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In this issue:

Tax implications of cross-border M&A in India: an uncertain landscape.....	1
China: Collection of Trade Union Contribution to be enforced.....	3
Iceland: Parliament approves new legislation on taxation of hydrocarbon processing	4
India: Delhi tribunal rules on installation PE under Mauritius treaty.....	5
Thailand: New requirements to report revenue and expense.....	6
Tunisia: Measures introduced to encourage investment.....	7
United Arab Emirates: Implementation of VAT postponed	8
United States: CBP proposes change to interpretation of transaction value and post-importation adjustments.....	8
In brief	9
Tax treaty round up.....	10
Are You Getting Your Global Tax Alerts?	12

Tax implications of cross-border M&A in India: an uncertain landscape

In the highly competitive global economic environment, cross-border M&A deals have attained unprecedented importance as a means of achieving operational synergies. However, the benefits of these synergies can be reduced or even eliminated if certain challenges they entail are not addressed. One of the most important of these challenges is managing the underlying tax implications of M&A transactions.

For taxpayers contemplating mergers where the underlying assets include shares in Indian subsidiaries, determining the tax implications (particularly with respect to any capital gains arising from such transactions) has become increasingly fraught with uncertainty in India. The Indian tax authorities have been seeking to tax the gains arising from these transactions on the grounds there has been a taxable event in India, and the uncertainty has been exacerbated by the 14 July 2011 decision of the Bombay High Court in the *Idea Cellular* case, which did not follow previous jurisprudence of the Indian Supreme Court (i.e. the 2003 *Azadi Bachao Andolan* case) on the availability of benefits under the India-Mauritius tax treaty.

Mauritius is frequently used as a route for Indian investment, primarily because its treaty with India contains very favorable provisions relating to the taxation of capital gains. Specifically, India does not have the right to tax gains derived by a resident of Mauritius from the sale or disposal of shares of an Indian company; in other words, a Mauritian resident selling shares of an Indian company can obtain benefits under the India-Mauritius tax treaty and not be liable to Indian capital gains tax.

Case law

The *Azadi Bachao Andolan* case arose from Circular 789, issued by the Central Board of Direct Taxes (CBDT) in 2000. Circular 789 provided that a certificate of residence issued by the Mauritius government to a Mauritius company was sufficient for the Mauritius company to establish residence and beneficial ownership under the India-Mauritius tax treaty.

The circular also reiterated that companies incorporated in Mauritius were “liable to tax” under the laws of Mauritius and, therefore, were deemed to be residents of Mauritius for purposes of the treaty. Accordingly, under the India-Mauritius tax treaty, such companies would not be taxable in India on income from capital gains arising in India on the sale of shares.

Circular 789 was challenged and ultimately – though temporarily – rejected by the Delhi High Court on the grounds (among others) that the circular exceeded the scope of the CBDT’s authority. The Delhi High Court’s decision was reversed by the Supreme Court in *Azadi Bachao Andolan*. The Supreme Court upheld the validity of Circular 789 and confirmed that residents of Mauritius were not liable to tax in respect of capital gains derived in India. The Supreme Court also held that the phrase “liability to tax” as used in a tax treaty could not be equated with the actual payment of tax, i.e. simply because an exemption is granted to an entity with respect to income from a particular source does not mean that entity is not “liable to tax” at all. The Supreme Court also stated that, in the absence of a limitation-on-benefits provision, an attempt by a resident of a third country to take advantage of the provisions of the treaty does not jeopardize the entitlement to treaty benefits.

On 22 March 2010, India’s Authority for Advance Rulings (AAR) held in the *M/s. E*Trade Mauritius Limited* case that the capital gains tax exemption under the India-Mauritius tax treaty cannot be denied to Mauritius-based companies, and reaffirmed that a taxpayer can claim treaty benefits on the basis of a tax residence certificate. However, the Indian tax authorities have challenged that ruling by filing a Special Leave Petition with the Supreme Court.

The Supreme Court’s reasoning in *Azadi Bachao Andolan* and its decision was held not to be applicable in the 14 July 2011 decision of the Bombay High Court in the *Aditya Birla Novu Ltd. v. DDIT case (Idea Cellular)*. The Bombay High Court held that capital gains on the sale of shares of an Indian company by a Mauritius company were taxable in India because the seller was not the beneficial owner of the shares and, therefore, was not entitled to the benefits of the India-Mauritius treaty.

