been enacted and were still subject to change.

The new proposals both address some of the technical issues previously identified (although not always in the manner that tax advisers had hoped) and defers the application of the new rules until, generally, 1 January 2007.

The proposals had as their genesis the concern on the part of Canada's tax policy makers that Canadian taxpayers were abusing the then applicable rules to move investment assets outside of Canada and beyond Canada's tax net. The view was that both the then applicable rules for nonresident trusts and "foreign investment funds" needed to be strengthened.

b) *Overview of the Rules*

Although broad in their potential application, the proposed NRT rules should generally not be of concern in a commercial context, but only in what might be labeled "personal" circumstances. In very general terms, the NRT rules will cause a trust that is not resident in Canada to be liable for Canadian tax on its income if a resident of Canada has contributed property to the trust. In such a case, the liability for the Canadian tax of the trust can potentially be visited upon the contributor of the property or upon any Canadian resident beneficiaries, within certain limits.

Of greater concern in a commercial context will be the proposed FIE rules. These rules can apply to a Canadian resident investor in a nonresident corporation, trust, partnership or other entity. In general terms, a taxpayer that holds an interest in a FIE at the end of a taxation year will be required to include in its taxable income for the year one of three different amounts under three different regimes. First, the taxpayer may be required to include an imputed amount of income from the FIE (the "Prescribed Rate of Return Regime"). Alternatively, the taxpayer may be entitled to elect or, in certain circumstances will be required, to include in income for the year the increase or decrease in the fair market value of the taxpayer's interest in the FIE (the "Mark-to-Market Regime"). Finally, in certain circumstances, the taxpayer may be able to simply include in income his or her proportionate share of the FIE's actual income for the year.

In all three cases the income inclusion will apply notwithstanding the fact that the taxpayer may not have received any distributions from the FIE. However, mechanisms are included in the rules to try to prevent double taxation from arising upon the receipt at a later date of distributions from the FIE or from the disposal of the taxpayer's interest in the FIE.

Among the circumstances in which these new rules can be of concern is where a tax resident of Canada invests in a non-Canadian investment fund. Although the FIE rules include exemptions that should apply in most such circumstances, the exemptions are very much fact-specific, and will have to be reviewed in each circumstance. Moreover, because availability of the exemptions will generally depend on the particular investments of the fund, it will usually be difficult for advisers to provide complete assurances that these rules will not apply.

3. CHINA

3.1 Transfer Pricing ("TP") update

a) *Worse than double tax*

The State Administration of Taxation ("SAT") issued Circular GSH [2006] 901 on 28 September 2006.

The Circular states that any amount received by a related party in excess of what would have been obtained by an unrelated party

will be treated as a dividend if the company does not make the appropriate accounting adjustments after transfer pricing tax adjustments. The "deemed dividend" would not qualify for the current exemption from withholding tax ("WHT") under Article 19 of the PRC Enterprise Income Tax ("EIT") Law for Foreign Investment Enterprises and Foreign Enterprises.

The Circular also states that if payment of interest, rental income or royalties to related parties is disallowed as a transfer pricing adjustment, no refund of the WHT on the excess payment will be available.

b) *TP documentation requirements*

An international TP seminar was held in Shanghai on 17-18 November 2006. An SAT official indicated that the transfer pricing documentation requirements were being finalized. Information on the requirements will most probably be released in the coming weeks.

c) *Focus on royalties and inter-company service fees*

The SAT is putting together highly qualified tax audit teams and is looking to make more substantial transfer pricing adjustments at enterprises. SAT officials indicated that royalties and inter-company service charges will in their sights. They will clamp down on companies whose net margins are 1-2% of sales, but can pay royalties of 6-7% on sales. Their investigations have already uncovered some cases where companies are paying unfair service fees to overseas related parties.

d) *Use of comparables*

An SAT official has confirmed that China will not give up using "secret comparables." The SAT argues that many other countries also allow the use of secret comparables. However, in all bilateral APAs and competent authority cases, SAT will use sets of public comparables. The official also confirmed that the SAT is considering buying the Standard & Poor's database. The SAT currently obtains comparables from (a) its in-house foreign investment enterprise financial statements database, (b) the import and export prices database belonging to the General Administration of Customs, (c) the National Statistics Bureau database, and (d) Bureau van Dijk database.

3.2 New customs duty planning opportunities for goods traded between China and Korea

With effect from 1 September 2006, certain goods between China and Korea qualify for reduced tariffs under the Asia Pacific Trade Agreement (APTA).

For example, tariffs on imports of plastics/polymers in Chapter 39 from Korea to China will be reduced from 10% to 7%, electrical items in Chapter 85 from 30% to 21%, and automotive items in Chapter 87 from 12% to 10.8%.

In the case of exports to Korea, tariffs on compounds in Chapter 28 will be reduced by 50% (based on the current tariff), while tariffs on clothing in Chapter 62 will be reduced by 37%.

3.3 Abolishing bonded treatment for imports of raw materials for the manufacture of goods on the "Cancellation of Export VAT refunds" list

With effect from 15 September 2006, any goods on the "Cancellation of Export VAT refunds" list will be barred from processing trade and thus will no longer be allowed to be imported as "bonded goods" which are free from customs duty ("CD") and import VAT. CD and VAT must be charged on the imported raw materials.

3.4 Corrections to the tax treaty with Georgia

Circular GSF [2006] 124 in August 2006 made a correction to the Chinese version of Article 10(2) (Dividends) of the treaty as follows:

"However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

- 0% of the gross amounts of the dividends if the beneficial owner is a company which holds directly or indirectly at least 50 per cent of the capital of the company paying the dividends **and** [note that the previous wording was "*or*"] has invested more than €2 million in the capital of the company paying the dividends;

- 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly or indirectly at least 10 per cent of the capital of the company paying the dividends **and** [note that the previous wording was "*or*"] has invested more than €100,000 in the capital of the company paying the dividends;
- 10% of the gross amount of the dividends in all other cases."

The treaty is in 3 languages, English, Chinese and Georgia, and in the event of discrepancy, the English prevails.

4. FRANCE

Finance Bill for 2007 and Amended Finance Bill for 2006

a) *Tax treatment of the expenses incurred in acquiring equity securities*

For fiscal periods ending on or after 31 December 2006, the expenses incurred in acquiring equity securities must be included in the cost of the securities and the proportion of the cost of the securities that corresponds to acquisition expenses may be deducted over a 5-year period.

Acquisition expenses comprise transfer taxes, fees, commissions and the costs of legal instruments related to the acquisition.

b) *Rules on the fourth advance corporate income tax payment*

Companies that are liable for corporate income tax have to pay four advance corporate income tax payments by 15 March, 15 June, 15 September and 15 December at the latest, with each payment being equal to one-fourth of the corporate income tax payable with regard to the previous fiscal period. Any outstanding balance in respect of corporate income tax is paid by no later than the 15th day of the fourth month following the end of the fiscal period, i.e., on 15 April, where the company's fiscal period is the same as the calendar year.

In the case of companies with revenues of over €1 billion and whose estimated earnings for the current fiscal period have increased to a certain extent when compared with earnings for the previous year, the fourth advance corporate income tax payment must be calculated on the basis of estimated earnings for the fiscal period then in progress.

In the event of any variance between estimated and actual earnings, financial penalties will be imposed.

It is planned that this method of calculating the fourth advance corporate income tax payment will also be used in the case of companies that generate revenues of at least €500 million.

Furthermore, the method of calculation of the fourth advance corporate income tax payment is modified as follows:

- in the case of companies with revenues of between €500 million and €1 billion and whose estimated earnings for the fiscal period in progress have increased by over 50% when compared with earnings for the previous fiscal period, the fourth advance corporate income tax payment will be equal to 66 2/3% of the difference between the amount of tax calculated on the basis of estimated earnings and the first three advance corporate income tax payments;
- in the case of companies with revenues of between €1 billion and €5 billion and whose estimated earnings for the fiscal period in progress have increased by over 25% when compared with earnings for the previous fiscal period, the fourth advance corporate income tax payment will be equal to 80% of the difference between the amount of tax calculated on the basis of estimated earnings and the first three advance corporate income tax payments;
- in the case of companies with revenues of over €5 billion and whose estimated earnings for the fiscal period in progress have increased by over 25% when compared with earnings for the previous fiscal period, the fourth advance corporate income tax payment will be equal to 90% of the difference between the amount of tax calculated on the basis of estimated earnings and the first three advance corporate income tax payments.

Lastly, the fines imposed in the event of variance between actual and estimated earnings will be increased.

These new provisions will apply as from 1 January 2007, except for companies with revenues of over €1 billion (in which case, the new provisions already apply to the fourth advance corporate income tax payment in 2006).

c) *Tax consolidation*

- Increased flexibility in the method for calculating the 95% holding threshold

  As from 1 January 2007, the 95% holding test used to assess whether a company is considered to be the parent company or subsidiary of a consolidated tax group will be calculated without taking into account, up to the limit of 10% of the company's capital, any securities issued under a stock option plan, a procedure for the award of shares at no charge, or a capital increase restricted to the members of an employee savings plan.

- Reduction in the add-back period for financial expenses

  The period for the add-back of a proportion of the Group's financial expenses, applicable when a company of the Group acquires from the persons controlling it the shares of a company that becomes a member of the same group, will be reduced from 15 to 8 years.

  The add-back mechanism will continue to apply if the acquired company is merged into a company that is a member of the group.

- Neutral treatment of the percentage of costs and expenses incurred in respect of a sale of shares

  The percentage of 5% taxable at the standard rate in the case of a long-term capital gain on the sale of equity securities will be treated neutrally for the purposes of calculating consolidated tax group income.

  This percentage will cease to be treated neutrally where shares are sold outside the group or the selling or purchasing company leaves the consolidated tax group.

5. INDONESIA

Delay in the entering into force of the proposed tax amendments

The new amendments to Indonesian tax laws have not entered into force on 1 January 2007 as originally intended by the government. The House of Representatives has not finalized the deliberations on the proposed changes. At this point, the revised tax laws are expected to have full effects starting 1 January 2008.

Efforts to prepare the amendments to the current Indonesian tax laws started in 2004 and the final drafts were submitted by the President to the House of Representatives for deliberations early 2006.

The proposals would amend three tax laws, namely, the General Taxation Procedures & Provisions Law, the Income Tax Law and the VAT & Luxury Sales Tax Law. This will be the fourth revision to the Indonesian tax laws, which were first enacted in1983. The latest revision was made in 2000.

This tax reform is a part of the Indonesian government's three economic policy packages to improve the investment climate in the country.

6. LUXEMBOURG

6.1 Luxembourg reduces its dividend withholding tax but increases its VAT rate on certain services

The 2007 Luxembourg Budget Law was voted on on 20 December 2006. The main new tax provisions include a reduction in the dividend withholding tax rate from 20% to 15%. This change should reduce the administrative burden both for the Luxembourg tax authorities and for foreign investors qualifying for the 15% reduced rate, as is available under most of the tax treaties signed by Luxembourg. In the case of foreign investors that are not entitled to a reduced rate (for example, because they cannot benefit from the treaty provisions due to privileged tax status), the withholding tax reduction will represent a permanent saving in tax cost.

The Budget Law also include some changes in VAT, so that certain services, including services rendered by professionals ("*professions libérales*") will no longer be subject to the 12% VAT rate, but to the standard 15% rate instead.

6.2 New Bill on Specialized Investment Funds ("SIFs") to replace the Law on Institutional Investor Funds with a view to introducing more flexibility and widening the definition of "eligible investors" to include professional clients and well-informed investors

The Bill on SIFs will supersede the Law of 19 July 1991 (the "1991 Law") on undertakings for collective investment ("UCIs") the securities of which are not intended for public placement and amends the Law of 20 December 2002 (the "2002 Law") on UCIs.

The Bill largely reproduces the provisions of the 2002 Law, as amended. In addition, though, SIFs benefit from the same attractive tax regime as funds subject to the 1991 Law (i.e., no tax on income or gains, a flat capital duty on incorporation of €1,250, 0.01% subscription tax on the net asset value (although certain exemptions are available), a VAT exemption for management services supplied to SIFs).

The Bill enlarges the scope of the definition of "eligible investor", when compared with the 1991 Law: "professional clients" within the meaning of Directive 2004/39/EC on markets in financial instruments (mainly banks, investment firms with the European Passport, managers of UCITs) and other well-informed investors who either invest a minimum of €125,000 or have an assessment from a credit institution certifying that they are capable of evaluating the investment and risk, can invest in SIFs.

SIFs enjoy more flexibility than other regulated funds as regards the rules applicable to investment restrictions (no restriction on eligible assets, risk spreading rules set only as a principle), company law, valuation rules, reporting requirements, approval process, etc.

The Bill provides that UCIs currently falling within the scope of the 1991 Law will automatically fall within the scope of the new rules as of the date of entry into force of the new rules.

The Bill is a positive development in that additional individual investors who originally did not qualify to invest in funds under the 1991 Law will now be able to do so. This makes the Bill more consistent with current market practice which recognizes that individuals may also have a level of sophistication at least the equal of that of certain institutional investors. SIFs may also be viewed as an alternative to other Luxembourg vehicles, notably for hedge funds, and for private equity and real estate investments.

6.3 Amendments to the France-Luxembourg tax treaty

The amendment to the real estate provisions of the France-Luxembourg tax treaty described in the October Taxand newsletter was signed by Luxembourg and France on 24 November 2006. The new provisions will enter into force on 1 January of the year following completion by both countries of the ratification process. The Luxembourg Government recently announced that a Bill would be put forward by the beginning of 2007 so that the amendment would enter into force at the earliest on 1 January 2008.

7. MALTA

7.1 2007 Budget

In his review of the country's economic performance during the Budget Speech, the Prime Minister (who is also the Minister of Finance) announced that during 2006, Gross Domestic Product (GDP) had increased by 2.6% in real terms and inflation had risen to 3.42% (up from 2.8% in 2005). The Government also cut the budget deficit from 3.9% in 2005 to 2.8% in 2006, putting Malta on track to meet the Maastricht criteria, although inflation remained high.

Foreign investment increased substantially in the first six months of the year and the financial services industry has performed well. Malta has 18 banking institutions and more than 150 investment funds. This industry should continue to grow and contribute to the local economy, especially now that Malta will soon publish legislation to implement the agreement reached with the EU Commission.

Apart from a review of economic performance, the Minister of Finance presented the financial estimates for 2007 and a series of fiscal measures, some of which are reviewed below.

a) *Cost-of-living increase*

The cost-of-living increase for 2007 will be Lm2.25 per week. In view of rising fuel prices the Government had already anticipated an additional increase of Lm0.50 per week in last year's budget. Accordingly, the effective increase for 2007 will be Lm1.75 per week. The minimum wage for 2007 will be Lm59.63 per week.

b) *Revision of income tax bands*

The income tax bands for individuals and married couples opting for joint income tax computation have been revised.

The revised income tax bands will reduce the tax burden for individuals or married persons opting for separate computation by up to Lm155 per annum while the burden for married couples opting for joint computation will be reduced by up to Lm242.50.

c) *Income tax deductions*

As from 1 January 2007, taxpayers whose children attend approved private schools can deduct up to Lm400 (previously Lm200) from their chargeable income for every child attending primary school, and up to Lm600 (previously Lm300) for every child attending secondary school.

Expenses of up to Lm400 incurred by taxpayers on licensed childcare centers will be deductible from their chargeable income. Any expenses incurred by an employer in connection with childcare services made available to its employees will be tax deductible for the company. Where an employee is given compensation for childcare services, such compensation will not be treated as a fringe benefit to the employee.

d) *Reduced tax rate on rental income*

The Government has launched a program to encourage private property owners to let out their property to the Housing Authority for a term of not less than 10 years by charging a reduced tax rate of 5% on the rental income received by them.

e) *Employees with family-owned businesses*

Individuals working with family-owned businesses will be able to register as employees of these businesses for tax purposes. Their social security contributions will be tax deductible for the business and they will be eligible to claim all social security benefits and be entitled to a pension subject to their having paid the appropriate contributions.

7.2 Agreement with the European Union

Earlier in 2006, the Maltese Government reached an agreement with the European Commission which preserves Malta's full imputation system of taxation. The Government is currently discussing the anti-abuse provisions in the proposed tax system with the Code of Conduct (Business Taxation) Group and will shortly be publishing legislation to give effect to the agreement with the EU. A detailed review of the proposed tax changes was included in the previous issue of this Newsletter; the next one will cover the new legislation.

7.3 Malta continues to expand its treaty network

In the last three months Malta has published tax treaties with Spain, Iceland and San Marino, and signed a new treaty with Greece.

On 3 October 2006 Malta published the 'Convention between Malta and The Kingdom of Spain for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.' The tax treaty provides that tax on dividends paid by a Spanish company to a Maltese shareholder must not exceed 5% of the gross amount of dividends. If the Maltese shareholder is a company which owns at least 25% of the capital of the Spanish company, then the dividends are exempt from tax in Spain. Both interest and royalties are exempt from tax.

The 'Convention between Iceland and Malta for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income' was published by Malta on 31 October 2006. The tax treaty provides that dividend tax paid by a company resident in Iceland to a Maltese shareholder must not exceed 15% of the gross dividends. If the Maltese shareholder is a company owning at least 10% of the capital of the Icelandic company, then the withholding tax is reduced to 5%. Interest is exempt from tax in the country of source and the tax on royalties may not exceed 5%.

Lastly, on 10 November 2006 Malta published the 'Convention between Malta and the Republic of San Marino with respect to taxes on income.' The tax treaty provides that the tax on dividends paid by a company resident in San Marino to a Maltese shareholder must not exceed 10% of the gross dividends. If the Maltese shareholder is a

company which owns at least 25% of the capital of the company in San Marino, then the withholding tax is reduced to 5%. Both interest and royalties are exempt from tax in the country of source.

Also of note is an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed by the Minister of Foreign Affairs and his Greek counterpart on 14 October 2006. The agreement provides that dividend withholding tax paid by a Greek company to a Maltese shareholder must not exceed 10% of the gross dividends. If the Maltese shareholder is a company owning at least 25% of the capital of the Greek company, then the withholding tax is reduced to 5%. Interest is exempt from tax in the country of source and the tax on royalties may not exceed 8%. The agreement with Greece has not yet been published.

All the treaties and the agreement are based on the OECD Model Convention and the number of tax treaties which are in force now totals 46. Two of these treaties are limited to profits from shipping and air transportation and are with Switzerland and the United States.

Malta has already started talks with the US to sign a new treaty based on the OECD Model Convention, but no details are yet available. Other treaties which are in the pipeline include Ireland, Jordan, Morocco, Russia, Serbia & Montenegro, Singapore, Thailand, Turkey, Ukraine and the United Arab Emirates.

Malta's current treaties include those with Albania, Australia, Austria, Barbados, Belgium, Bulgaria, Canada, China, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Finland, France, Germany, Hungary, Iceland, India, Italy, Korea, Kuwait, Latvia, Lebanon, Libya, Lithuania, Luxembourg, Malaysia, the Netherlands, Norway, Pakistan, Poland, Portugal, Romania, San Marino, Slovakia, Slovenia, South Africa, Spain, Sweden, Syria, Tunisia and the United Kingdom.

7.4 The MFSA concludes Memoranda of Understanding with De Nederlandsche Bank N.V. and the Banking, Finance and Insurance Commission of Belgium

On 23 October the Malta Financial Services Authority (MFSA) concluded two significant Memoranda of Understanding with two European Union countries.

The first Memorandum of Understanding was between the MFSA and De Nederlandsche Bank N.V. (DNB). The Memorandum, which was signed at the MFSA by its Chairman Prof. J.V. Banister and DNB Executive Director Prof. A. Schilder, covers cooperation and exchange of information in the field of prudential supervision of banks, their cross-border establishments and the provision of services.

While the MFSA is the single regulator for financial services in Malta, the supervision of financial institutions in the Netherlands is shared between two institutions. DNB focuses on the prudential supervision of banks, insurance companies, pension funds and investment and securities institutions. It is responsible for promoting and maintaining the financial soundness of financial institutions that are subject to supervision. Its main objectives are to protect the interests of creditors and to ensure the stability of the financial system. Banking activities are subject to rules which aim to keep the risks of loss within acceptable limits.

On the same day another Memorandum of Understanding was signed between the MFSA and the Banking, Finance and Insurance Commission (CBFA) of Belgium on closer co-operation in the area of supervision of credit institutions. The CBFA is responsible for supervision of credit institutions and for their compliance with obligations relating to the prevention of the use of the financial system for money laundering or financing terrorism.

These two Memoranda are important additions to a growing number of bilateral and multilateral Memoranda of Understanding that the MFSA has entered into in the past few years. The aim of concluding a bilateral or multilateral Memorandum is to facilitate the exchange of information and to create a formal framework for regulatory collaboration and cooperation between regulatory authorities. Another bilateral Memorandum of Understanding currently being negotiated with a European regulatory authority is at an advanced stage and should be finalized in the near future.

8. MAURITIUS

New Protocol to the Tax Treaty with the People's Republic of China

A new protocol ("the Protocol") to the tax treaty of 1 August 1994 between Mauritius and the People's Republic of China ("the treaty") was signed on 5 September 2006. The Protocol has amended Article 13 (on Capital Gains) and Article 26 (on the

Exchange of Information) of the treaty. These amendments are summarized below:

a) *Article 13 – Capital gains*

Until now, a Mauritian company ("MCo") was not liable for PRC income tax on gains arising from the transfer of its interest or shares in a PRC company ("ChinaCo"), the assets of which did not primarily consist of immovable property, and was only subject to Mauritius income tax on such disposal. Mauritius has no capital gains tax regime and, accordingly, the gains on the disposal of PRC shares were not taxable at all.

However, as a result of the ratification of the Protocol with Mauritius, Article 13 has been amended and a clause has been added to the treaty giving the PRC the right to tax the Mco's capital gains arising from the transfer of any amount of shares in ChinaCo in cases where MCo owns directly or indirectly, a holding of at least 25 percent in ChinaCo in the 12 months preceding such transfer. Under PRC law, the withholding tax ("WHT") rate for capital gains is currently 10%.

Since it is unclear how the PRC tax authorities will interpret an "indirect holding" that triggers PRC tax on the disposal of the holding by an MCo, clarification will be required in due course.

b) *Article 26 – Exchange of information*

The Protocol has extended the scope of the exchange-of-information Article. Under the new Article 26, information will now be exchanged by the competent authorities of Mauritius and the PRC on all taxes, and not just income tax.

c) *Entry into force*

At the time of preparing this Newsletter, we understand that the Governments of both countries are following the necessary domestic legal procedures/undergoing the notification process for ratification of the Protocol. When the notification process has been completed, the Protocol will enter into force and be effective in either country in respect of income derived on or after the first day of the domestic fiscal year, i.e. 1 January in the case of China and 1 July in the case of Mauritius, following the year in which the Protocol enters into force.

d) *Additional comments*

Apart from the foregoing amendments, the other Articles of the treaty remain the same. Thus, MCo will continue to benefit from both the tax sparing provisions of the treaty as well as from the unilateral provisions of the 1996 Mauritius Income Tax (Foreign Tax Credit) Regulations.

Furthermore, although the PRC currently exempts WHT on dividends payments by a Foreign Investment Enterprise (an entity in which a stake of at least 25% is held by a foreign person) to its foreign shareholder, it is expected that a new set of corporate income tax rules will be issued in 2008 requiring WHT to be levied on dividends.

Under these provisions, the appropriate dividend policy may mean that Mauritius remains a suitable holding company jurisdiction for investments in the PRC.

e) *Planning opportunities*

For MCos that may be affected by the aforementioned change in the capital gains tax provisions of the treaty, there are various planning opportunities that may be considered with a view to maintaining a tax efficient structure for holding investments in the PRC. However, it goes without saying that identifying the most appropriate arrangement to be implemented would require detailed consideration of the client's circumstances, commercial plans and other relevant factors.

9. PERU

9.1 Tax reform

The Government asked Congress for special legislative powers in order to enact certain tax measures. In fact, a substantial number of measures has been enacted at the end of 2006 with a view to their becoming effective in 2007, among others:

- The income tax exemption for capital gains derived from transfers of stock listed on the Lima Stock Exchange has been extended for two additional years, i.e., through 31 December 2008.
- Income tax rules for hedging transactions, as well as other financial products, have been introduced for the first time in Peru.

- The term for a foreign individual to be considered domiciled in Peru has been reduced from two years to 183 calendar days in a twelve month period.
- An unlimited VAT exemption has been introduced for lending services by domiciled and non-domiciled financial and banking institutions, effectively superseding the temporary exemption that had been extended on a rolling basis.
- VAT early refunds are extended through 31 December 2009 for mining and gas companies in the exploration phase of their operations.
- The net assets temporary tax has been reduced from 0.6 to 0.5%, although the exempted limit has been reduced from 5 to S/. 1 million.

9.2 Transfer pricing regulations

Transfer pricing rules were introduced into Peruvian income tax legislation in 2004, but the formal obligation to have a transfer pricing study was held in abeyance in 2004 and 2005. Even though the Peruvian Tax Office (SUNAT) has the authority to grant exemptions from transfer pricing obligations in transactions between related parties, regulations were issued only on 14 October 2006.

The new regulations impose the following obligations:

- To file an affidavit with the tax authorities indicating: a) all transactions with entities located or established in tax havens, and b) all transactions with related parties above S/. 200,000.
- To have a transfer pricing study applicable to all entities that: a) have annual accrued revenues exceeding S/. 6,000,000 and have engaged in transactions with related companies exceeding S/. 1,000,000; or b) have engaged in transactions with or through entities located in tax havens.

Since income tax legislation does not allow any exemption from the transfer pricing rules applicable to transactions with or through entities located in tax havens, such rules are applicable to any entity or individual, including nonresidents receiving taxable income from a Peruvian source.

10.POLAND

Update on the Polish tax reform

On 24 November 2006 the President signed the legislation amending the Polish Corporate Income Tax Law, Personal Income Tax Law and Capital Tax as proposed by the Ministry of Finance in the course of the tax reform. The new legislation will take effect on 1 January 2007.

In the area of corporate income tax, a new system of taxing dividends, with a participation exemption also being applicable to distributions of profits between Polish companies, should make Poland a more friendly jurisdiction for holding companies. The changes to the Personal Income Tax Law, including the introduction of more precise rules on business operations, open up certain tax planning opportunities in respect of the taxation of management fees.

The elimination of the capital tax exemption for loans to companies by direct shareholders (which are to be treated as a capital increase subject to 0.5% tax) tightens the capital tax regime on raising capital. Despite this, Poland is one of a number of countries that may be affected by the latest proposal by European Commission to abolish such taxes. The proposed Directive would eliminate tax on such transactions by 2010.

11. PORTUGAL

Budget for 2007

The Budget Law for 2007 presented by the Portuguese Government has been recently approved.

Summarized below are the most important aspects of the Law, which applies as from 1 January 2007:

a) *Personal income tax*

Interest paid directly by nonresident entities to Portuguese residents (without the intermediation of, or any subsequent tax withholding by, a Portuguese resident entity) is taxed at a 20% flat rate, instead of being included in taxable income. As a result of this change, the taxation of interest follows the same rules as the taxation of dividends paid by nonresident entities.

b) *Parent-Subsidiary Directive*

The percentage holding in the capital stock of a Portuguese resident company that a company of an EU Member State must have in order to benefit from the exemption applicable to dividends distributed within the meaning of the Parent-Subsidiary Directive has been reduced from 20% to 15%.

Following negotiations with Switzerland with reference to the Savings Directive, the scope of the exemption has been extended to include Swiss resident entities, albeit subject to more exacting requirements, namely:

- The Swiss entity must have a holding of at least 25% in the Portuguese company's capital stock.
- Within the meaning of any tax treaty entered into by Portugal or Switzerland, the shareholder must not be considered a "resident" of a third country.
- Both payor and payee must be subject to and not exempt from corporate income tax.

c) *Corporate income tax*

- Double taxation of dividends received

  Dividends received by Portuguese resident companies from EU resident companies, whenever the conditions regarding the holding are not met (10% of capital stock, or an acquisition cost higher than € 20,000,000, maintained for one year), qualify for a partial exemption (50%), as long as they comply with the above-mentioned Directive, in the same terms as it already applies to Portuguese-source dividends.