The facts of the *Idea Cellular* case are as follows: Idea Cellular, an Indian company, was formed as a joint venture under a joint venture agreement (JVA) between “AT&T USA” and the Birla Group to carry out telecommunications services. Under the JVA, 51% of the shares were to be held by Birla Group and 49% by AT&T USA. These shares could be held by the JV partners in their own name or through a “permitted transferee,” which could be any company that was a 100% subsidiary of the relevant JV partner. The permitted transferee was merely a representative of the JV partner. The JVA was legally binding on AT&T USA and enforceable against it. The JV partners were allowed to transfer their shares to the permitted transferee and the transfer would be effective once the permitted transferee was bound by the terms of the JVA. Consequently, 49% of the shares in Idea Cellular were allotted to AT&T Mauritius as a permitted transferee. Tata Industries Ltd (TIL) was subsequently added as a joint venture partner due to the merger of Tata Cellular with Idea Cellular. A new shareholder agreement was entered into by all of the JV partners. In October 2004, Cingular Wireless LLC acquired AT&T Wireless Services Inc. (which held shares of AT&T Mauritius) from AT&T USA and renamed it New Cingular Wireless Services Inc. (NCWS).

NCWS decided to exit the venture in 2005, having received an offer from a third party to acquire its holding in Idea Cellular. As required by the shareholder agreement, NCWS offered its shares in Idea Cellular to Birla Group and TIL (as they had a right of first refusal) and both accepted. It was decided that Indian Rayon, representing the Birla Group, would directly acquire the shares of Idea Cellular from AT&T Mauritius, and Tata Industries, representing the Tata Group, would thereafter acquire AT&T Mauritius’ entire shareholding from NCWS. Indian Rayon requested a certificate from the tax authorities to determine the withholding tax to be applied to the payment to AT&T Mauritius. The tax authorities issued a nil withholding certificate, on the basis of which Indian Rayon paid AT&T Mauritius USD 150 million without withholding tax. The Indian tax authorities subsequently proceeded to treat Indian Rayon as an agent of AT&T Mauritius and TIL as an agent of NCWS.

The Bombay High Court agreed with the Indian tax authorities and concluded that the sale of the shares of an Indian company by a Mauritius company is taxable in India because AT&T Mauritius was not the beneficial owner of the shares that were sold, but rather was a “permitted transferee” of its U.S. parent company under the JVA (the shares were allotted to AT&T Mauritius as a permitted transferee). In arriving at this conclusion, the High Court observed that, although the shares of Idea Cellular were allotted to AT&T Mauritius (the seller), all rights in respect of the shares actually vested in AT&T USA. Consequently, AT&T Mauritius was held not to be the beneficial owner of the shares but only a permitted transferee.

While the *Idea Cellular* decision is fact specific, it has raised concerns among the international community, as it casts doubt on the ability of companies using Mauritius entities to claim capital gains exemptions under the India-Mauritius treaty.

Concept of beneficial ownership

The beneficial ownership requirement was introduced into articles 10 (Dividends), 11 (Interest) and 12 (Royalties) of the 1977 OECD model treaty to deal with a specific form of abuse affecting the right of a contracting state (i.e. the source state) to tax income arising in that state. The Commentary on article 10 of the 2003 OECD model treaty further clarified the meaning of beneficial ownership by indicating that it was not used “in a narrow technical sense; rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.” More recently, in a discussion draft released in April 2011, the OECD, for the first time, attempted to introduce a definition of the term beneficial ownership. In the context of dividends, the draft makes it clear that the recipient of a dividend is the beneficial owner of the dividend if it has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass the payment received to another person.

Beneficial ownership requirement with respect to capital gains

The position of the Indian tax authorities now seems to be that the beneficial ownership requirement laid down in tax treaties with respect to dividends, interest and royalties also applies to capital gains, and the *Idea Cellular* decision indicates that this position enjoys at least some judicial support. The tax authorities’ approach is in line with that being taken by some other tax authorities, for example, China’s State Administration of Taxation, which issued a circular in 2009 targeting the taxation of transactions involving indirect equity interests in Chinese resident companies, and Indonesia’s Director General of Taxation, which, in the same year, issued Regulation 62, setting out the technical conditions that must be satisfied to claim treaty benefits. Regulation 62 states that treaty abuse will be deemed to exist when the recipient of income is not the beneficial owner of the income (although this was subsequently clarified as applying only to income with respect to which the relevant treaty article contains a “beneficial owner” requirement).

New Indian Direct Taxes Code

The draft provisions of the proposed Direct Taxes Code Bill 2010 further strengthen the Indian tax authorities’ position on cross-border acquisitions involving Indian companies. The code provisions stipulate that tax is payable in India whenever a foreign company’s shares are transferred if at least 50% of the company’s assets are situated in India. Even though the code is not yet law, the Indian tax authorities are already consistently taking the position that, where the transfer of shares of a foreign company involves an indirect transfer of an Indian business, the transaction is taxable.