  The scope of the anti-avoidance rule that fully restricts the tax exemption in cases where the dividends have not been effectively taxed has been revoked and replaced by a partial exemption rule (50%) or, in the case of holding companies, a full exemption.

  Finally, Portuguese companies that hold shares of companies resident in Portuguese-speaking African countries (PALOP) also benefit from the exemption, provided that:

  - The Portuguese company must hold, for two years, at least 25% of the Portuguese company's capital stock.
  - Both the payor and payee are subject to and not exempt from corporate income tax.
  - The dividends were subject to a minimum tax rate of 10% and do not derive from passive income.

- Exemption from withholding tax

  Portuguese-source dividends paid to Portuguese financial institutions are no longer exempt from withholding tax and, in turn, suffer 20% withholding tax (on account of the final tax).

- International Accounting Standards (IAS)

  With the acceptance of, and consequent adaptation to, IAS in Portugal, financial institutions that have already adopted IAS are no longer bound to keep, in parallel, accounting records in accordance with the former accounting standards for financial institutions, as would have been the case had the former legislation remained in force.

  Until the Corporate Income Tax Code is adapted to IAS (which is expected to be completed within year 2007), a set of transitional provisions were introduced in order to establish rules for calculating taxable income that are compatible with the accounting standards already followed by some entities.

- Venture capital funds

  The rules applicable to investors in venture capital funds is completely overhauled. Generally speaking, income obtained by resident members is subject to a flat rate of 10%. On the other hand, income and capital gains obtained by nonresidents other than through a permanent establishment in Portugal (except residents in blacklisted territories) are tax exempt.

- Real estate investment funds

  Closed-end real estate investment funds with private placement are no longer exempt from property tax or property transfer tax, although they will still benefit

from a 50% reduction in applicable rates. This new taxation regime will be applicable retroactively to funds created after 1 November 2006 and to those who increased their capital after that date, and also to real-estate that was detained by these funds when all the participants, at that date, were non qualified investors or financial institutions acting on their behalf.

However, a new regime is to be created for Forest Real Estate Investment Funds.

The general rule is that the regime mirrors that applicable to venture capital funds so long as 75% of the fund capital is invested in the exploration of forest resources.

- Privatizations

  The tax exemption of capital gains on the restructuring of corporations earmarked for privatization is abolished.

12. SPAIN

Tax reform approved

On 29 and 30 November 2006, tax reforming Laws 35/2006 and 36/2006 were published in the Official State Gazette. As mentioned in previous issues of this Newsletter, the reform mainly affects the Personal Income Tax Law, the Corporate Income Tax Law, the Nonresident Income Tax Law, the Wealth Tax Law, and the VAT Law.

We summarize the main reforms implemented as follows:

a) *Corporate income tax*

- The tax rate is reduced to 32.5% for 2007 and to 30% for 2008 (from 40% to 37.5% and 35% for 2007 and 2008, respectively, for entities engaging in oil and gas exploration, research, and exploitation).

  In the case of enterprises of a reduced size, the 25% tax rate (applicable to the first €120,202.41) will apply from 1 January 2007.

- The deduction for investments to establish enterprises abroad has been eliminated as of 1 January 2007.
- Tax credits, including the tax credit for exports, considered to be a harmful tax measure by the EU Commission (except those for domestic and international double taxation and for the reinvestment of extraordinary income) are gradually phased out by 2011, 2012 or 2014.
- With respect to the tax credit for reinvestment, under which capital gains on the sale of certain assets are now effectively taxed at 18% (15% until 2006), several relevant changes have been introduced, mainly in connection with the kind of assets in which the reinvestment must be materialized.
- As for changes in the field of transfer pricing, the new legislation includes:
  - the obligation for tax payers of valuating their transactions with related persons or entities at normal market value (the former legislation only conferred on the tax authorities the power to adjust the agreed value in related-party transactions when they observed that such agreed value led to lower taxation in Spain or to a deferral) ;
  - documentation obligations;
  - the transactional net margin method;
  - and a system of penalties.

b) *Personal income tax*

The main changes in the area of personal income tax are as follows:

- The tax scale applicable to the general component of taxable income is reduced from five brackets between 15% and 45% to four, between 24% and 43%.
- The new legislation establishes a "savings" component of taxable income, which is composed of capital gains from transfers of assets and of most income from movable capital. The result of this component is taxed at a flat rate of 18%, regardless of how long the assets have been owned.
- With respect to dividends received by residents in Spain, the legislation does not draw any distinction between Spanish-source and foreign-source dividends. In both cases, €1,500 are treated as exempt, subject to certain

exceptions, and any excess is taxed at an 18% rate.

- The ceiling on reductions in taxable income due to contributions to pension plans and the like is set at €10,000 and at €12,500 in the case of taxpayers who are older than 50.
- Personal and family exemptions are increased.

c) *Nonresident income tax*

The main reforms in this area are as follows:

- As in the case of the corporate income tax rate, the nonresident income tax rate is reduced in the case of income and/or gains obtained through a permanent establishment to 32.5% for 2007 and 30% for 2008.
- As for income and/or gains obtained other than through a permanent establishment, the changes are as follows:
  - The rate for dividends, interest is increased by 3 points to 18%,
  - The rate for capital gains is reduced significantly from 35% to 18%.
  - The standard rate is reduced from 25% to 24%.
  - Withholding tax on transfers of real estate by nonresidents decreases from 5% to 3%.
- Lastly, tax havens are redefined in the reform, with the inclusion of anti-abuse rules targeting at: (i) zero-taxation territories; (ii) countries with which there is no effective exchange of tax information; and (iii) certain structures including a tax haven when its principal assets consist, directly or indirectly, of property located or rights fulfilled or exercised in Spain, or where its principal activity is pursued in Spain.

d) *VAT*

- The new legislation introduces and regulates a special VAT consolidation regime applicable to corporate groups, with the following features:
  - All of the places of business must be established within the territory where Spanish VAT applies (mainland Spain plus the Balearic Islands).
  - The parent company must own at least 50% of the capital of the subsidiaries, which cannot belong to two different consolidated groups.
  - The group must elect to apply the special regime, which will be valid for at least 3 years.
  - Special rules as regards intragroup transactions can also be applied (e.g. tax-exempt transactions and special determination of the taxable base).
- It will be necessary to file periodic individual returns and periodic aggregate returns which include the results of each of the individual returns.

13. UNITED KINGDOM

13.1 Changes to the UK CFC rules

On 6 December 2006, the UK Government announced draft legislation that amends the controlled foreign company ("CFC") rules following the recent ECJ decision in the *Cadbury-Schweppes* case.

The changes will enable UK companies to apply to HM Revenue & Customs to disregard CFC profits that arise from "genuine economic activities" in business establishments located in other European Economic Area ("EEA") countries, to the extent that the CFC profits represent the "net economic value" created directly by work carried out by individuals working for the CFC.

"Net economic value" is defined as the real economic profit to the group as a whole created directly by the labor of individuals working for the CFC in the EEA State.

According to the UK Government, profits arising from capital will rarely, for these purposes, constitute profits from "genuine economic activities." Furthermore, activities that are entirely intra-group (e.g. intra-group lending) will be regarded as adding no value to the group, and therefore will not be regarded as giving rise to profits from "genuine economic activities."

However, these changes appear to be incompatible with the ECJ's decision in favor of the taxpayer in the *Cadbury-Schweppes* case, in which the ECJ ruled that the UK CFC rules should only

apply to wholly artificial arrangements where there is "a fictitious establishment not carrying out genuine economic activity."

The case involved two Irish finance subsidiaries that provided intra-group finance to the Cadbury-Schweppes group, and these subsidiaries were found not to be CFCs by the ECJ. However, if the Government's new legislation were now to be applied to these Irish subsidiaries, then they would apparently be treated as CFCs because they would not be regarded as generating profits from "genuine economic activities" as these profits would arise from capital, and would be entirely intra-group.

The new CFC legislation therefore appears to be act of desperation by the Government to try to protect its tax revenues, and is unlikely to withstand an ECJ challenge. Therefore, there appears to be nothing to prevent a UK multinational from following the Cadbury-Schweppes structure, and establishing an intra-group finance company with genuine economic substance in a low tax EU regime.

13.2 New stamp duty land tax anti-avoidance rules

On 6 December 2006, the UK Government announced new legislation, effective immediately, to counter stamp duty land tax ("SDLT") avoidance schemes.

The legislation deals with the situation where there are a number of transactions involved in the disposal and acquisition of UK real estate, and the total SDLT chargeable on the transactions is less than would have been charged on a single land transaction.

The legislation requires the scheme transactions to be disregarded, and instead requires the transactions to be recharacterized as a single "notional land transaction" with the chargeable consideration being the total consideration received.

COURT CASES AND RULINGS

A) EUROPEAN UNION

1. *BRITISH AMERICAN TOBACCO* CASE – ECJ DECISION

On 12 December 2006, the European Court Of Justice ("ECJ") announced its decision in the *British American Tobacco* case, which considered the taxation of foreign dividend income received by UK companies.

The case concerned the apparent difference in UK tax treatment between dividends received from UK companies, which are exempt from tax, and dividends received from foreign EU companies, which are taxable, albeit with a tax credit for foreign tax suffered on the profits (provided that at least 10% of the voting shares in the foreign EU company are owned by the UK recipient company).

To most observers' surprise, the ECJ overturned the Advocate-General's opinion, and found against the taxpayer. In a complex ruling, the ECJ firstly confirmed the principle that a dividend received from a foreign EU company must be treated in the same way as a dividend received from a UK company.

However, the ECJ then ruled that the UK system of taxing dividends does achieve equanimity of treatment, and does not contravene EU law, provided that:

- The tax rate applied to foreign EU dividends is not higher than the tax rate applied to UK dividends; and
- The foreign tax credit on the foreign EU dividend is at least equal to the foreign tax paid on the profits, up to the limit of the UK tax charged on the dividend receipt.

The UK tax system satisfies both these conditions if the UK company holds at least 10% of the voting shares in the foreign EU company, and accordingly complies with EU law in this situation.

However, where the UK company holds less than 10% of the voting shares in the foreign EU company, then no foreign tax credit is available for the foreign tax paid. The ECJ therefore ruled that, in this situation, the UK system is contrary to EU law.

Accordingly, the ECJ ruling is a victory for the UK Government in relation to dividends received from foreign EU companies where at least 10% of the voting shares are owned by the UK recipient company.

However, any UK companies that have previously received, and paid UK tax on, dividends received from foreign EU companies in which they own less than 10% of the voting shares, should now consider applying for a refund of this UK tax.

2. THE *SCORPIO* CASE AND ITS IMPLICATIONS IN SPAIN

In its judgment of 6 October 2006, in the *Scorpio* case (C-290/04), the ECJ established a number of principles governing the tax treatment of nonresidents who provide services in other EU Member States.

In the case considered in the judgment, note that the services in question (artistic performances in Germany by an individual resident in the Netherlands) were not provided through a permanent establishment, and that this led the ECJ to analyze the compatibility of the national (in this case, German) tax legislation with the freedom to provide services established in Article 49 of the EC Treaty, as the Article is currently worded, rather than with the freedom of establishment.

To sum up, the principles flowing from the *Scorpio* judgment (and their potential impact on Spanish legislation) are as follows:

a) *The withholding tax mechanism applicable to payments for services provided by nonresidents (generally not applicable to income and/or gains received by residents) is not contrary to EU law, nor is it contrary for national legislation to make the party required to withhold the tax liable for tax purposes, since otherwise the withholding tax mechanism would not be effective.*

   The ECJ has established that these mechanisms—i.e., withholding tax at source and liability for tax purposes of the payor of the income (applicable, by definition, to income received by nonresidents)—are not an unjustified restriction on the freedom to provide services. Thus, both the withholding tax mechanism and the liability resulting from a failure to perform the withholding obligation address the legitimate need to ensure effective tax collection and,

moreover, are proportionate (not overly restrictive) to the objective sought.

In this respect, the Spanish statute is similar to German legislation, since Article 9 of the Revised Nonresident Income Tax Law, approved by Legislative Royal Decree 5/2004, of 5 March 2004, establishes that payors of income are jointly and severally liable, precisely in cases where the separate withholding obligation established (with respect to certain types of income) in Article 31 of that Law does not apply. Based on the stance taken in the *Scorpio* judgment, Articles 9 and 31 of the Revised Nonresident Income Tax Law would be compatible with the freedom to provide services.

b) *When computing the income subject to tax (withholding) in the source country, the nonresident must be able to deduct the expenses directly related to the activity pursued in that State. Expenses not communicated to the withholder need not be deducted immediately, but rather can be taken into account in a subsequent refund of the excess received by the source State.*

In keeping with the line already taken in the judgment of 12 June 2003, in the *Gerritse* case (C-234/01), the ECJ held that when it comes to directly deducting expenses related to the activity that generates the income, both residents (who can usually deduct such expenses and be taxed on the net income) and nonresidents (who in the legislation analyzed are taxed on the gross income) are in a comparable situation and should, therefore, be able to apply the same rules (expense deduction).

Furthermore, unlike *Gerritse* (where this issue was not raised), the ECJ had the opportunity in *Scorpio* to clarify that, given the greater difficulty involved in controlling the actual existence of the expenses incurred by nonresidents and their relatedness to the activity pursued, a system whereby tax is withheld on gross income (or, in any case, net of expenses that the nonresident cannot prove at that time) can be compatible with EU law, and leave for a later time—when such proof is provided—the refund of the tax paid in excess of what would result from the tax being charged on net income.