Conclusion

The recent trend seems to be that the Indian tax authorities will pierce the corporate veil to look into the real nature of a transaction to determine the capital gains chargeable to tax in India. Although the decision in *Idea Cellular* is fact specific, it is nonetheless likely to have wide repercussions, particularly while taxpayers continue to wait for the verdict of the Supreme Court in the tax authorities’ challenge to the AAR’s *E*trade Mauritius* ruling. The intention to bring overseas M&A within the Indian tax net is further fortified by specific proposals in the draft Direct Taxes Code. Given the potential tax implications of such deals, taxpayers need to consider the risks and potential pitfalls to avoid unintended consequences.

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China: Collection of Trade Union Contribution to be enforced

The Chinese local tax authorities have taken steps to ensure that companies comply with their obligation to make a Trade Union Contribution. The enforcement of this obligation will increase the operating costs of affected companies.

According to the Trade Union Law and related regulations, companies in China are required to contribute 2% of the total salary costs for the creation of primary trade unions. Until recently, collection of the Trade Union Contribution was enforced in practice (particularly for private companies and including foreign-invested enterprises (FIEs)), with the result that the contribution used to be a “voluntary” payment, with most FIEs not making the payment.

In early 2010, the Beijing municipal government announced a pilot program under which the local tax authorities in certain districts (e.g. Xicheng, Changping and Fengtai) would assist with the collection of the trade union contribution as from 1 July 2010. On 29 June 2011, the Beijing Federation of Trade Unions and the Beijing Local Tax Bureau jointly issued a notice that expands the collection program to Dongcheng, Xicheng, Chaoyang, Mentougou and Shunyi with effect from 1 October 2011 and requiring a retroactive payment as from 1 July 2011. In addition, all districts in Beijing will fall within the scope of the collection program on 1 January 2012.

The following rules apply under the Trade Union Law and recent notices:

- All entities and organizations (including branches and representative offices) set up in the relevant districts must pay the contribution.
- The contribution will be collected by the local tax bureau on behalf of the municipal trade unions.
- The contribution is equal to 2% of the total wages and salaries of all employees (including foreign employees). Payment of the contribution is mandatory even if the company has not set up a trade union.
- The scope of salaries and wages for purposes of the contribution is determined based on the definition provided by the Statistics Bureau. According to guidance issued by the Bureau in 1990, that amount includes the base salary, bonuses, allowances and subsidies paid directly to employees, but excluding expenses for labor insurance and employee benefits, such as pension costs, health care or public health care costs, subsidies for collective welfare causes, culture and education costs of trade unions and collective welfare payments, etc.
- The contribution must be paid on a quarterly basis by the 15th day of the month following the end of the quarter, with a late payment interest surcharge assessed on the overdue amount at 0.5% per day. The quarterly filing can be made through the on-line filing system or an on-site visit to the local tax bureaus. Currently, payment cannot be made through the on-line system of the local tax bureaus but rather through an actual payment at the bank.
- Companies must register with the local tax authorities in advance of making the first payment of the contribution.
- The contribution is deductible for corporate income tax purposes, provided the company can substantiate payment with a valid receipt issued by the local tax authorities. Once an employer sets up a trade union, 60% of the contribution will be refunded.

Comments

In determining the total wages and salaries, the prevailing regulations do not provide clear guidance on whether tax-exempt benefits provided to foreign employees (e.g. housing, education, home leave expenses, etc.) and salary costs for expatriates not charged back to the Chinese entity should be included. Based on an informal confirmation with some of the trade union authorities, such expenses paid on a non-cash or reimbursement basis may be excluded. These authorities also were of the opinion that salary costs for expatriates without recharge to the Chinese local entity may not be included. However, companies should obtain confirmation of the position to be taken with the relevant district trade union authorities.

It also appears that some provinces and cities will follow suit and may institute the mandatory collection of the contribution via the local tax authorities. Companies in China should carefully monitor future developments.

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Iceland: Parliament approves new legislation on taxation of hydrocarbon processing

Iceland's Parliament approved legislation on 8 September 2011 on the taxation of revenue generated from the exploration, processing and sale of hydrocarbons, as well as all related operations (e.g. transport by pipeline or tanker). The new rules, which include the introduction of two new taxes and an amendment to the VAT Act, apply as from 19 September 2011 (having been approved by the president and officially published). The new legislation replaces previous legislation.

Under the new legislation, “hydrocarbon” refers to petroleum, natural gas and other natural hydrocarbons, whether in liquid or gaseous form, located in the stratum under Iceland’s territorial waters and other ocean areas for which the production of hydrocarbons is regulated by Iceland under international agreements. Parties liable to tax are entities licensed to explore or process hydrocarbons in the affected areas and parties that participate directly or indirectly in the exploration, processing or distribution of hydrocarbons. The new legislation applies to legal entities, independent contractors and employees that generate revenue (including salaries) from the designated activities.