In the case of Spain, Article 24 of the Revised Nonresident Income Tax Law establishes that where nonresidents obtain income other than through a permanent establishment they will, as a general rule, be taxed on the gross amount received (the taxable income), which would run counter to the precedent set by the ECJ in the *Gerritse* and *Scorpio* cases. Admittedly, in certain cases (which could also be comparable to the cases analyzed in those judgments: provisions of services and, in general, activities or economic operations carried on in Spain), the Revised Nonresident Income Tax Law *does* allow certain expenses to be deducted, but these are few and far between (personnel, material procurement and supply expenses) and, moreover, the expense must be physically connected with Spain, which is a requirement possibly more restrictive than that imposed by the ECJ (the ECJ only refers to expenses that are directly related to the activity pursued in the other State).

Moreover, although the calculation of the tax to be withheld in Spain must not take into account expenses incurred by the nonresident (even if they are exceptionally deductible, as we have just seen), we consider that the possibility of obtaining a refund of the excess tax paid permits the Spanish legislation in this respect to be compatible with the ECJ's stance.

Lastly, it must be recalled that the practical impact of the above measures (taxation in Spain of service providers established in other Member States on gross amounts) could be limited by the application of the tax treaties that Spain has signed with the other EU Member States. Under these treaties, the income, depending on its characterization (business profits, income obtained by independent professionals or even income obtained by artistes or sportsmen), may not be taxable in Spain.

c) *Requiring a certificate of residence to apply the exemption established in a tax treaty is not contrary to EU law, unlike the situation where the nonresident has not furnished such certificate and the payor (and party*

liable for the tax) cannot now substantiate the appropriateness of the exemption.

Spanish legislation requires the production of a certificate of residence for the application of the exemptions established in the tax treaties signed by Spain. However, since this certificate may also be produced, as the case may be, by the party liable for the tax (equally authorized to file the return and under the obligation to justify the appropriateness of the exemption) or by the withholder, the Spanish legislation in this respect would be consistent with the ECJ's stance.

B) COUNTRIES

1. BRAZIL

Brazilian CFC rules: Conflict decisions

Unlike most jurisdictions, where the imposition of CFC rules is usually conditional on several criteria, including the size of shareholding owned by the local company in the foreign corporation, the nature of the income earned abroad[1], and the country of residence of the CFC (a tax haven, for instance), in Brazil only the criterion of the size of shareholding is taken into account for the purposes of applying domestic CFC legislation. In other words, the CFC rules in Brazil adopt an unlimited approach to transparency, regardless of the nature of the income earned by the foreign corporation or of the foreign corporation's jurisdiction.

In this regard, since late 2002, entities domiciled in Brazil must pay corporate income tax in Brazil on any income earned by their affiliates or subsidiaries[2] domiciled abroad. Payment must be made at the end of the tax year in which the foreign income is earned by the CFC, irrespective of the actual distribution of profits.

With regard to tax treaties, the main issue is whether or not Article 7 ("Business Profits") restricts the application of the Brazilian CFC rules.

The relevance of this issue is borne out by recent tax treaties (such as the Brazil-South Africa tax treaty), which expressly provide that the Brazilian CFC rules are compatible with treaty provisions.

In older treaties signed by Brazil, however, there is no specific or express provision in this regard. In such cases, on the one hand, most Brazilian tax experts argue that the Brazilian CFC rules are incompatible with treaty provisions, based either on Article 7 or Article 10 of the OECD Model Tax Convention. On the other hand, the Commentaries to the OECD Model Tax Convention expressly state that domestic CFC rules and treaty provisions, namely, Article 7, are compatible.

There are no case law precedents addressing the applicability of Brazil's CFC legislation in treaty situations. In the administrative jurisdiction, however, the *Conselho de Contribuintes*[3] has recently ruled on two cases involving this issue, respectively in March and October of this year. In both cases, the dispute concerned the federal tax authorities' attempt to assess tax against a Brazilian entity, on income including that attributed to subsidiaries domiciled in Spain, a country with which Brazil has signed a tax treaty. The outcomes of these two cases were, however, completely different.

The March 2006 decision, reached by a majority of votes, went against the taxpayer, and applied the Brazilian CFC rules to the profits earned by the foreign subsidiary, on the ground that they should be deemed fictitious dividends and be taxable in Brazil under Article 10 of the Brazil-Spain tax treaty. Although there is a particular tax exemption that must be granted by Brazil on Spanish-source dividends which are taxable in Spain, pursuant to Article 23(4) of the tax treaty, it was not considered

[1] Income is usually defined either as passive income (dividends, interest and royalties) or active income (deriving from business activities).

[2] Under Brazilian law, entities are deemed to be 'affiliates' where 10% (ten percent) of their capital stock is held by another entity without control being exercised. An entity is 'controlled' where a corporation holds rights over it, either directly or indirectly, that ensure control at shareholders' meetings and the right to elect the majority of its officers.

[3] The *Conselho de Contribuintes* is Brazil's second-tier administrative tax tribunal, and is organized into a several chambers. As a rule, the tax authorities file a tax claim and appeal when the taxpayer files an administrative defense. An unfavorable decision rendered by the *Conselho de Contribuintes* can only be further contested at court by the tax authorities in very specific cases. Accordingly, the *Conselho*'s decisions are viewed as authoritative guidance on the interpretation of income tax legislation in Brazil.

applicable to "deemed dividends," as in the case of a CFC scenario. The issue of whether any restriction would be imposed by Article 7 of the treaty should the income in question be considered profits rather than dividends was not specifically addressed either. Nonetheless, in the dissenting opinion in the decision, the income was indeed characterized as profits and taxation by Brazil was deemed to be restricted under Article 7 of the treaty.

In contrast, in the October 2006 decision, the *Conselho de Contribuintes* unanimously ruled for the taxpayer, finding that the income taxed pursuant to domestic CFC rules should be considered profits under Article 7 of the Brazil-Spain tax treaty, rather than deemed dividends. Accordingly, the application of Brazil's CFC rules was held as restricted by the treaty. The reporting official in the case argued that even if the income were treated as dividends, Brazil should treat it as exempt in accordance with Article 23(4) of the Brazil-Spain tax treaty. Accordingly, the October 2006 decision is clearly at odds with the interpretation adopted in the March 2006 case.

In view of these two conflicting decisions, the issue may be analyzed by the *Câmara Superior de Recursos Fiscais*, Brazil's highest administrative tribunal hearing income tax proceedings[4]. At present, it is not possible to anticipate the outcome of such analysis should the matter be brought before this tribunal. Nevertheless, it should be noted that any such decision would probably be treated as a persuasive precedent in future cases on whether Article 7 restricts the application by Brazil of its CFC rules.

Lastly, also note that the Brazilian CFC rules are being disputed in a lawsuit at the Brazilian Supreme Court on the ground that they contravene the Brazilian Constitution's definition of triggering events for income tax purposes, namely, the economic or legal availability of income. Since the application of the Brazilian CFC would be triggered merely by the foreign resident affiliate obtaining profits, it would contravene these two criteria. If the Supreme Court rules that the Brazilian CFC rules are unconstitutional, the divergence in interpretation by the *Conselho* will become academic. As of today's date, four out of the eleven Supreme Court judges have already delivered their opinions: two voted for the unconstitutionality of the Brazilian CFC rules, one voted for their constitutionality, and the fourth voted for its constitutionality, but only where the foreign resident affiliate is controlled by the Brazilian resident company.

[4] The chief officials of all the chambers of the *Conselho de Contribuintes* sit on this Tribunal.

2. INDIA

2.1 Summary of important rulings in India

a) *Tax withholding on reimbursement of salaries for seconded employees*

The Authority for Advance Rulings ("AAR") has passed a ruling that reimbursement of salaries by an Indian subsidiary to its parent company (based in Austria) in respect of employees seconded by the parent company to the Indian subsidiary is in the nature of fees for technical services and is therefore, subject to tax withholding.

The AAR observed that the Indian subsidiary had entered into a Foreign Collaboration Agreement ("FCA"), pursuant to which the parent company was to provide all assistance and co-operation to the Indian subsidiary by providing appropriate support, technology and such other services as may be required. The FCA also required the parent company to offer services of its technical experts to the subsidiary. Pursuant to the FCA, a Secondment Agreement ("SA") was entered into whereby, certain technical personnel were seconded to the subsidiary. Under the SA, it was agreed that the subsidiary shall reimburse the parent company for all costs arising from the secondment of the personnel. The parent company also had the right to replace the seconded personnel at any time. The subsidiary had also entered into employment agreements with the seconded persons in India and the seconded persons were to work under the control of the subsidiary. The global salary income of the seconded personnel was subjected to tax in India.

Based on the aforesaid facts, particularly in light of the FCA and the SA, the AAR concluded that the payment could not be treated as a reimbursement of salary but was in the nature of fees for providing technical personnel to the subsidiary, irrespective of the fact that there was no margin charged by the parent company.

The AAR also did not accept the argument that the real employer of the seconded employees was the subsidiary company and not the parent company. The AAR therefore, held that the subsidiary company was required to withhold taxes as applicable to fees for technical services under the India-Austria tax treaty.

b) *Tax withholding on salaries paid to employees working overseas*

The AAR has passed a ruling that taxes are not required to be withheld in India on salaries paid to employees of an Indian company who were deputed to overseas countries, if these salaries were offered to tax in the overseas jurisdiction.

The Indian company sent two of its employees on deputation to one of its affiliate companies in the United Kingdom ("UK") for a period of two years, extendable to three years. The employees continued to be on the payroll of the Indian company and were paid their salaries in India. They were also entitled to receive certain allowances and perquisites directly from the UK affiliate which were taxable in the UK.

The AAR held that as per Article 16 of the India-UK tax treaty, the salaries earned by such an individual from employment exercised in the UK could be taxed only in the UK and not in India. The AAR therefore held that since in the instant case, the concerned employees could be seen as having exercised their employment in the UK, their salaries were not taxable in India, provided the salaries received in India were offered by them to tax in the UK. It was held that the Indian company was not required to withhold taxes in India on the salaries paid in India.

c) *Tax withholding requirement on license fees for use of software*

The AAR has passed a ruling that taxes are required to be withheld at the time of payment of license fees for use of software.

In providing services to the parent company in the USA, an Indian company required certain software. Initially, the parent company in the USA obtained a license to use the software from the software vendor in the USA. Subsequently, the rights under this license agreement were assigned to the Indian subsidiary. The software was an internet-based software and could be used only on the vendor's server platform. As per the license agreement, the Indian subsidiary had access to the object code of the software. A minimum royalty was payable to the vendor under the agreement for each calendar month. However, if the number of sessions exceeded a pre-agreed limit, additional sums were payable to the vendor. The vendor was to provide its technical personnel to the Indian subsidiary for technical support. However, no fees were charged by the vendor in this regard.

Based on these facts, the AAR held that the software made available to the Indian subsidiary to develop its own application was in the nature of 'scientific equipment' that was licensed for use of the Indian subsidiary. Therefore the payments made to the software vendor were in the nature of 'royalty' (under the India-USA tax treaty) for use of scientific equipment. The AAR also observed that the technical support services provided by the vendor were also incidental to the use of software and were in the nature of 'included services' under the India-USA tax treaty. However, since no amounts were charged by the vendor in this regard, the question of withholding would not arise. The AAR rejected the argument of the tax payer that the payments were towards 'business information reports'.

The above ruling follows an earlier ruling of the AAR, wherein the AAR held that taxes were to be withheld on the payments towards purchase of packaged business software solutions. However, given that the Tax Tribunal has passed orders in favour of the tax payer in the context of withholding requirement on software payments, the Indian Revenue is expected to rely on these two rulings of the AAR.

2.2 Payments for data processing on overseas mainframe computers do not require tax withholding

The Indian Income-tax Appellate Tribunal (the second appellate authority) has ruled that payments made by an Indian company to an Australian company towards data processing charges were not taxable in India and therefore, no withholding tax is required.

As per an agreement entered into by the Indian company with the Australian company, the Indian company was required to pay a fixed 'maintenance fee' and a variable 'recurring fee' for permitting the Indian company to access the mainframe computers (and related software applications) in connection with the processing of data supplied by the Indian company.

The Revenue held that the payments were towards use of the mainframe computer and the software applications residing on it. Therefore, the payments were in the nature of 'royalty' under the India-Australia treaty requiring tax withholding. The Revenue relied on an AAR ruling which was given on similar facts in favour of the Revenue. The tax payer argued that the payments were in the nature of business income in the hands of the Australian vendor and in the absence of a Permanent Establishment ("PE") of the vendor in India, the payments were not taxable in India.

The Tribunal observed that the payments were in substance towards data processing. It held that no part of the payment can be said to be towards use of the specialized software with which the data is processed or for the use of the mainframe computer because the Indian company does not have any independent right to use the computer or even physical access to the mainframe computer. It observed that the rights were only for processing the data and that the use of the mainframe computer was only for this limited purpose. The Tribunal observed that no privilege or rights were granted to the Indian company by the Australian company and that the actual data processing was in the exclusive control of the Australian company, for which it gets paid. The Tribunal therefore, concluded that the payment could not fall within any of the limbs of the definition of 'royalty' as per the India-Australia tax treaty and therefore, as the payments were not taxable in India, no tax withholding was required. The Tribunal also held that it was not bound by the observations of the AAR ruling relied upon by the Revenue.

3. SWEDEN

3.1 Swedish rules on group contributions contrary to the freedom of establishment

Sweden has a system called group contribution for "tax consolidation" within groups of companies. Group contributions are actual transfers of funds between companies, which are deductible by the contributor and taxable at the recipient, if certain conditions are met. There are no limitations in the tax legislation on the size of contribution, i.e., a profitable company should be able to contribute an amount that leaves it with a net taxable loss. Correspondingly a contribution can be made to (and is taxable at) a recipient regardless of whether or not the recipient is in a loss-making position. Group contributions are made at year-end, and adjust that taxable income for that year.

One of the conditions for allowing deduction of a group contribution is that the recipient must be liable for tax in Sweden on activities to which the contribution is attributed. It is clear from the legislation that contributions to a non-Swedish, EU-resident company are deductible if the company is liable for tax in Sweden, for instance by reason of its having a permanent establishment in Sweden.

On 29 September, 2006, the **Council for tax rulings** issued two rulings on group contributions to non-Swedish companies, which were not liable for tax in Sweden.

In the first ruling (**Case I**), a Swedish company planned to make a contribution to a Finnish parent company which had tax loss carryforwards per the Finnish tax accounts. Since the Finnish parent was not liable for tax in Sweden, a deduction was not allowed under the rules in domestic Swedish legislation.

The Council held that the condition of liability for taxation under the Swedish rules constituted a restriction on freedom of establishment. In assessing whether such restriction could be justified, the Council referred to two judgments by the European Court of Justice (ECJ), namely the *Marks & Spencer* case (case number C-446/03) and the *Futura* case (C-250/95). The former concerned the issue of loss equalization between different Member States, while the latter concerned the territoriality principle in international taxation.

The Council concluded that the obligations imposed on the EU Member States as a result of various rulings by the ECJ, to allow for loss equalization between companies in different Member States did not go further than the situation under test in the Marks & Spencer case, "i.e., transfers of losses from foreign subsidiaries to a resident parent company." Hence, the Council concluded that the restriction on the freedom of establishment could be justified in Case I and, consequently, no deduction was allowed for a group contribution to the Finnish parent company.

Case II concerned a Swedish parent company with loss-making subsidiaries in Denmark, Finland, Norway, the Netherlands and Germany, none of which were liable for tax in Sweden. The parent company planned to make contributions to these subsidiaries. If it did so, the contributions received would be taxable in the first three countries, but exempt from tax in the Netherlands and Germany.

The Dutch subsidiary was about to be liquidated, after which it would not be able to offset its tax loss carryforwards.

The issue in dispute was whether the planned contribution would be deductible by the Swedish parent company.

The Council again referred to the *Marks & Spencer* case and concluded that it was irrelevant whether a contribution was taxable in the resident State of the foreign subsidiary when deciding on whether a deduction should be allowed.

Deduction was allowed only for the planned contribution to the Dutch subsidiary. The main difference between the Dutch and the other subsidiaries was that the Dutch company was to be liquidated. The Council commented on the following conditions set by the ECJ in the *Marks & Spencer* case:

- the subsidiary must have exhausted all possibilities in the current and previous accounting periods for using the losses in its State of residence; and
- there must be no possibility of using the losses in future periods, either at the subsidiary itself or a third party.

The Council held that the liquidation of the Dutch subsidiary would have the effect of meeting the above conditions in relation to the Dutch company, and that, subsequently, the parent company should be entitled to deduct a group contribution to the Dutch subsidiary in the fiscal year during which the Dutch company could no longer use its tax loss carryforwards due to its liquidation. The deductible amount was the lower of the loss in question calculated according to Dutch principles or according to Swedish principles.

Both Cases have been appealed to the Administrative High Tribunal, which means that they cannot be relied on as precedents. However they do reflect a growing trend in Swedish tax law being contested by looking to European tax law. Indeed, many more cases will probably revisit the *Marks & Spencer* judgment. Even though the above-mentioned Cases are on appeal, they still provide preliminary answers to certain questions, apart from raising further questions in their own right, such as the following:

- it seems that the group itself *does* have some kind of right to rule out, by its own actions, all possibilities of using the losses at the subsidiary (i.e., the decision to commence liquidation is a conscious one);
- the impression given by the *Marks & Spencer* case was that the tax calculation rules in the State of residence of the parent company should form the base for calculating the deductible amount of the loss. The Swedish Council held instead that the rules that gave the least favorable result/the lowest loss should be used;
- the ruling in Case II seems to imply that a deduction may only be granted following an actual group contribution in the fiscal year in which the losses at the subsidiary are finally eliminated, and that all the formal rules attaching to group contributions must be observed. In future cases, the issue is likely to be whether transfers of funds made in previous years can be retroactively deducted in the year in which the subsidiary's losses are eliminated.

3.2 Exit taxation on migration contrary to the freedom of establishment, but may be justified

A Swedish property company considered migrating to Malta by moving its effective management there. The migration of a Swedish company is considered a taxable event with the effect that the migrating company is deemed to have disposed of its assets at market value (under the exit taxation rule). The rule does not apply if the migrating company's assets are allocated to a permanent establishment in Sweden. In the case under consideration,

however, the properties were located in another Member State.

According to the Council for Tax Rulings (in a ruling dated 29 September 2006):

- the exit taxation imposed was contrary to the freedom of establishment, since the taxation would not have been due had the properties been located in Sweden, i.e. the rule discouraged Swedish entities from establishing permanent establishments in other Member States;
- however, the restriction was justifiable, considering the territoriality principle, the apportionment of revenue-raising power between Member States, and the fact that the exit rule concerned values created when the company was resident in Sweden;
- the direct application of the rule–i.e., exit taxation upon migration–was nonetheless disproportionate.

The conclusion from the above was that the rule was applicable to the migration of the Swedish company, but its application should be postponed until the company disposed of its assets.

This ruling is also likely to be appealed. Furthermore, numerous practical issues remain unanswered, not least the fact that no administrative rules exist to address a situation where exit taxation is in principle applicable, while application of the exit taxation rule is postponed until certain future events occur.

3.3 Clarification on the scope of the Swedish participation exemption rules

In an advance ruling from the Council for Tax Rulings (not appealed against), a Swedish company was to be liquidated and certain of its holdings in subsidiaries subsequently distributed to its parent company. Such distribution would be considered tantamount to a disposal, and, therefore, the issue before the Council was whether the deemed disposal would be covered by the rules on exempt capital gains. The main question concerned two subsidiaries resident in Barbados. These companies had the status of "International Business Companies," and were subject to a Barbados corporate tax rate of 1% – 2.5 %.

The relevant Swedish tax provision stipulates that holdings in foreign companies are covered by the participation exemption rules provided that:

- the holdings would have been covered had the foreign company been a Swedish limited liability company; and
- the foreign company is “equivalent” to a Swedish limited liability company.

The Council held that the subsidiaries resident in Barbados were covered by the participation exemption rules. The grounds on which the Council reached its decision were not clearly stated, but it was informed that the companies in question bore several of the “hallmarks of legal personality,” such as the ability to sue and to enter into agreements entailing obligations and rights, and the fact that the companies’ capital was separate from the shareholders’ equity.

In previous cases it had been established that shareholdings in companies resident in Hong Kong, Estonia, Ireland (subject to 10% income tax), Luxembourg (captive insurance company) and Bahamas (companies limited by shares, according the International Business Companies Act) were also covered by the participation exemption rules. However, it has still not been fully clarified on what principles the assessment as to whether or not a foreign company is “equivalent” to a Swedish limited liability company should be made. In all likelihood, the foreign company will have to have legal personality and, in principle, also be a taxable person, albeit potentially subject to a very low tax rate. One observation on the participation exemption rules is that they are also applicable to holdings in companies considered to be CFCs under Swedish legislation.

OTHER NEWS

1. LUXEMBOURG

1.1 The future of existing H29 companies following the decision of the European Commission

A recently enacted Law clarifies the transitional rules applicable to existing 1929 holding companies (“H29s”). These companies had for many years largely ceased to be used in a corporate context and were being mainly used for private wealth management.

A decision of the European Commission required Luxembourg’s Exempt, Milliardaire and Financial Holdings of 1929 tax regime (hereafter referred to as “H29 tax regime”) to be repealed by the end of 2006 and defined the “grandfathering” rules applicable to existing H29s until the end of 2010. Following this, a Law was enacted by the Luxembourg Government on 19 October 2006 abolishing the H29 tax regime and defining the rules applicable to existing H29s during the transitional period ending on 31 December 2010.

As a result of the new Law, the provisions of the Law of 31 July 1929 (as amended) are abolished as from 1 January 2007. In addition, the regime does not apply to companies incorporated after the notification of the Commission’s decision, i.e., after 20 July 2006.

Grandfathering rules will apply during a transitional period starting on 1 January 2007 and ending on 31 December 2010 to companies that benefited from the H29 regime on 20 July 2006, meaning that existing H29s may still benefit from the H29 regime during this period.

The benefit of the regime ends however if all or some of the shares of the H29 are sold, except in the following situations:

- a sale of shares of H29s that were listed on a recognized stock exchange before 20 July 2006. The regime will remain applicable as long as they remain listed on a recognized stock exchange;
- a transfer of shares between existing shareholders, members of the same group or between “related companies” within the meaning of Articles 309 and 310 of the amended Companies Law of 10 August 1915; this principally covers situations where one company controls a majority of the voting rights at another; or
- a sale of shares in an inheritance, matrimonial or similar context.

The next step for existing H29s will be to consider appropriate restructuring processes to engage in during the transitional period. Alternatives are in the process of becoming available for H29s used for private wealth planning since a Bill has just introduced a new vehicle: the SPF (see below). Other H29s, including advisory companies belonging to one single SICAV and currently benefiting from the H29 regime, will need to plan now for the situation after 31 December 2010.

1.2 SPF, the new Luxembourg vehicle for Private Wealth Management

As announced by the Luxembourg Government following the recent decision of the European Commission on H29s, Luxembourg is introducing a new investment vehicle for private wealth management. A Bill was laid before the Luxembourg Parliament on 20 November 2006, defining the characteristics and conditions of the “*Société de Gestion de Patrimoine Familial*” (or “SPF”).

An SPF is defined in the Bill as a company, the purpose of which is limited to the acquisition, holding, management and disposal of financial assets and excludes any type of commercial activity, the shares of which are exclusively held by eligible investors, and the bylaws of which make a specific reference to the present law. SPFs have to be set up under the specific legal forms defined in the Bill.

a) *Purpose of SPFs*

SPFs only engage in private wealth management activities and any commercial activity is therefore prohibited. The SPFs may hold “financial instruments” within the meaning of the Law of 5 August 2005 on Financial Guarantees; e.g. shares in companies, other securities equivalent to shares/units in companies, undertakings for collective investment, bonds and other forms of debt instruments, as well as cash and assets of any kind held in a bank account. An SPF may also hold interests in the capital stock or voting rights of other companies, but only to the extent that it does not involve itself in the management of these companies. The SPF cannot render services of any kind, including

the granting of interest-bearing loans, even to companies in which the SPF holds a interest. It may, however, make advances to, or guarantee the liabilities of, a company in which it holds an interest, but only on an ancillary basis and at no charge.

b) *Eligible investors*

"Eligible investors" are defined by the Bill as:

- individuals managing their private wealth, or
- private wealth entities acting for one or several individuals, or
- intermediaries acting on behalf of either of the two preceding types of investor.

Based on commentaries to the Bill, "private wealth entities" are intended to include entities such as trusts, foundations, *stichtings* or any other entity of this nature.

c) *Tax regime governing SPFs*

An SPF is exempt from corporate income tax, municipal business tax and net worth tax. It is also exempt from Luxembourg withholding tax on distributions.

Income from financial assets is therefore exempt at the level of the SPF but will be taxed subsequently once the income is distributed to the private investor:

- interest paid by the SPF on its debts to individuals are subject either to the final 10% withholding tax for individuals resident in Luxembourg, or to withholding tax under the provisions of the so-called "Savings Directive," mainly for EU resident individuals;
- dividends paid to Luxembourg shareholders (individuals) will be fully taxed in their hands.

Gains realized by nonresidents on the disposal of a holding in a SPF, either on sale or on liquidation of the SPF will not be taxable in Luxembourg.

Given its tax regime, an SPF will not be able to benefit from the tax treaties signed by Luxembourg.

An SPF is excluded from the participation exemption regime for a given fiscal year if at least 5% of the total dividend income it receives during that year is derived from participations in nonresident unlisted companies that are not subject to an income tax similar to Luxembourg corporate income tax (i.e., subject to an effective rate of less than half the Luxembourg corporate income tax rate, which is currently 22%, i.e., 11%).

The SPF is subject to 0.25% subscription tax on its capital stock, including any additional paid-in capital. The minimum tax is €100 and the maximum tax is €125,000 a year. Subscription tax will also apply to the part of the debt (if any) that exceeds a debt-equity ratio of 8 to 1.

d) *EU dimension: no state aid*

The EU dimension was taken into account when drafting the Bill. Since an SPF is a passive investment vehicle that manages the private wealth of investors and does not interfere in the management of any subsidiary, it does not engage in any economic activity and should therefore not be construed as benefiting from "state aid" within the meaning of Article 87 of the Treaty of Rome, since Article 87 deals with aid granted to enterprises carrying on an economic activity. A recent decision of the European Court of Justice (ECJ judgment dated 10 January 2006 in the *Cassa di Risparmio di Firenze* case) confirms this interpretation.

2. ROMANIA'S ACCESSION TO THE EU ON 1 JANUARY 2007 – KEY TAX IMPLICATIONS

On 1 January 2007 Romania joined the European Union. The Romanian tax system has undergone significant changes with effect from 1 January 2007, mainly as a result of harmonization with EU Directives on direct and indirect taxation. This section describes succinctly the main tax changes implemented in Romania on 1 January 2007, based on Law 343/2006 amending the Romanian Fiscal Code.

a) *Corporate income tax and capital gains tax*

The **corporate income tax rate** of **16%** applicable to all types of income earned by a Romanian entity remains in force in 2007. The **deductibility** of certain items is however eliminated, e.g. specific reserves set up by banks and other credit institutions. On the other hand, the limits on debt-equity ratio no longer apply to non-banking financial institutions.

Another change relates to the **payment** of corporate income tax: in the past, the tax was calculated on the basis of actual figures and payments were made quarterly (monthly for banks). As of 1 January 2008, quarterly payments will be made based the tax on the previous year's profits, adjusted for inflation – this provision entered into force on 1 January 2007 for banks operating in Romania, while the old system still applies in 2007 for all the other corporate income tax payers. Also, annual corporate income tax returns for taxpayers other than banks will have to be filed by 15 April of the following year.

With effect from 2007, the provisions of the Romanian Fiscal Code implement and flesh out the detail of the current provisions on domestic mergers and spin-offs. Provisions in line with the **EU "Merger Directive"** are introduced, allowing tax neutral mergers between companies resident in different EU Member States.