The first charge to tax is a production fee calculated as 5% of the value of the output of hydrocarbons collected by a taxable entity according to the relevant license (both output intended for further processing and for own use). The value of the hydrocarbons will be determined by a committee appointed by the Minister of Finance and based on pricing in the international market. The second charge is a special hydrocarbon tax levied on parties licensed to research and process hydrocarbons. The tax base for this tax is the total revenue generated by the relevant operations, less expenses that are generally deductible for income tax purposes, with some restrictions. The special hydrocarbon tax is collected upon assessment of the taxpayer’s income tax return. The tax rate is a multiple of 0.45, and the profit margin is calculated as the taxable party’s hydrocarbon tax base as a portion of total revenue (i.e. $0.45 \times (\text{Hydrocarbon tax base} / \text{Total revenue})$).

Under the amendments to the VAT Act, the sale of certain goods and services related to the production of hydrocarbons will be zero rated (i.e. effectively exempt from VAT but with credit for input tax). The zero rate applies to:

- The sale and leasing of oil platforms and other floating stations used to process hydrocarbons, including equipment delivered in connection with these structures;
- The sale of services and equipment directly related to the construction, maintenance and repair of such platforms/stations and the construction and repair of pipelines originating from outside Iceland’s territorial waters and leading to land; and
- The sale of goods and services for use outside Iceland’s territorial waters in connection with the research and development of hydrocarbon resources located on the ocean floor.

Extensive research has been carried out during the past decade to determine whether oil or gas could be extracted from the ocean floor around Iceland. This research has seen positive outcomes. The new legislation was enacted in connection with the upcoming contract announcement to explore and extract hydrocarbons in Icelandic waters, and is to some extent based on Norwegian taxation of similar enterprises.

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India:

Delhi tribunal rules on installation PE under Mauritius treaty

The Delhi Income Tax Appellate Tribunal (ITAT) ruled on 16 September 2011 that the taxpayer’s activities of installing and joining pipelines in India fell within the scope of article 5(2)(i) of the India-Mauritius tax treaty and would not create an installation permanent establishment (PE) in India if the activity did not exceed the prescribed threshold period of nine months (*GIL Mauritius Holdings Ltd.*).

Background

Article 5(1) of the India-Mauritius treaty provides that a PE is a “fixed place of business through which the business of the enterprise is wholly or partly carried on.” In addition to the “fixed place PE” of article 5(1), article 5(2) provides deeming rules under which a PE will be found to exist, including an “installation PE” (article 5(2)(i)), which is defined as “a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than nine months.”

Once a PE is found to exist under the treaty, the country in which the PE is located (e.g. India) may tax (under article 7(1)) the profits of an enterprise resident in the other contracting state (e.g. Mauritius) to the extent the profits are attributable to a PE in the first state.

The interplay between a fixed place PE under article 5(1) and the situations specified in article 5(2) in which a taxpayer would be deemed to have a PE has been the subject of considerable controversy and litigation in India. The question that arises is whether a taxpayer that does not have a PE under the deeming rules of article 5(2) is still exposed to the risk of a fixed place PE under article 5(1). As discussed below, the Delhi ITAT ruled in favor of the taxpayer in *GIL Mauritius Holdings Ltd.*, at least with respect to an installation PE.

Facts of the case

GIL Mauritius Holdings Ltd. (GIL), a Mauritius tax resident, was engaged by BG Exploration & Production India Ltd. for the installation/joining of pipelines in India, both on land and under water. The installation activities were carried out using a specialized vessel and personnel for a period that, according to the taxpayer, was less than nine months. GIL claimed that, because the installation activity did not exceed the time threshold under article 5(2)(i), it did not have a PE in India. The tax authorities took the position that GIL had a fixed place PE under article 5(1) and that India therefore was entitled to tax GIL's profits attributable to the PE under article 7(1).

The Delhi ITAT first analyzed whether GIL's activities were covered by article 5(2)(i). The ITAT observed that the treaty does not define "construction" or "assembly," so the ordinary definition of the words must be considered. The dictionary meaning of "assemble" is to fit or join together and, accordingly, the word "assembly" would mean the act or process of fitting together the parts of a machine, etc., especially where such parts are machine-made in great numbers so as to be interchangeable. The ITAT held that putting together pieces of pipelines in a desired manner amounts to "assembly." However, under the treaty's PE deeming rules, India and Mauritius included only assembly projects that last for more than nine months.

While the ITAT acknowledged that the use of "fixed place" in article 5(1) represents an area of space, rather than a point in space (and thus GIL had a "fixed place" available in India for assembling the pipeline), the ITAT did not agree with the tax authorities' interpretation under which the nine-month threshold in article 5(2)(i) of the treaty is rendered irrelevant if a "construction or assembly project" satisfies the "fixed place of business" test under article 5(1). According to the ITAT, such an interpretation would make article 5(2) redundant. The ITAT consequently reiterated the principle that paragraph (1) and (2) of article 5 must be read harmoniously and, if the time threshold prescribed by paragraph 2(i) is not exceeded, there cannot be a fixed place PE under article 5(1).