Further developments to the **transfer pricing** rules were introduced from 2007 and more emphasis will be placed on the appropriate documentation of related-party transactions, including the requirement for taxpayers to prepare a transfer pricing file to be available for review by the authorities. The transfer pricing provisions were not enforced for domestic transactions between Romanian legal entities qualifying as related parties, a position that will seemingly continue in 2007. Also, the possibility to apply for and obtain Advance Rulings and APAs is available under the recently adopted rules (Fiscal Procedural Code).

As regards **capital gains**, note that under Romanian law, foreign legal entities dealing in shares held in a Romanian company, including shares held in companies largely owning real estate assets, are required to pay corporate income tax (at 16%) on the gains derived and submit corporate income tax returns, unless more favorable treatment is afforded under a relevant tax treaty.

b) Indirect taxation

For indirect tax purposes, the effect of Romania's accession to the EU is reflected in the adoption of the "*acquis communautaire*," i.e. the set of directives, regulations, rules, court cases (of the European Court of Justice) and practical solutions adopted already by other EU Member States. The most important indirect tax implications of doing business in Romania will be immediate and are related to value added tax (VAT), and customs and excise taxes. The **standard and reduced VAT rates** remain **19%** and **9%,** respectively, in 2007.

Both Romanian and foreign entities trading in Romania have to consider the following key VAT changes, arising mainly from implementation of the 6th EU VAT Directive:

- VAT changes for cross-border supplies of goods and services, namely in the case of exports and imports of goods to and from third territories; trade with EU Member States; services to/from entities in EU Member States or to/from third territories;
- removal of customs borders, but maintenance of VAT borders will result in implementation of new place-of-supply rules for goods and services (e.g. leasing of means of transportation, supply of gas and electricity, supply of goods with installation, intra-community transportation, telecommunications services, services relating to movable goods ('*lohn*"/"tolling"), e-services, etc.);
- Exports to third territories continue to be exempt from Romanian VAT if the supplier can prove that the goods have left the enlarged EU;
- Imports (i.e., goods are released into "free circulation") into the EU through Romania are subject to VAT, but the reverse-charge ("**postponed accounting**") mechanism will be applicable (and hence neutral from a cash-flow perspective);
- the free intra-community movement of goods results in new rules applicable to intra-community acquisitions (ICAs) and supplies (ICSs), including new place-of-supply rules, documentation requirements, etc. – for instance, on ICAs there will be no payment of VAT or customs duties as the VAT reverse-charge mechanism applies in certain circumstances; in ICSs, no VAT will be charged if proof of transportation to

another EU Member State and the VAT number of the customer is available to the supplier;

- new reporting requirements are introduced for intra-community transactions for VAT and statistical purposes – e.g. quarterly recapitulative statements (EC Sales and Purchase Lists), Intrastat, new VAT returns, VAT journals, "Non-transfer" register, register of "Goods received", etc.; these new requirements may result in the need to change ERP systems to permit records on the customer's EU VAT numbers to determine the VAT treatment, registration on the EU's VAT Information Exchange System ("VIES"), classification of goods traded by 8-digit codes (similar to customs codes) for Intrastat reporting purposes, etc.
- new invoicing procedures (EU Directive on simplifying VAT invoicing requirements) are adopted, and the old "fiscal invoices" are eliminated; self-billing requirements; electronic invoicing and third-party invoicing will also be allowed;
- certain simplifications are possible in given conditions, e.g. postponed accounting mechanism for imports of goods, consignment stock and call-off stock simplifications, triangulation simplifications, etc. However, possible foreign VAT registration requirements need to be reviewed by foreign and Romanian entities (e.g. in case of triangulation, distance sales, ICAs in other Member States); new VAT refund procedures for foreign entities (implementation of the 8th and 13th Directives);
- new rules on real estate transactions are implemented: exemption from VAT without credit for input VAT will apply to rental and leasing of real estate assets (with the option to tax); sale of new buildings and building land (specifically defined) will be taxable at 19%, however the current simplification rules for sale of real estate assets will continue to apply, provided both seller and buyer are taxable persons, registered for Romanian VAT purposes (in this case, the reverse-charge mechanism applies, without cash-flow implications for either party); the sale of buildings and land other than as noted above will be VAT exempt without credit for input VAT, with the option to tax such transactions; the adjustment period for real estate assets is increased to 20 years (from the past adjustment period of 5 years); a capital assets register (including real estate assets) will have to be kept for the adjustment period;
- other VAT changes: a new threshold for small enterprises (reduced to €35,000, down from the past threshold of RON 200,000), new rules for distance sales, new means of transportation and excisable products, second-hand goods, travel agents, special scheme for non-established taxable persons supplying e-services to non-taxable persons, joint and several liability of recipient with the supplier, transfer of own goods between Member States, debt collection, factoring and custody activities become VAT-able, pro-rata calculation amended, etc.

Other major changes occurred in the area of customs, with the adoption of the Community Customs Code and its Implementing Regulation, as well as the Integrated Tariff of the European Communities (TARIC). There are applicable new customs regimes and procedures, a new definition of "release into free circulation," customs status of goods ("community" and "non-community" goods), customs regimes with economic impact (authorization), application of compensatory interest, Authorized Economic Agents (AEA) regime, etc.

c) Micro-enterprises

The old system of turnover taxation of micro-enterprises is maintained in future years, but with new applicable tax rates: 2% in 2007, 2.5% in 2008 and 3% in 2009. However, new conditions to qualify as a micro-enterprise must be fulfilled - apart from a maximum annual turnover of €100,000 and a headcount of between 1-9 employees, a new requirement that not more than 50% of the turnover be derived from consultancy services has been introduced. In case one of these two thresholds is exceeded during the year, the entity becomes a corporate

income tax payer from the beginning of that year.

d) *Personal income tax*

The flat personal income tax **rate** of **16%** applicable in 2006 for salary income remains unchanged in 2007, but the tax rate for capital gains arising in transactions with long-term privately held shares is set to rise (from 1% to 16%). The 1% capital gains tax rate remains applicable only for sales of shares held in listed companies for a minimum 1-year period.

Another significant aspect is harmonization with the EU Savings Directive (exemption from taxation of interest derived by individuals).

As regards real-estate transactions, the former system taxing gains on such transactions at 16% is replaced by the following mechanism:

- If the real estate is sold within 3 years from the date of acquisition, the applicable income tax is:
  - 3% on the sale value, where such value is less than RON 200,000 (or approximately €57,000); or
  - RON 6,000 plus 2% on the amount exceeding RON 200,000.
- If the real estate is sold after 3 years from the date of acquisition, the applicable income tax is:
  - 2% on the sale value, should such value be less than RON 200,000; or
  - RON 4,000 plus 1% on the amount exceeding RON 200,000.

Stamp tax (also applicable to real estate transactions) is eliminated as from 1 January 2007.

e) *Withholding tax*

As from 1 January 2007 the Fiscal Code is harmonized with the **EU "Parent-Subsidiary" Directive**, allowing exempt dividend distributions by Romanian companies to EU-resident legal entities with a minimum 15% holding (10% from 2009 onwards) in the capital of the Romanian company, for a minimum period of 2 years ending on the date of the dividend payment.

The **"Interest & Royalties" Directive** is set to apply as from 1 January 2011. In the transitional period until 31 December 2010, a 10% reduced domestic rate (down from the standard 16% tax rate) will apply to payments by Romanian entities to EU legal entities deriving interest and royalties from Romania, provided that they have owned a minimum 25% shareholding for a minimum of 2 years ending on the date of payment of the interest/royalties (unless a more favorable rate applies under the applicable tax treaty).

f) *Local taxes*

The legislation which entered into force in 2007 establishes new local tax rates (0.1%) for buildings owned by individuals (down from 0.2% for urban buildings; the 0.1% rate remains for rural buildings) and also establishes new building tax rates for legal entities (0.25-1.5%, instead of 0.5-1%) applicable to book value (the tax varies between 5% and 10% in the case of buildings not revalued in the past 3 years). Nevertheless, certain local tax exemptions may be granted by local councils. Local taxes will be paid to local councils in two half-yearly installment payments on 31 March / 30 September (instead of quarterly tax payments).

1. FOCUS ON THE REVERSE-CHARGE MECHANISM IN THE EUROPEAN UNION: THE EXTENDED SCOPE OF THE VAT REVERSE CHARGE MECHANISM IN FRANCE, AND BENCHMARKING EXISTING REGIMES IN SPAIN AND GERMANY

The amended Finance Bill (LFR) for 2005 has extended the scope of the VAT reverse charge mechanism. A supplier who is not established in France no longer has to account for VAT through the reverse-charge mechanism – instead, it is the customer, identified for VAT purposes in France, who has this obligation. This new treatment will apply to supplies of goods to and from France, supplies of goods after assembly and installation, supplies of services related to buildings located in France, supplies of cultural, artistic, sports, educational, entertainment and scientific services, and supplies of all types of services other than those related to intra-community transportation.

It is important to stress that the former rules remain unchanged where the new regime is not applicable. Accordingly, while its effect will be a more widespread use of the reverse charge mechanism, the new regime is not intended to replace existing "traditional" cases where the reverse charge is used, such as those involving intra-community acquisitions. The former rules will therefore continue to apply in their own right with a specific VAT line and different VAT codes for ERP purposes.

1.1 Summary of the new French provisions

a) *Effects on foreign suppliers*

The effect of the new rules on foreign suppliers will be similar, regardless of whether they are registered for VAT in France (i.e., the VAT identification number of the foreign supplier has no ‘force of attraction’). The resulting treatment may be very difficult to define. Thus, when a supplier of goods or services not established in France performs transactions for French VAT-identified customers and transactions for clients who are not identified for VAT purposes in France:

- he may be liable for VAT on supplies of goods and services to French customers not identified for VAT purposes in France;
- he may not be liable for VAT on supplies of goods and services to companies identified for VAT purposes in France;
- he may be liable for VAT on transactions such as the rental of unfurnished offices not subject to the VAT charging option, or imports.

b) *Effects on French companies (customers identified for VAT purposes in France)*

Mirroring the above, for French companies (customers identified for VAT purposes in France), the foreign supplier’s invoices are affected by the new provisions. A French company (customer identified for VAT purposes in France) should no longer be concerned by whether or not the supplier has a VAT identification number in France. What is now important is the exact *type* of supply of goods or services made. The French company must not totally rely on the VAT rules applied by the foreign supplier. Indeed because of the novelty and complexity of these provisions, it is very likely that some foreign suppliers may not apply the correct VAT rules. Indeed, the French company (customer identified for VAT purposes in France) could receive from a supplier established abroad (who may or may not be registered for French VAT), the wrong invoice with French VAT instead of an invoice with no French VAT, despite the obligation being on the customer to account for VAT under the reverse-charge mechanism. The fact that the supplier’s invoice refers to French VAT should not be considered as an indication that the right VAT rules were applied by the supplier.

Since three penalties (detailed below) could be imposed on the customer in the event that the wrong VAT rules were applied by the foreign supplier or the customer, it is important to check the correctness of the VAT rules applied before the invoice is sent.

c) *French administrative leniency*

The new approach is tempered by administrative leniency as referred to in the Notice of June 2006. However, such leniency does not alter the fact that the party liable for VAT is the customer who has a French VAT number.

Nevertheless, if the supplier of goods or services and the customer agree (more often than not, they are two companies belonging to the same group), the VAT legally payable by the customer is reported and paid by the seller for and on behalf of the customer. For this purpose, the seller should designate a *répondant* (guarantor), a taxable person who is established in France and who will fulfill the VAT return formalities and pay the VAT to the tax authorities on behalf of the seller. The *répondant* has to be approved by the competent tax authority. Where the supplier of goods and services is not established within the European Union, the tax representative will be the *répondant*.

As a result of this arrangement, it is possible in the same group to offset the adverse cash-flow effects of the reverse-charge mechanism on the seller, since it can no longer offset the VAT collected on the sale against the VAT that it has to pay. The *répondant* mechanism enables him to charge in the seller's VAT return the tax payable by the customer identified for VAT purposes in France, thereby reducing the amount of VAT that the seller can deduct. The Notice also mentions the particular cases in which leniency can be applied.

d) *Steps to be taken in france*

- By French companies (customers identified for VAT purposes in France)

  The Notice contains a reminder that failure to apply the VAT reverse-charge mechanism will result in a penalty of 5%, no deduction of the VAT incorrectly paid, and late-payment interest due to nonpayment of VAT. These three penalties combined are only levied on customers identified for VAT purposes in France and will be imposed even if the error was made by the foreign supplier. Under these circumstances, it is essential for companies identified for VAT purposes in France to examine their flows and determine whether they become liable for VAT where their supplier is a foreign taxable person. They have also to adapt their VAT returns and processes accordingly.

- By foreign suppliers

  Suppliers of goods and services who are not established in France must also identify their flows and determine whether they need to cancel their French VAT number.

  They have also to adapt their invoicing processes as well as their procedures for complying with Intrastat requirements.

1.2 Reverse-charge provisions in Spain

Spanish VAT legislation has traditionally included the reverse-charge mechanism where non-established traders carry out taxable transactions falling within the scope of Spanish VAT. The concept of “established trader” or, in other words, the concept of “fixed establishment” is defined in the Spanish VAT Law as any fixed place of business from which traders or professionals carry on economic activities and the Law also lists example circumstances that result in the existence of a fixed establishment. If a trader has a fixed establishment in Spain, he is generally considered to be the person liable to pay VAT on his transactions within the territory where Spanish VAT applies (even if the supply of goods or services is not made through the fixed establishment).

However, if the supplier is not established in Spain (even though it might be registered for VAT with the Spanish tax authorities), the reverse charge generally applies. In particular, tax liability is shifted onto the customer in the following cases:

- Local supplies of goods by a non-established trader where the customer is a trader, regardless of his status. Thus, the reverse-charge mechanism applies, not only where the customer is established in Spain, but also where he does not operate through any fixed place of business. This latter case adds complexity to the VAT treatment of these transactions and the customer has to register for VAT in Spain.
- Supplies of services by a non-established trader where the recipient is established for VAT purposes. If the recipient of the services is also not established in Spain, the reverse-charge procedure does not apply, unless the supplies of services qualify as intermediary services, works on movable goods, or intra-community transportation and ancillary

services, and the recipient provides the supplier with a Spanish VAT identification number.