Comments

The ruling highlights the importance of an interpretation of a tax treaty that is consistent with the Vienna Convention on Law of Treaties, which states that a treaty should be interpreted according to the ordinary meaning to be given to the treaty's terms and context in light of the treaty's objectives and purpose. Additionally, there was no apparent discussion in the ruling as to the availability of the benefits under the Mauritius treaty or the controversy relating to treaty shopping. The ITAT did, however, refer the case back to the Assessing Officer to determine the exact period of presence of the taxpayer in India to decide whether the project lasted less than nine months, an issue that was not examined by the lower authorities.

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Thailand: New requirements to report revenue and expense

Thailand's National Anti-Corruption Commission (NACC) issued a notification dated 11 August 2011 that requires parties to a contract with the Thai government to prepare and report revenue and expenses relating to the project in conjunction with the filing of an income tax return. Although the notification does not apply to nonresident legal entities that do not have a

representative in Thailand, but that provide goods or services in the country and for which Thai government units remit payment overseas, the NACC may subsequently establish a reporting procedure for such entities.

The notification provides as follows:

- "Parties to a contract" refers to individuals or juristic persons that enter into a contract for the sale of goods or the provision of services or for obtaining a subsidy from a Thai government agency, provincial administration, state enterprise, public organization, organization under the Constitution Act or other government unit as stipulated by the NACC.
- The revenue and expense report must be submitted where the contract is valued at THB 500,000 or more; the report must be filed with the annual corporate or personal income tax return. The filing obligation remains until the completion of the project and expiration of the liabilities covered under the relevant contract.
- The parties to a contract are required to record revenue and expenses for each project (including details of receipts and payments (e.g. in cash, account receivables, account payables, etc.)) on Form Bor Chor 1 and maintain such records at the business premises for at least five years after the end of the relevant contract or until the NACC completes an investigation of the contract.
- When a contracting party files its annual income tax return, the Thai Revenue Department may take the revenue and expense report that has been submitted into consideration for corporate and personal income tax purposes and, if there is any indication of corruption in any project, it will inform the NACC, which may request the Revenue Department to provide the relevant information (e.g. the revenue and expense report).
- The parties to a contract must receive and make payments through current accounts, except where the payment is less than THB 30,000, in which case the payment can be made in cash.

The notification is effective as from 1 January 2012.

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Tunisia: Measures introduced to encourage investment

The Tunisian transitional government has introduced a number of measures to re-start the economy, ease administrative procedures and encourage investment.

The following measures apply to export companies:

- The exemption for income and profits derived from exports has been extended for one year (up to 31 December 2012); and
- The allowable quota for FY2011 has been increased from 30% to 50% based on FY2010 export turnover (i.e. the percentage of goods that may be sold on the local market without a company forfeiting its status as an export company).

Other measures target companies affected by recent political events:

- Depreciation on fixed assets acquired during FY2011 may be taken at an exceptional rate of 33.33% (normally at rates ranging from 5% to 33.33%);
- The full employer social contribution (i.e. the employer part of social security) need not be paid; instead, the government will pay up to 50% of the contribution; and
- A 100% advance on tax refunds available as a result of the overpayment of advance tax may be obtained without undergoing a prior tax audit (i.e. an audit may still be carried out after the refund advance has been granted).

Finally, an exemption for an indefinite period of time is granted from the Business Training Tax and the Employee Housing Fund Contribution for companies established in the regional development area, as defined under Tunisian tax regulations.

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United Arab Emirates: Implementation of VAT postponed

The United Arab Emirates (UAE) government has announced that it is in the early stages of a process to introduce VAT, but the tax will not be implemented until 2014 or 2015 at the earliest.

According to the announcement, the UAE has completed a study on the social and economic effects that VAT would have on the country and it expects that implementation of VAT would take three years once the UAE agrees on the general principles of such a system with the Gulf Cooperation Council (the "GCC," which is comprised of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE).

There have been various announcements from the GCC in the past that its member countries were considering the implementation of a VAT system as a way of diversifying revenue sources. These comments highlight that, although the UAE is taking first steps towards implementation, it is unlikely that VAT will be implemented until 2014 or 2015 at the earliest.

Although there is no concern over an immediate imposition of VAT in the UAE, businesses may wish to consider the future consequences that VAT will have on transactions taking place in or involving the UAE. The implementation of VAT would have various compliance and administrative costs, as well as a potential effect on sales and purchases.

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United States: CBP proposes change to interpretation of transaction value and post-importation adjustments

The U.S. Customs and Border Protection (CBP) notified importers on 23 September 2011 that it has re-examined its views on the applicability of the "transaction value" method of customs valuation to transactions involving post-importation adjustments to a transfer price made pursuant to a transfer pricing study, transfer pricing policy or Advance Pricing Agreement (APA), as well as an importer's ability to obtain a duty refund when customs value adjustments are made as a result of a downward adjustment to the transfer price.

Specifically, under its proposed change in interpretation, which the CBP would implement via the revocation of a 2001 ruling (Headquarters Ruling 547654), the CBP would allow an importer to apply "transaction value" in cases in which post-import price adjustments are made if:

- The study/policy/APA is in writing, applies to the imported goods, sets forth a clear formula on how adjustments are to be calculated and is in place before importation of the goods that are the subject of the study/policy/APA;
- In cases where post-importation adjustments are made, the importer provides a detailed explanation and calculations of adjustments incurred in the U.S. and claimed after the importation; and
- There is an absence of other circumstances that could indicate that the post-importation adjustments do not result in an arm's length price between the parties.

No single factor listed above would be determinative of an objective formula, and the CBP would determine the existence of such a formula on a case-by-case basis. In addition, the importer still would be required to show that the transaction value is acceptable under the "circumstances of sale" test or the "test values" test, and adjustments to customs value would

be required to be made via CBP's Reconciliation program. Finally, and significantly, CBP's proposed change in interpretation also would allow for duty refunds in cases where downward adjustments are involved and the above criteria are satisfied.

CBP requested comments to the proposed change, which were due on 24 October 2011. It remains to be determined if and when any change will be finalized following CBP's review of comments received.

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In brief

European Union – The European Court of Justice has ruled unlawful a Belgian provision giving a tax credit on income from loans granted to Belgian coordination centers only to the extent that the borrowed funds were used by center or other group companies to acquire or develop new tangible assets that were used in Belgium.

European Union – The European Commission has published a draft directive that will replace and update the existing Accounting Directive and modify the Transparency Directive. The proposals would require some form of country reporting by companies in the extractive industries and logging sector and would require EU Member States to implement the new Directive into national law by 1 July 2014.

Vietnam – The government issued a decree on 20 October 2011 that adds new penalties for violation of the foreign currency control regulations. Except for specific cases as approved by the Governor of the State Bank of Vietnam, a penalty ranging from VND 300 million to VND 500 million (approximately USD 15,000 to USD 25,000) will be imposed if a company (whether Vietnamese or foreign-invested company operating in Vietnam) violates the rule requiring the price (public price or contract price) of goods or services to be in VND, i.e. where the company sets the price in foreign currency or in gold.

United States – House Ways and Means Committee Republicans released a discussion draft of a tax reform plan on 26 October 2011 that would reduce the top corporate tax rate to 25% and adopt a territorial system through a participation exemption (PE) for foreign-source income. Under the PE, domestic corporations that are at least 10% shareholders of controlled foreign corporations (CFCs, which would include branches) would be allowed a 95% deduction for the foreign-source portion of CFC dividends (as well as gains on the sale/exchange of qualified shares). Related foreign tax credits and deductions would not be available. CFC rules would be retained for certain "highly mobile" and passive income, with foreign tax credits available for this income. Before the PE could take effect, 10% shareholders would be subject to repatriation at an effective tax rate of 5.25% (paid over a period of eight years) on their pro-rata share of undistributed and previously untaxed foreign earnings. In addition to other reforms, a thin capitalization rule would be introduced to deny interest expense deductions for worldwide affiliated groups exceeding certain debt-to-equity ratios and "base erosion caused by shifting intangible property and its related income" would be addressed.

United States – The Financial Crimes Enforcement Network (FinCEN) issued guidance on 11 October 2011 related to form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts or "FBAR") reporting requirements for former employees who had signature authority over, but no financial interest in, a foreign financial account of a former employer during a reportable calendar year. Notably, FinCEN does not expect former employees to maintain records of the foreign financial accounts of their former employers personally. Although a former employee is not expected to maintain such records, he or she must provide as much information as possible when filing an FBAR. At a minimum, the former employee must: include the fact that he or she had signature or other authority over a foreign financial account; provide information about his or her former employer for whom he or she was acting, including the name of the former employer; and provide his or her title with the former employer. Under general rules, "U.S. persons" are required to file FBARs annually if they have a financial interest in or signature authority over financial accounts, including bank, securities or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds USD 10,000 at any time during the calendar year.

Tax treaty round up

At the end of each month, the World Tax Advisor provides an update on recent tax treaty developments, with a focus on items that directly affect the withholding tax rates of the key jurisdictions covered by the Deloitte International Tax Source (DITS). Additional coverage may include stated negotiating priorities and other important tax treaty trends. For updates on tax information exchange agreements, visit our DITS special feature.