The rule also applies to certain transactions such as those in investment gold and certain supplies of industrial waste materials in accordance with specific anti-fraud provisions.

Where the reverse charge applies, the customer or recipient must, as the person liable to pay the VAT on the transaction, issue an invoice to account for VAT (this obligation is not applicable to intra-community acquisitions of goods) and record it in the corresponding register books as well as report the VAT due in its periodic VAT returns. If VAT is not duly accounted for in the relevant returns, a penalty amounting to 10% of the VAT payable and not reported may be imposed. This penalty has been very recently introduced into Spanish law and there are certain issues over its scope. In this connection, in certain cases, the Spanish tax authorities still take the view that failure to comply with VAT return obligations gives rise to underpayment of VAT when the tax became chargeable and such VAT cannot be recovered until the specific invoice is issued and recorded in the relevant books. This also results in late-payment interest accruing.

1.3 Reverse-charge provisions in Germany

EU VAT legislation already provides for a reverse-charge mechanism. In accordance with such legislation, a German business customer (not the supplier liable for VAT) must pay VAT on:

- supplies of services per Art. 9(2)(e) of the 6th Directive, where the supplier of the services is resident abroad;
- supplies of services per Art. 28b C, D, E and F of the 6th Directive, provided that the customer is registered for VAT by the Member State under whose VAT number he is receiving the services and the supplier of the services is resident abroad;
- supplies of goods per Art. 28c (E) (3) of the 6th Directive.

It should be noted that these rules only apply to cross-border B2B transactions. The local taxable person already known to the local tax authorities (unlike the unknown foreign taxable person) will become the party liable to pay VAT. Instead of charging the foreign taxable person, the local taxable person will reverse charge the local VAT accruing and pay it over to the local tax office, unless he is authorized to deduct it as input tax and has nothing to pay.

However under those circumstances the German tax authorities also have no tax to refund, since, at best, the amounts of VAT due and VAT deducted match each other. The reverse-charge mechanism could be also interpreted as a means to ensure a stream of VAT revenues, because the German tax authorities do not receive other revenues where the input VAT paid by a taxable person exceeds his VAT liabilities. Germany has consequently introduced a reverse charge mechanism with a broader scope, although, from a German standpoint, the rules are still unsatisfactory and to ensure equivalent treatment of B2B transactions, VAT should in fact only be paid by the last trader, who serves the (initial) customer that must pay the price due, including the related VAT in full. The German Government, with the backing of the Austrian Government, has proposed to the European Commission that this interpretation be accepted. However, the Commission has objected to the requests for derogation made by Austria and Germany, because such a widespread use of the reverse-charge mechanism would fundamentally change the VAT system. Germany has now linked its request for derogation to the VAT simplification proposal, which is currently the subject of Ecofin talks. From a German standpoint, it now makes sense for the Commission to allow several Member States to operate a reverse charge mechanism with a different scope by way of derogation from the existing VAT rules.

For a trader who is not resident in Germany, it is important to know that he will not be liable for German VAT if he supplies services in Germany or makes installment supplies (*werklieferungen*) within Germany, unless he supplies certain personnel transportation services or services in connection with trade fairs or shows. In the case of these supplies, he has to register for VAT, issue the correct VAT invoices, and file returns for and pay over the German VAT chargeable in this connection. Where he receives services for business purposes in Germany in accordance with Art. 9(2) or (3) of the 6th Directive from a supplier that is also not resident in Germany, he should accept invoices showing the net price only (except invoices regarding personnel transportation services or services in connection with trade fairs and shows, for which a nonresident supplier is also liable for VAT), since he is the taxable person under an obligation to register for VAT, and file

VAT returns, regardless of the fact that he may need to pay nothing to the German Treasury because he can deduct the input VAT in full.

Since the application of the new provisions in France is a delicate matter, and the reverse-charge mechanism is quite different in the various EU Member States, the professional advice and services of a team specializing in the tax/VAT aspects of ERP implementations should be sought (in this connection, you may contact the Taxand team: erpcontact@taxand.com).

2. UNITED STATES. 2006: A "MORE LIKELY THAN NOT" YEAR

Years or decades can pass without the publication of meaningful professional literature about accounting for income taxes. However, during the year 2006, not one, but two, critically important pronouncements were issued that will change the status quo in ways both obvious and sublime. Both of these pronouncements elected to use the arcane tax technical threshold dubbed "more likely than not" as a key operating element of the related pronouncement.

a) *The PCAOB weighs in first*

The first of these pronouncements was the Securities and Exchange Commission (SEC) adoption on 19 April 2006 of Public Company Accounting Oversight Board (PCAOB) rule 3522. This rule, being a part of a broader package of rules intended to reinforce the requirement that auditors must maintain independence from their audit clients, declared that certain tax services could not be performed by the auditor of a client (Issuer) that is subject to the Security Exchange Commission (SEC). In addition, these rules now require increased communications between the auditor and the Board of Directors of the Issuer regarding the tax services that it wishes to perform for the Issuer, and these discussions are to be documented by the auditor.

Rule 3522 declared that it was no longer appropriate for the auditor to engage in the "marketing, planning or opining in favor of a tax treatment of a transaction ... that was initially recommended, directly or indirectly, by the registered public accounting firm and a significant purpose of which is tax avoidance, unless the proposed tax treatment is at least **"more likely than not"** to be allowable under applicable tax laws." This particular rule applies to any affected services not completed by 18 June 2006. Whereas the rule requiring increased communications with the Board of Directors has a more complex effective date, it generally provides that for Issuers that have a practice of approving tax services using an engagement-by-engagement methodology, then approval of the engagement must have been occurred by 18 June. In the case of Issuers that approve such services via policies and procedures (e.g. an annual approval for compliance services), if the Board approved such services before 19 April 2006 and the work commences before 19 April 2007, then no "re-approval" will be required.

b) *The FASB comes next*

Not quite three months later, the Financial Accounting Standards Board (FASB) released its much anticipated FASB Interpretation (FIN 48) concerning Accounting for Uncertainty in Income Taxes. This FIN is an interpretation of FAS 109, Accounting for Income Taxes.

The FIN states that "diversity in practice exists in the accounting for income taxes," And that the stated purpose of FIN is to address this diversity (read this to say "eliminate the diversity"). The FIN "clarifies" the application of FAS 109 by prescribing a single criterion that each tax position must meet in order for any part of the position to be recognized in the financial statements of the issuer. That criterion is the same **"more likely than not"** threshold that is used in the PCAOB rule mentioned above. Issuers will be required to identify all tax positions taken and some not taken; they will be required to break these positions down into "units of account"; they will need to assess the merits or validity of the position using the **"more likely than not"** standard, then will need to construct tables of cumulative probability of success. All of this sounds more like differential calculus than accounting to us.

Issuers are required to adopt this new FIN for their first fiscal year beginning after 15 December 2006, which, for most, means the 1st quarter of 2007. In addition, many companies are likely to disclose the promulgation of this Interpretation in their 3rd

quarter 10-K, but the calculation of the probable impact of this pronouncement may have to wait until the 4th quarter of 2006. There may be too much work to do to provide an impact assessment any sooner.

c) *So what does this all mean?*

Let's begin this discussion with a brief description of what is meant by "more likely than not." Prior to the release of these two financial accounting directives, this terminology was mainly used by tax professionals in order to measure the relative certainty that is inherent in any particular tax position taken by a taxpayer. Naturally, this measure is dependent both on points of law and the particular facts and circumstances of the taxpayer. Over the years, a hierarchy of sorts has emerged to describe these relative degrees of certainty. This hierarchy is:

Level of Authority	% Chance of being Sustained [5]
Not Frivolous	10%
Reasonable Basis	>10% to 25%
Realistic Possibility of being Sustained	33%
Substantial Authority	>33% but <50%
More Likely than Not	50.1%
Should Prevail	75%
Will Prevail	>75%

The principal purpose of this hierarchy is to avoid certain accuracy-related IRS penalties. The "more likely than not" level of authority is not specifically given a numerical percentage equivalency by any IRS directive - this is interesting, given that it is the level prescribed by law whereby a corporate taxpayer can avoid certain substantial understatement penalties by prevailing with a "reasonable cause" defense.

d) *How these two directives may interact*

Although, neither directive makes mention of the other, we think that important changes in thinking and behaviors will take place over the next one to three years. The full impact of these two rules is not yet fully developed, but here is our list of the immediate and likely impact these two rules will have on affected enterprises:

Item	Impact	Comment
1	The cost of tax reporting and compliance will continue to rise.	Don't minimize the impact of these two rules. Get budget dollars approved now to tackle what we think will take a significant amount of work.
2	Tax planning will continue to take a "back seat" in many companies as tax reporting and compliance place further strains on in-house tax services and budgets.	You have to keep your eye on your competition's ETR. If you find your relative standing slipping, the CEO/CFO won't be your friend for long.
3	The relationship between the in-house tax department and the audit firm will become even more stressed.	Plan for this. Don't expect the audit firm's tax partner to stand behind his prior work. It's a different world. He can't advocate your interest any longer. He must be independent. Move on. Get a new advocate.
4	The audit partner will want to see "memos" that document the "more likely than not" position for various items, but the tax partner will not be able to comply because he isn't allowed to use those words in anything short of a formal opinion letter. Such letters require multiple levels of internal reviews and approvals. A memo may cost $10X whereas a letter costs $100X.	Be careful not to stretch. Remember, once you develop a position of "more likely than not" it will constantly need to be refreshed, especially when it is an area that is under attack by the tax authorities. This will be especially true for borderline items.
5	Companies will not be able to use the tax arm of their audit firm to assist them with government tax audits for items that the audit firm previously advised on, if the item does not reach the "more likely than not" level of authority.	Be proactive here. The last thing you want to have happen is to have your auditor lose their independence. New audits will have to be performed by different auditors.
6	Many items that arguably may meet the "more likely than not" threshold will not be recorded before resolution with the government, because companies will not want to "show their hand" before they finalize settlement negotiations.	Again, be careful. What is more important, booking, say, half of the benefit now, or possibly being able to book more if you can keep a level negotiating plane? There may be no "universal" answer to this question.

5 Assigning numerical percentages to these Levels of Authority is a bit like trying to measure beauty with differential calculus. Only one of the above terms (Realistic Possibility of Success) is actually assigned the specific percentage listed above by IRS Regulations. The others are fairly presented in the view of the author.

Item	Impact	Comment
7	Effective tax rates will rise in the short run and become increasingly volatile.	Model and communicate. Hire someone (or a staff) whose sole responsibility is to manage this important metric. You will need to show that this area is complex and that modeling and predictive skills will need to be used to get control of this variable.
8	Businesses will put pressure on the FASB to modify FIN 48, but aside from some "tinkering at the margins," substantive adjustments are not likely.	But hope springs eternal. Participate in and push for substantive refinements. Find common issues across multiple industries, and spend some money with the right associations.
9	Some unpleasant surprises are looming. Not many companies will be told by their audit firm that independence has been compromised, but look for the PCAOB to find one or two poster children to demonstrate how seriously they view these new rules. We also expect to see more turn-over and early retirements within tax staff. This is especially so if tax liabilities rise unexpectedly because CFOs first learn about tax return positions taken or not taken when the "audit detection risk" defense is taken away.	Be proactive. Conduct an inventory of all of the global tax services you currently receive from any audit firm. Are they performing any audit service, statutory or financial, internal or third party? Ask your audit firms to do the same. Ask to see their administrative documentation and see if they note any risks. Don't let a surprise happen late in a reporting period. Hire someone who can advocate your interest. Your audit firm cannot.
10	There are likely to be more instances of SOX 404 determinations of Significant Deficiencies or Material Weaknesses. This is likely to occur when either a company tries to merely "tinker" with its old FAS 5 models in order to be compliant with FIN 48, or if it becomes apparent that tax risks have been taken that had not been previously communicated to the CFO.	Again be proactive. These circumstances are easier to avoid than to cure. Get outside help to analyze your circumstances, and to suggest improvements now. This is clearly an area where allocating some resources now will help you avoid a "black hole" later.

e) *Final thoughts*

Finally, we think that the PCAOB directive is generally well devised and will result in better behaviors that should ensure better quality audits. Yes, this all comes with a cost. But many companies have already made these rules moot by mandating that their audit firm should not be hired to perform any tax services. Just five years ago, it was a common practice for auditing firms to measure what they referred to as "audit penetration." This was a percentage of tax consulting and compliance fees derived from audit clients as compared to total tax fees. Historically, this percentage was quite high, more than 50%, and in some instances approaching 75%. Today, many companies have preempted the impact of the PCAOB rules by unilaterally deciding to eliminate or limit the amount of tax consulting and compliance services that they receive from their audit firms. The International Tax Review notes in its July/August 2006 issue that this trend continues with sharp drops reported by respondents to one of their recent surveys.

Unfortunately, we do not come to the same conclusion for the FASB directive. They may have achieved some measure of uniformity, but we do not believe that financial statements will necessarily become more accurate because of this directive. We do not want to sound too cynical here. But what good is a rule, if the best that can be said is "We are all doing the same thing. It isn't likely to be accurate, but at least we are all are forced to make the same misjudgments."

Accuracy to us means reporting an asset at an amount that ultimately is as close to actual as is possible. Creating a concept of a unit of account, and, on top of that, mandating the use of a two-step approach (Validation, then Measurement), may seem reasonable at first, but this approach doesn't necessarily track with the way issues are negotiated, settled and compromised. All negotiations are artful. Negotiations with tax authorities are no less artful. The FASB understands this, but it opted for calculus over art. It opted for rules and formulas that can be measured. It eschewed reliance on professional representations and recommendations. And in our view it compounded its error by requiring detailed disclosures for matters that may be at a delicate negotiating stage.

We wonder how the audit firms would react if the PCAOB required them to report and disclose all of their firm's tax exposures. After all, is the investing public's interest not just as well served by transparency into the financial health of the firms that attest to the wellbeing of publicly traded companies?

TAXAND NOW SPANS 36 COUNTRIES AND HAS MORE THAN 1,600 TAX PROFESSIONALS

Taxand has welcomed 5 new firms into the Global Alliance, thus expanding its presence to 36 countries.

Taxand's newest member firms and their respective countries are Barros & Errázuriz, from Chile, Simon Rutherford Ltd., from New Zealand, Sojong Partners, from the Republic of Korea, Pepeliaev, Goltsblat & Partners (PG&P), from Russia, and Van Mens & Wisselink, from the Netherlands.

Taxand now is a key provider of global tax services, including tax planning for cross-border transactions, transfer pricing and tax litigation support.

LONDON TAXAND CONFERENCE

On 6, 7 and 8 December 2006, 32 Taxand Firms met in London for the fifth Taxand conference.

During the conference, in addition to participating in numerous technical sessions on current developments of interest to our clients in different jurisdictions, we took the opportunity to hold meetings between members of the different service lines (Real Estate, VAT, Transfer Pricing, Reward Consulting, BD & Marketing and Knowledge Management), and with several clients.

Like previous events (which were staged in Paris, Madrid, Luxembourg and Nimes), the fifth conference was a great success and has helped the 173 participants to further hone their tax and "networking" skills.

The next Taxand conference will take place in Italy in June 2007.

UPCOMING TAXAND SEMINARS FOR JUNIOR TAXAND PROFESSIONALS

A second international Tax Training Seminar for our junior colleagues will take place in Amsterdam in February 2007.

50 junior tax professionals from 15 Taxand Firms will spend a week at the IBFD's International Tax Academy for an intensive introduction to the principles of international taxation and transfer pricing.

In addition, another Seminar for junior Taxand professionals will take place in Kuala Lumpur in spring 2007, where 35 young Tax advisers from the Taxand Asian Firms will also get the chance to meet to improve their skills in advising on tax treaties and other relevant tax issues.

Contact information

Argentina
Bruchou, Fernández Madero, Lombardi & Mitrani

Ing. Enrique Butty, 275, 6th Floor
C1001AFA-Buenos Aires
www.bfmlym.com

Matías Olivero
E. matias.olivero.vila@bfmlym.com
Analia Miqueri
E. analia.miqueri@bfmlym.com
T. +54 11 5 288 2308
F. +54 11 5 288 2301

Belgium
AB Partners BVBA

Avenue Louise, 240
1050 Brussels

Geert De Neef
E. gdn@ab-partners.be
Marjorie Voltas
E. m.voltas@ab-partners.be
T. +32 2 600 52 08
F. +32 2 600 52 01

Brazil
Barbosa, Müssnich & Aragão Advogados

Avenida Almirante Barroso
52 – 29º e 32º andares
20031-000 Rio de Janeiro
www.bmalaw.com.br

Silvania Conceiçao Tognetti
E. sct@ bmalaw.com.br
T. +55 (21) 3824 5875
F. +55 (21) 2262 5536

Canada
Gowling Lafleur Henderson

1 First Canadian Place
Suite 1600
100 King Street W.
Toronto, Ontario
Canada M5X 1G5
www.gowlings.com

Timothy S. Wach
E. timothy.wach@gowlings.com
T. +416 369 4645
F. +416 862 7661

Chile
Barros & Errázuriz

Isidora Goyenechea, 2939 piso 11
Las Condes
Santiago – Chile
www.bye.cl

Fernando Barros
E. fbarros@bye.cl
Carola Trucco
E. ctrucco@bye.cl
T. +56 2 378 8900
F. + 56 2 362 0386

China
Hendersen Consulting

Room 2308
1 Grand Gateway
N0. 1 Hongqiao Road
Shanghai, 200030, PRC
www.hendersen.com

Dennis Xu
E. dennis.xu@hendersen.com
Kevin Wang
E. kevin.wang@hendersen.com
T. +86 21 6447 7878
F. +86 21 6447 3722

Colombia
Gómez-Pinzón Linares Samper Suárez Villamil Abogados

Carrera 9 No. 73-24
Bogotá
www.gomezpinzon.com

Mauricio Piñeros
E. mpineros@gomezpinzon.com
T. +571 310 2900
F. +571 310 6646

Cyprus
Eurofast Global Limited

5 Chytron Str., P.C. 1075
P.O. Box 24707, Lefkosia
www.eurofastglobal.eu

Marios Lenas
E. marios.lenas@eurofastglobal.eu
T. +357 2269 9222
F. +357 2269 9004

France
Arsene

5, rue Soyer
92523 Neuilly-sur-Seine Cedex
www.arsene.fr

Frederic Donnedieu
E. frederic.donnedieu@arsene-avocats.com
Roland Schneider
E. roland.schneider@arsene-avocats.com
T. +33 (0)1 70 38 88 00
F. +33 (0)1 70 38 88 10

Germany
ArAnTax Steuerberatungsgesellschaft mbH

Stresemannallee 30
60596 Frankfurt am Main

Dr. Klaus Goutier
E. goutier@arantax.de
Arno Bermel
E. bermel@arantax.de
T. +49 69 97 557 500
F. +49 69 97 557 499

India
BMR & Associates

The Great Eastern Center, 1st floor
70, Nehru Place
New Delhi 110 019
www.bmrtax.com

Mukesh Butani
E. mukesh.butani@ bmrtax.com
Abhishek Goenka
E. abhishek.goenka@bmrtax.com
T. +91 11 3081 5000
F. +91 11 3081 5001

Indonesia
PB & CO

Menara Imperium, 27th Floor
Jl. H.R. Rasuna Said Kav. 1
Jakarta 12980
www.pb-co.com

Prijohandojo Kristanto
E. prijohandojo@pb-co.com
T. +62 21 8399 9919
F. +62 21 8379 3939

Italy
Fantozzi & Associati

Via Privata Maria Teresa n. 11
20123 Milan
www.fantozzieassociati.it

Alfredo Fossati
E. afossati@ fantozzieassociati.it
Guido Arie Petraroli
E. gpetraroli@fantozzieassociati.it
T. +39 02 7260591
F. +39 02 72605950

Luxembourg
Atoz

Aerogolf Centre
1B, rue Heienhaff
L-1736 Senningerberg
www.atoz.lu

Alex Sulkowski
E. alex.sulkowski@atoz.lu
Olivier Remacle
E. olivier.remacle@atoz.lu
T. +352 26 940 1
F. +352 26 940 300

Malaysia
VS ON TAX Sdn Bhd

Suite 13A.05, Level 13A
Wisma Goldhill
67 Jalan Raja Chulan
50200 Kuala Lumpur
www.vsontax.com

Veerinderjeet Singh
E. vs@vsontax.com
T. +60 3 2032 2799
F. + 60 3 2032 2893

Malta
Avanzia Tax Advisors

Cobalt House – 2nd Floor
Notabile Road, Mriehel QRM09
www.avanzia.com.mt

Walter Cutajar
E. walter.cutajar@avanzia.com.mt
James Scerri Worley
E. james.scerri.worley@avanzia.com.mt
T. +356 2149 3313
F. +356 2149 3318

Mauritius
Multiconsult Limited

10, Frère Félix de Valois Street,
Port Louis
www.multiconsult.mu

Uday Kumar Gujadhur
E. uday.gujadhur@multiconsult.mu
Pamela Balasoupramanien
E. pamela.bala@multiconsult.mu
T. +230 202 3000
F. +230 212 5265

Mexico
Mijares, Angoitia, Cortés y Fuentes, S.C.

Montes Urales, 505, 3er Piso
Lomas de Chapultepec, 11000
Mexico DF
www.macf.com.mx

Marcela Fonseca
E. mfonseca@ macf.com.mx
Manuel Tamez Zendejas
E. mtamez@macf.com.mx
T. +52 55 5201 7400
F. +52 55 5520 1065

New Zealand
Simon Rutherford Limited

PO Box 2298
Shortland Street
Auckland 1140

Simon Rutherford
E: simon@simonrutherford.co.nz
T.: +64 9 921-6881
F: + 64 9 921-6889

Norway
Selmer

P.O. Box 1324 Vika
N-0112 Oslo
www.selmer.no

Einar Bakko
E. e.bakko@selmer.no
T. +47 2311 6500
F. +47 2311 6501

Peru
Miranda & Amado Abogados

Av. Larco 1301 Piso 20,
Torre Parque Mar
Miraflores – Lima 18
www.mafirma.com.pe

Alfredo Vidal
E. avidal@mafirma.com.pe
T. +511 610 4747
F. +511 610 4748

Philippines
Salvador Guevara & Associates

815-816, Tower One and Exchange Plaza
Ayala Triangle, Ayala Avenue
1226 Makati City

Edmundo P. Guevara
E. edmundo.p.guevara@salvadorguevaralaw.com
T. +63 2 811 25 00
F. + 63 2 893 69 87

Poland
ACCREO Sp. z o.o.

Al. Jana Pawła II 29
00-867 Warszawa
www.accreo.pl

Andrzej Puncewicz
E. andrzej.puncewicz@taxand.pl
Radoslaw Czarnecki
E. radoslaw.czarnecki@taxand.pl
T. +48 22 653 72 50
F. +48 22 653 72 52

Portugal
Garrigues Portugal

Av. Engº Duarte Pacheco
Amoreiras, Torre 1
1070-101 Lisbon
www.garrigues.com

Fernando Castro Silva
E. fernando.castro.silva@garrigues.com
T. +35 121 382 1200
F. +35 121 382 1290

Puerto Rico
Zaragoza & Alvarado LLP

104 Acuarela Marginal Street
Martínez Nadal Expressway
Guaynabo. PR 00969
www.zatax.com

Juan Zaragoza
E. jzaragoza@zatax.com
T. +787 999 4400
F. +787 999 4646

Republic of Korea
Sojong Partners

9th Floor, Star Tower
737 Yeoksam 1-dong
Kangnam-gu, Seoul
135-984, Republic of Korea
www.sojong.com

Young-Lae Son
E. ylson@sojong.com
Kyung Won Kim
E. kimkw@sojong.com
T. +02 2112 1114
F. + 02 2112 1115

Romania
Taxhouse

22 Frumoasa Street
010985, Sector 1
Bucarest
www.taxand.com

Angela Rosca
E. angela.rosca@taxhouse.ro
T. +40 722 272 546

Russia
Pepeliaev, Goltsblat & Partners (PG&P)

54 Shpalernaya St.,
Golden Shpalernaya Business Center
St. Petersburg, 191015 Russia
www.pgpspb.ru

Maria Andreeva
E. m.andreeva@pgplaw.ru
Andrey Tereschenko
E. a.tereschenko@pgplaw.ru
T. + 7 812 333 0717
F. + 7 812 333 0716

Spain
Garrigues Abogados y Asesores Tributarios

Hermosilla, 3
28001 Madrid
www.garrigues.com

Ricardo Gómez
E. ricardo.gomez@garrigues.com
Vicente Bootello
E. vicente.bootello@garrigues.com
T. +34 91 514 52 00
F. +34 91 399 24 08

Sweden
Skeppsbron Skatt AB

Skeppsbron 20
SE-111 30 Stockholm
www.skeppsbronskatt.se

Niklas Bang
E. niklas.bang@skeppsbronskatt.se
Martin Larsson
E. martin.larsson@skeppsbronskatt.se
T. +46 8 440 41 40
F. +46 8 23 63 30

Switzerland
Tax Partner AG

Talstrasse, 80
8001 Zürich
www.taxpartner.ch

David Ryser
E. david.ryser@taxpartner.ch
T. +41 44 215 77 77
F. +41 44 215 77 70

The Netherlands
Van Mens & Wisselink

Piet Heinkade 55
1019 GM Amsterdam
Postbus 2911
1000 CX Amsterdam
www.vmw.com

Philip Ruys
E. ruys@vmw.nl
Jan Kooi
E. kooi@vmw.nl
T. + 31 (0) 20 301 66 33
F. + 31 (0) 20 301 66 22

Turkey

ERDIKLER, Yeminku Mali Müsavirlik Ltd. Sti

Dr. Orhan Birman Is Merkezi
Barbados Bulvari No: 121 Kat: 12
34349 Balmuncu, Istanbul
www.erdikler.com

Saban Erdikler
E. saban.erdikler@erdikler.com
T. +90 212 337 0000
F. +90 212 347 5789

United Kingdom

Chiltern PLC

3 Sheldon Square
London, W2 6PS
www.chilternplc.com

John Willmott
E. willmottj@chilternplc.com
Andrew Shilling
E. shillinga@chilternplc.com
T. +44 0(20) 7153 2428
F. +44 0(20) 7153 9022

United States

Álvarez & Marsal Tax Advisory Services, LLC

875 Third Avenue
Suite 1550
New York, NY 10022
www.alvarezandmarsal.com

Bob Lowe
E. blowe@alvarezandmarsal.com
Kristin Fonseca
E. kfonseca@alvarezandmarsal.com
T. +(212) 759 4433
F. +(212) 759 5532

Venezuela

Candal Consultores Tributarios & Corporativos

Paseo Colón, Torre Polar Oeste,
Espacio Ofitel, piso 8
Caracas
www.taxand.com.ve

Manuel Candal
E. mcandal@taxand.com.ve
T. +58 212 782 0075
F. +58 212 782 0124

Disclaimer

The information contained in this document is intended only to be a guide. It must not be relied on in, or applied to, specific situations without previously seeking proper professional advice. Even if all reasonable care has been taken in its preparation, Taxand and all the members of this Alliance do not accept any liability for any errors that it may contain or lack of update before going to press, whether caused by negligence or otherwise, or for any losses, however caused, or sustained by any person. Descriptions of, or references or access to, other publications within this publication do not imply endorsement of them.

As provided in the U.S. Treasury Department Circular 230, this Tax Newsletter is not intended or written by any Taxand Firm or to be used, and cannot be used, by a client or any other person or entity for the purpose of avoiding tax penalties that may be imposed on any taxpayer. The Taxand Firms have produced this Tax Newsletter in connection with the marketing of our tax services relating to matters discussed therein. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.