URL: <http://www.dits.deloitte.com>

URL: <http://www.dits.deloitte.com/Administration/ManageHomePage/Popup.aspx?ChildPage=InfoExchange>

Unless otherwise noted, the developments discussed are not yet in force.

Austria-Tajikistan – When in effect, the treaty signed on 7 June 2011 to replace the treaty between Austria and the former USSR provides that the withholding tax rate on dividends will be 5% if paid to a company (other than a partnership) that holds directly at least 15% of the capital of the payer company; otherwise, the rate will be 10%. The rate on interest and royalties will be 8%, with an exemption for interest paid to a financial institution or arising from the sale on credit of any equipment, merchandise or services.

Canada-Anguilla – The tax information exchange agreement (TIEA) between Canada and Anguilla entered into force on 12 October 2011. Accordingly, under Canadian income tax regulations amended in 2008, certain tax incentives previously only available to countries with which Canada has concluded a tax treaty are extended with respect to Anguilla. These incentives provide that active business income earned by a foreign affiliate (FA) of a Canadian corporation that is resident in the relevant jurisdiction (Anguilla) and carrying on business there will be included in “exempt surplus” and, consequently, dividends paid to the Canadian corporation from the FA will not be subject to Canadian tax. The regulations also provide that the FA can earn exempt surplus in respect of active business income for its taxation year that includes the effective date of the particular TIEA, retroactive to the beginning of the taxation year. Thus, an FA in Anguilla that has a taxation year based on the calendar year will be eligible to earn exempt surplus for its entire 2011 taxation year.

China-Malta – The 2010 treaty to replace the treaty dating from 1993 entered into force on 25 August 2011 and will generally apply from 1 January 2012. When in effect, the withholding tax rate on dividends will be 5% if paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise, the rate will be 10%. The rate on interest and royalties will be 10%, with the 10% applicable on only 70% of the gross amount of the royalties derived in consideration for the use of, or the right to use, industrial, commercial or scientific equipment.

Cyprus-Slovenia – The 2010 treaty to replace the 1985 treaty between Cyprus and the former Yugoslavia entered into force on 14 September 2011 and will apply from 1 January 2012. When in effect, the treaty provides for a 5% withholding tax rate on dividends, interest and royalties.

Hong Kong-Netherlands – The 2010 treaty entered into force on 24 October 2011, with a second exchange of notes in 2011 modifying the original dates of application. The Hong Kong Inland Revenue Department has announced that the treaty will apply in Hong Kong for any year of assessment beginning on or after 1 April 2012. Further clarification may be needed with respect to the date of application in the Netherlands, which can be interpreted as applying to any financial year that starts (i) on or after 1 January 2012, or (ii) on or after the date of entry into force (24 October 2011), which, for most taxpayers, would also entail the financial year that starts 1 January 2012. When in effect, dividends will be exempt from withholding tax if paid to a (1) company that holds at least 10% of the payer and the shares are regularly traded on a recognized stock exchange or at least 50% of the shares of the recipient company are owned by a company whose shares are regularly traded on a recognized stock exchange, but only if the latter company is (a) a resident of a contracting state, or (b) is a resident of an EU Member State and that company would be entitled to similar or more favorable benefits as provided by the dividends article under a tax treaty; (2) a bank or insurance company established and regulated as such under the laws of the treaty partner jurisdiction of which it is a resident, provided that, under an exchange of notes on July 2010, it holds at least 10% of the share capital of the company paying the dividends; (3) a contracting party, or a political subdivision or local authority thereof; (4) an institution created by the government of a contracting party, or a political subdivision or local authority thereof that is recognized as an integral part of that government as agreed by the competent authorities of the contracting parties; (5) a headquarters company for a multinational corporate group that provides a substantial portion of the overall supervision and administration of the group and that has, and exercises, independent discretionary authority to carry out these functions, provided that, under an exchange of notes in July 2010, it holds at least 10% of the share capital of the payer company; (6) a pension fund or scheme; or (7) a company other than a company mentioned under subparagraphs (1), (2), (4) or (5) provided the competent authority of the contracting party that has to

grant the benefits concludes that the establishment, acquisition or maintenance of the company does not have as its main purpose or one of its main purposes to secure the benefits of the dividends provision. Otherwise, the rate will be 10%. Interest will be exempt from withholding tax and the rate on royalties will be 3%.

Hungary-Mexico – When in effect, the treaty signed on 24 June 2011 provides that the withholding tax rate on dividends will be 5% if paid to a company (other than a partnership that is not liable to tax) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 15%. The rate on interest and royalties will be 10%.

India-Ethiopia – When in effect, the treaty signed on 25 May 2011 provides that the withholding tax rate on dividends will be 7.5%. The rate on interest, royalties and technical services fees will be 10%.

India-Switzerland – The 2010 protocol to the 1994 treaty entered into force on 10 October 2011 and will apply in India as from 1 April 2012 and from 1 January 2012 in Switzerland. When in effect, the protocol adds an exemption for interest paid to a resident of the other contracting state that is engaged in the operation of ships or aircraft in international traffic, such that interest will be taxable only in the residence state to the extent the interest is paid on funds connected with those activities. The generally applicable withholding tax rate under the treaty is 10%.

Ireland-Saudi Arabia – When in effect, the treaty signed on 19 October 2011 provides that dividends will be exempt from withholding tax if paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise, the rate will be 5%. Interest will be exempt from withholding tax. The rate on royalties for the use of, or the right to use, industrial, commercial or scientific equipment will be 5%; otherwise, the rate will be 8%.

Luxembourg-Barbados – The 2009 treaty entered into force 8 August 2011 and will generally apply from 1 January 2012. When in effect, dividends will be exempt from withholding tax if paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company for an uninterrupted period of at least 12 months prior to the decision to distribute the dividends; otherwise, the rate will be 15%. Interest and royalties will be exempt.

Netherlands-Switzerland – The 2010 treaty will enter into force 9 November 2011 and apply as from 1 January 2012. When in effect, dividends will be exempt from withholding tax if paid to a company that holds directly at least 10% of the capital of the payer company; a pension fund; or, as far as Switzerland is concerned, to a social security scheme. Interest and royalties also will be exempt.

Spain-Barbados – The 2010 treaty entered into force on 14 October 2011 and applies from that date. Dividends are exempt from withholding tax if paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise the rate is 5%. Interest and royalties are exempt.

Switzerland-United Kingdom – Under a withholding tax agreement signed on 6 October 2011, funds of U.K. taxpayers in Switzerland will be subject to a one-off deduction of between 19% and 34% to settle past tax liabilities. There will be no clearance of past liabilities, however, for those involved in criminal behavior or where Swiss assets are the proceeds of a non-tax crime. Also, from 2013, a new withholding tax of 48% on investment income and 27% on gains will apply to those taxpayers who have not previously notified the U.K. tax authorities (HMRC) about their Swiss assets. The new charges will not apply if the taxpayer authorizes a full disclosure of their affairs to HMRC. Other features include an anti-abuse clause to prevent the promotion of avoidance by Swiss banks; an audit program to be overseen by a new Swiss-U.K. joint commission; collection and sharing by Switzerland of data on the destination of funds withdrawn from the country; a prohibition against anyone who has failed to disclose Swiss assets when challenged of benefitting from clearance of past tax liabilities; and preservation of HMRC's ability to carry out investigations.

United States – President Obama signed into law on 21 October 2011 free trade agreements (FTAs) with Colombia, Panama and South Korea. The Colombian and Panamanian governments had already ratified their respective agreements, while the Korean parliament is expected to ratify the U.S.-Korea FTA by the end of October 2011. Concurrent with enacting these FTAs, the U.S. has renewed the Generalized System of Preferences (through 31 July 2013 with retroactive application back to 31 December 2010), reauthorized the Trade Adjustment Assistance program and temporarily increased the Merchandise Processing Fee (which is, however, waived under the Korea FTA through 30 November 2015).

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European Union

German WHT on dividends paid to EU/EEA minority shareholders violates free movement of capital

The European Court of Justice has issued a decision concluding that German withholding tax on outbound dividends paid to foreign (EU/EEA) corporations violates the free movement of capital provisions in the Treaty on the Functioning of the European Union and the EEA Agreement. [Issued: 21 October 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/902064f39b723310VgnVCM1000001a56f00aRCRD.htm?id=us_email_Tax_WTA_102811

URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_EuropeanUnion_211011.pdf?id=us_email_Tax_WTA_102811

France

Anti-abuse measure on deductibility of loan interest proposed

The Finance Committee has agreed to include in the 2012 Finance Bill a measure that would disallow the deductibility of certain costs related to equity shareholdings benefiting from France's participation exemption for capital gains.

[Issued: 19 October 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/3f49d90770c13310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_102811

URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_France_191011.pdf?id=us_email_Tax_WTA_102811

Hungary

Extensive changes proposed to tax regime

The government has submitted a proposal for extensive tax law changes that cover corporate and personal income tax, VAT and tax procedure, as well as a host of other taxes. [Issued: 17 October 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/53a0eea48b213310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_102811

URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_Hungary_171011.pdf?id=us_email_Tax_WTA_102811

OECD

OECD proposes changes to Commentary on PE definition in Model Tax Convention

The OECD has published a Discussion Draft on the interpretation and application of the Commentary to article 5 (Permanent Establishment) of the OECD Model Tax Convention, and has invited interested parties to submit comments.

[Issued: 19 October 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/457bc1a28dc13310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_102811

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